Chapter- 6

Resource Mobilization

NEED OF FINANCE

- ‘Finance’ refers to funds or monetary resources needed. Finance is one of the most important prerequisites to start an enterprise. Whether running a home-based business or a mid-sized venture, the first thing required is money. Right from the very beginning i.e. conceiving an idea; finance is required to:

a) Promote or establish the business

b) Acquire fixed assets

c) Make market investigations

d) Develop product

e) Keep men and machines at work

f) Encourage management to make progress and create value.

g) Expand, diversify, improve, and grow.

h) Be enough to meet unexpected/unplanned business expenses.

SOURCES OF FINANCE

- An enterprise can raise finance through various sources. These sources can be broadly classified as:
  - Internal sources: it includes those sources which are generated from within the business.
  - External sources: it includes those sources of financing, which are raised from outside the business.

INTERNAL SOURCES

- Equity shares
- Preference shares
- Retained earnings
- Global depository receipts
- American depository receipts

- Indian depository receipts

EXTERNAL SOURCES

- Debenture and bonds
- Loans from a financial institution
- Loans from commercial banks
- Public deposits
- Trade credit
- Inter-corporate deposits

CAPITAL MARKET

- A capital market may be defined as an organized mechanism meant for an effective and smooth transfer of money capital or financial resources from the investors to the entrepreneurs. Here, productive capital is raised and made available for industrial purposes. Capital markets are the most important source of raising finance for the entrepreneurs as this market can:

a) Mobilize the financial resources on a nation-wide scale.

b) Secure the required foreign capital and know-how to promote economic growth at a faster rate.

c) Ensure the most effective allocation of the mobilized financial resources by directing the same either to such projects which are capable of the highest yield or to the underdeveloped priority areas where there is an urgent need to promote balanced and diversified industrialization.

PRIMARY MARKET

- The primary market is basically to facilitate the transfer of resources from the savers to the entrepreneurs seeking funds for:

a) Setting new enterprises

b) Expanding

c) Diversifying

- The 'new issues' may be issued by:

1) New companies – also called initial issues.

2) Old companies – also called further issues.

INITIAL ISSUE

- The entrepreneurs highly bank on this type of "issue" to generate funds. When for the first time, an entrepreneur to obtain capital funds decides to issue securities to the public its first sale is in the primary market. Such issues of securities" are even referred to as "new money issues".
- **Methods of flotation of new issues**
- An entrepreneur can raise the required capital in the primary market by the following methods:

1. Public issue
2. Rights issue
3. Private placement
4. Offer to the employees

PUBLIC ISSUE

- The public issue is the most popular method of raising capital these days by entrepreneurs. This involves raising funds directly from the public through the issue of prospectus. An enterprise organizing itself as a public limited company can raise the required funds commonly by preparing a prospectus.

➢ ADVANTAGES

- Access to capital
- Mergers and acquisitions
- Higher valuations
- Benchmark trading price
- Capital formation
- Incentives
- Reduced business requirements
- Less dilution
- Liquidity
- Prestige

- DRAWBACKS
- Increasing accountability to public shareholders
- Need to maintain dividend and profit growth trends
- Becoming more vulnerable to an unwelcome takeover
- Need to observe and adhere strictly to the rules and regulations by governing bodies
- Increasing costs in complying with a higher level of reporting requirements
- Relinquishing some control of the company following the public offering
- Suffering a loss of privacy as a result of media interest.

RIGHTS ISSUE

- The rights issue is a method of raising additional finance from existing shareholders by offering securities to them on a pro-rata basis i.e. giving them a right to a certain number of shares in proportion to the shares they are holding.
- Normally, through a circular, rights issues are proposed to the existing shareholders and in case they are not willing to subscribe, they can renounce the same in favor of another person. This method of issuing securities is considered to be inexpensive as it does not require any brokers, agents, underwriters, prospectus or enlistment, etc.

PRIVATE PLACEMENT

- Private placement means the direct sale by a company of its securities to a limited number of sophisticated investors. Entrepreneurs, herein, raise funds by selling the issues mainly to the institutional investors like:

i) Unit Trust of India

ii) Life Insurance Corporation of India

iii) General Insurance Corporation of India

iv) Army Group Insurance

V) State Level Financial Corporations, etc.

- This is an effective source of raising capital if the company does not wish to disclose information in the open market.

OFFER TO EMPLOYEES

- Stock options or offering shares to the employees has gained much popularity in many countries of the world. This method enables employees to become shareholders and share the profits of the company leading to:

a) Higher efficiency

b) Low labor turnover

c) Better industrial locations

d) Low floatation cost

e) Wider/higher generation of funds.

SECONDARY MARKET

- Any transaction in shares or debentures after its primary offering is called "Secondary Transaction". Thus, the secondary capital market, which is also known as old securities market or stock exchange deals with buying and selling of old securities i.e. the market securities issued earlier are sold by existing investors in this market
- It operates through the medium of stock exchanges which regulate the trading activities in this market and ensures a measure of safety and fair dealings to the investors.

STOCK EXCHANGE

- A stock exchange means anybody of individuals, whether incorporated or not, constituted to assist, regulate, or controlling the business of buying and selling or dealing in securities.
- Features

1) Association of persons

2) Recognition from central government

3) Market for securities

4) Deals in second-hand securities

5) Regulates trade in securities

6) Allow dealings only in listed securities

7) Transactions effected only through members

8) Working as per rules

9) Specific location

10) Financial barometers

- FUNCTIONS OF STOCK EXCHANGE

a) A continuous and ready market for securities
b) Facilitates evaluation of securities
c) Checks on brokers
d) Provides safety and security in dealings
e) Regulates company management
f) Intensifying capital formation
g) Facilitates raising of new capital
h) Facilitates public borrowing
i) Facilitates healthy speculation
j) Serves as an economic barometer
k) Facilitates bank lending

IMPORTANCE OF STOCK EXCHANGE

- **From the viewpoint of investors**

(a) Dissemination of useful information: Stock exchange publishes useful information regarding price lists, quotations, etc., of securities through newspapers and journals. The interested persons buy and sell their securities based on information provided by the stock exchanges.

(b) Ready market: Persons desirous of converting their shares into cash may easily do so through a member of the stock exchange.

(c) Investors' interests protected: Stock exchanges formulate rules and regulations so that members may not exploit the investors.

(d) Genuine guidance about the securities listed: The investors can safely depend upon the information provided by the stock exchanges.

(*e*) Barriers of distance removed: Stock exchange removes the barriers of distance about securities listed there.

(f) Knowledge of profit or loss on investments: The investors can estimate the profit or loss on the total amount of investments in securities, by comparing the original amount invested and the price of securities on a particular day.

- **From the viewpoint of entrepreneurs /companies**

(a) Recognition: The market values of companies' shares are published in important dailies. This enhances the reputation of good companies.

(b) Wide market: The securities of some companies are listed in some stock exchanges. The market for the securities of such companies is considerably widened. Thus, larger amounts of capital may be raised from different types of investors.

(c) Higher share values: People tend to buy shares that have some premium value. The demand for such shares increases. This leads to a further increase in the price of such shares.

- **From the viewpoint of society**

(a) Rapid capital formation: People get tempted to invest in securities when they study the trend of the necessary prices of shares of good companies. This habit leads to an investment of savings in corporate and government securities. The income from these securities may further be invested in buying more securities.

(b) Economic development: Through easy funds mobilizing, the boosted production fetches more capital, enhancing economic development.

(c) National projects: As stock exchange promotes, the capital formation rate the projects which bring National Prosperity can be easily undertaken.

POWERS OF THE GOVERNING BODY

1) Elect the office bearers and set up committees.

2) Admit and expel members

3) Manage the properties and finance of the exchange

4) Interpret rules, regulations, and by-laws

5) Adjudicate disputes

6) Conduct the affairs of the exchange.

SECURITIES EXCHANGE BOARD OF INDIA

- SEBI was established as a supervising and regulatory body to curb certain malpractices and to promote the securities markets in India. SEBI is managed by its members, which consists of the following:

a) The chairman is nominated by the Union Government of India.

b) Two members, i.e. Officers from the Union Finance Ministry.

c) One member from The Reserve Bank of India.

d) The remaining 5 members are nominated by Union Government of India; out of them, at least 3 shall be whole-time members.

POWERS OF SEBI

1. To approve by-laws of stock exchanges, SEBI
2. To enquire the stock exchange to amend their by-laws.
3. Inspect the books of accounts and call for periodical returns from recognized stock exchanges.
4. Inspect the books of accounts of financial intermediaries.
5. Compel certain companies to list their shares in one or more stocks exchanges.
6. Levy fees and other charges on the intermediaries for performing its functions.
7. Grant license to any person to deal in certain areas.
8. Delegate powers exercisable by it.
9. Prosecute and judge directly the violation of certain provisions of the Companies Act.
10. Power to impose monetary penalties.

FUNCTIONS OF SEBI

- Quasi – legislative
- Quasi – executive
- Quasi-judicial

ANGEL INVESTOR

- Business angel or informal investor or an angel investor is an affluent individual who provides capital for a business start-up and early-stage companies having a high-risk, high-return matrix usually in exchange for convertible debt or ownership equity.
- **Features of angel investors**

1) Most angel investors are current or retired executives, business owners, or high net worth individuals who have the knowledge, expertise, and funds that help start-ups match up to industry standards.

2) As angel investors bear the extremely high risk and are usually subject to dilution from future investment rounds. They expect a very high return on investment.

3) Apart from investing funds, most angels provide proactive advice, guidance, industry connections, and mentoring start-ups in their early days.

4) Their objective is to create great companies by providing value creation, and simultaneously helping investors realize a high return on investments.

5) They have a sharp inclination to keep abreast of current developments in a particular business arena, mentoring another generation of entrepreneurs by making use of their vast experience.

VENTURE CAPITAL

- Venture capital is a type of private equity capital provided as seed funding to early-stage, high potential, high risk, growth up companies/entrepreneurs who lack the necessary experience and funds to give shape to their ideas.
- **Features of venture – capital**
- Venture capital can best be characterized as a long-term investment discipline, usually occurring over five years that helps in the creation of:

a) Early-stage companies,

b) The expansion and revitalization of existing businesses, and

c) The financing of leveraged buyouts of existing divisions of major or privately owned enterprises.

- **Thus, venture capital finance has the following features:**

1) It is equity finance in relatively new companies.

2) It is a long-term investment in growth-oriented small or medium firms.

3) Venture capitalist not only provides capital but also business skills to investee firms.

4) It involves a high risk-return spectrum.

5) It is a subset of private equity.

6) The venture capital institutions have continuous involvement in the business after investing.

7) Such institutions disinvest the holdings either to the promoters or in the market.

INVESTMENT CRITERIA FOR VENTURE CAPITALISTS

1) They may invest in one in four hundred opportunities presented to it,

2) Looks for the extremely rare, yet sought after qualities, such as:

a) Innovative technology,

b) Potential for rapid growth,

c) A well-developed business model

d) An impressive management team.

3) Looks for an "exit" in the time frame of typically 3-7 years.

4) Is inclined towards ventures with exceptionally high growth potential.

- Thus, entrepreneurs are expected to carry out detailed due diligence before seeking venture capital as a source of financing.

WHEN TO SEEK VENTURE CAPITAL FINANCE

1) Early-stage financing: This stage includes:

(a) Seed capital: Relatively small amounts to prove concepts and to finance feasibility studies.

(b) Pre-start up and start-up: Product development and initial marketing, but with no commercial sales yet: funding to get company operations started.

(c) Second-round financing: The entrepreneur at this stage needs assistance from the venture capitalist for expansion, modernization, and diversification so that economies of scale and stability could be attained.

2) Last stage financing /bridge /pre-public stage: The main goal of this stage is for the venture to go public so that investors can exit the venture with a profit commensurate with the risk they have taken.

VENTURE CAPITAL INSTITUTIONS IN INDIA

- Industrial Development Bank of India's Venture Capital Fund
- Technology Development and Information Company of India Ltd. (TDICI)
- Risk Capital and Technology Finance Corporation Ltd.
- Gujarat Venture Finance Ltd. (GVFL)

- Andhra Pradesh Industrial Development Corporation (APIDC) Venture Capital Fund.
- National Venture Fund for Software and IT Industry.
- The Canbank Venture Capital Fund, Credit Capital Venture Fund Ltd, etc.

SPECIALISED FINANCIAL INSTITUTION

Industrial Development Bank of India (IDBI)

- The Industrial Development Bank of India was set up in July 1964 as a wholly-owned subsidiary of the Reserve Bank of India. The purpose was to enable the new institution to benefit from the financial support and experience of RBI. Before 16th February, it was delinked from RBI in 1976 and was made an autonomous corporation. The objective was to allow RBI to concentrate on its central banking function and allow IDBI to grow into a development agency. The government's shareholding in IDBI stands at 72.14%.
- **Objectives**

1) Co-ordination, regulation, and supervision of the working of other financial institutions such as IFCI, ICICI, UTI, LIC, Commercial Banks, and SFCs.

2) Supplementing the resources of other financial institutions and thereby widening the scope of their assistance.

3) Planning, promotion, and development of key industries and diversifications of industrial growth.

4) Devising and enforcing a system of industrial growth that conforms to national priorities.

FUNCTIONS

1) To grant loans and advances to IFCI, SFCs, or any other financial institution by way of refinancing of loans granted by such institutions which are repayable within 25 years.

2) To grant loans and advances to scheduled banks or state co-operative banks by way of refinancing of loans granted by such institutions that are repayable in 15 years.

3) To grant loans and advances to IFCI, SFCs, other institutions, scheduled banks, state cooperative banks by way of refinancing of loans granted by such institution to industrial concerns for exports.

4) To discount or rediscount bills of industrial concerns.

5) To underwrite or to subscribe to shares or debentures of industrial concerns.

6) To subscribe to or purchase stock, shares, bonds, and debentures of other financial institutions.

7) To grant a line of credit or loans and advances to other financial institutions such as IFCI, SFCs, etc.

8) To grant loans to any industrial concern.

9) To guarantee deferred payment due to any industrial concern.

10) To guarantee loans raised by industrial concerns in the market or from institutions.

11) To provide consultancy and merchant banking services in or outside India.

12) To provide technical, legal, marketing, and administrative assistance to any industrial concern or person for promotion, management or expansion of any industry.

13) Planning, promoting, and developing industries to fill up gaps in the industrial structure in India.

14) To act as trustee for the holders of debentures or other securities.

SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA

- SIDBI was established in April 1990, as a wholly-owned subsidiary of IDBI, under the Small Industries Development Bank of India Act, 1990. SIDBI is the principal financial institution for promotion, financing, and development of small-scale industries in India.
- Objectives: SIDBI's objectives are:

1) Initiate steps for technological up-gradation, and/or modernization of existing units.

2) Expand channels for marketing of SSI sector products in India and abroad.

3) Promote employment-oriented industries.

- **Functions**

1) SIDBI's financial assistance to SSS is primarily channelized through the existing credit delivery system consisting of commercial banks, co-operative banks, RRBs, and SFCs.

2) Refinance loans and advances extended by the primary lending institutions to small scale industrial units, along with providing them even resource support.

3) Discounts and rediscounts bills arising from the sale of machinery to or its manufacture by industrial units in the small-scale sector.

4) All forms of business organization are eligible for refinance assistance for:

a) Setting up of new venture

b) Expansion

c) Modernization

d) Diversification of existing units for all activities

5) Extends seed capital/loan assistance under the National Equity Fund Mahila Udyan Nidhi and Mahila Vikas Nidhi and seed capital scheme through specified lending agencies.

6) Grants direct assistance as well as refinance loans extended by Primary Lending Institutions for financing export of products manufactured by industrial concerns in the Small Scale Sector.

7) Provide Venture Capital assistance to the entrepreneurs for their innovative ventures if they have a sound management team, long term competitive advantage.

8) Leasing and factoring to small-scale units are also provided for by SIDBI.

INDUSTRIAL FINANCE CORPORATION OF INDIA (IFCI)

- IFCI was established as a statutory corporation on 1st July 1948 by a special Act passed in the Parliament, IFCI Act, 1948. It was converted into a public limited company on July 1, 1993. Its main objects are to provide medium and long term credit to eligible industrial enterprises in corporate sectors of the economy, particularly to those industries to which banking facilities are not available.
- **Objectives**

a) To provide long and medium-term credit to industrial concerns engaged in manufacturing, mining, shipping, and electricity generation, and distribution.

b) The period of credit can be as long as 25 years and should not exceed that period;

c) To grant credit to a single concern up to a maximum amount of rupees one crore. This limit can be exceeded with the permission of the government under certain circumstances;

d) Guarantee loans and deferred payments;

e) Underwrite and directly subscribe to shares and debentures issued by companies;

f) Assist in setting up new projects as well as modernization of existing industrial concerns in medium and large scale sector;

g) Assist project under co-operatives and in backward areas

- **Functions**

i) Granting loans and advances for the establishment, expansion, diversification, and modernization of industries in corporate and co-operative sectors.

ii) Guaranteeing loans raised by industrial concerns in the capital market, both in rupees and foreign currencies.

iii) Subscribing or underwriting the issue of shares and debentures by industries. Such investment can be held up to 7 years.

iv) Guaranteeing credit purchase of capital goods imported as well as purchased within the country.

v) Assisting, under the soft loans scheme, to selected industries such as cement, cotton textiles, jute, engineering goods, etc.

vi) Providing technical, legal, marketing, and administrative assistance to any industrial concern for the promotion, management, and expansion of the industrial concern.

vii) Providing equipment to the existing industrial concerns on lease under its 'equipment leasing scheme'.

viii) Procuring and reselling equipment to eligible exiting industrial concerns incorporate or co-operative sectors.

INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA

- Industrial Credit and Investment Corporation of India was established as a joint-stock company in the private sector in 1955. Its share capital was contributed by banks, insurance companies, and foreign institutions including the World Bank. Its major shareholders now are Unit Trust of India, Life Insurance Corporation of India and General Insurance Corporation and its subsidiaries. They together hold approximately 50% of the paid-up shares capital of ICICI.
- **Objective**

i) To assist in the formation, expansion, and modernization of industrial units in the private sector;

ii) To stimulate and promote the participation of private capital in such industrial units;

iii) To furnish technical and managerial aid to increase production and expand employment opportunities.

- **Functions**

i) It provides medium and long-term loans in Indian and foreign currency for importing capital equipment and technical services. Loans sanctioned generally go towards the purchase of fixed assets like land, building, and machinery;

ii) It subscribes to new issues of shares, generally by underwriting them or directly subscribing the same;

iii) It guarantees loans raised from private sources including deferred payment;

iv) It provides technical and managerial assistance to industrial units, along with consultancy services for new projects;

v) It provides assets on lease to industrial concerns. In other words, assets are owned by ICICI but allowed to be used by industrial concerns for a consideration called lease rent.

NATIONAL BANK FOR AGRICULTURE AND RURAL DEVELOPMENT

- On 15th December 1981, National Bank for Agriculture and Rural Development (NABARD) Bill was passed in the Parliament, which started functioning on 1st July 1982.

- **Objectives**

1) The bank will serve as a financing institution for institutional credit such as long-term, short-term, and the promotion of activities in rural areas.

2) To provide direct lending to any institution as may be approved by the Central Government.

- **Function**

1. Credit Functions
2. Developmental Functions
3. Regulatory Functions

INDUSTRIAL INVESTMENT BANK OF INDIA LTD.

- The Industrial Investment Bank of India Ltd. (IIBI) was formed by transforming The Industrial Reconstruction Bank of India (IRBI). It was set up by IDBI at the instance of the Government of India in April 1971 for the rehabilitation of sick industrial companies. IRBI was incorporated under the Companies Act, 1956, and renamed as the Industrial Investment Bank of India Ltd. in March 1997.

Functions

1) Term-loan assistance for project finance.

2) Short duration non-project asset-backed financing working capital/other short term loans to companies,

3) Equity Subscription Asset Credit

4) Equipment finance

5) Investments in Capital Market and Money market instruments.

STATE FINANCIAL CORPORATIONS

- To meet the financial needs of small and medium enterprises, the government of India passed the State Financial Corporation Act in 1951, empowering the State governments to establish development banks for their respective regions.
- **Objectives**

1) Provide financial assistance to small and medium industrial concerns.

2) Provide long and medium-term loan repayment ordinarily within a period not exceeding 20 years.

3) Grant financial assistance to any single industrial concern under the corporate or co-operative sector with an aggregate upper limit of rupees sixty lakhs. In any other case (partnership, sole proprietorship, or joint Hindu family) the upper limit is rupees thirty lakhs.

4) Provide Financial assistance generally to those industrial concerns whose paid-up share capital and free reserves do not exceed 3 crores.

5) To lay special emphasis on the development of backward areas and small scale industries.

- **Functions**

1) Grant of loans and advances to or subscribe to debentures of, industrial concerns repayable within a period not exceeding 20 years, with the option of conversion into shares of stock of the industrial concern.

2) Guaranteeing loans raised by industrial concerns which are repayable within a period not exceeding 20 years.

3) Guaranteeing deferred payments due to an industrial concern for the purchase of capital goods in India.

4) Underwriting of the issue of stock, bonds, or debentures by industrial concerns.

5) Subscribing to, or purchasing of, the stock, shares, bonds or debentures of an industrial concern subject to a maximum of 30 percent of the subscribed capital, or 30 percent of paid-up share capital and free reserve, whichever is less.

6) Act as an agent of the Capital government, State government, IDBI, IFCI, or any other financial institution in the matter of grant of loan or business of IDBI, IFCI, or financial institution.

7) Providing technical and administrative assistance to any industrial concern or any person for the promotion, management, or expansion of any industry.

8) Planning and assisting in the promotion and development of industries.

TOURISM FINANCE CORPORATION OF INDIA

- It is a specialized all-India development financial institution to cater to the needs of the tourism industry.
- **Functions**

i) TFCI provides financial assistance to enterprises for setting up or the development of tourism-related projects.

ii) It also provides advisory and merchant banking services in this field.

iii) The projects with a capital cost of ` 1 crore or above are generally eligible for assistance from TFCI. Smaller projects would also be considered.

iv) TFCI has sanctioned assistance to 2003 projects aggregating to 5.2 billion during the last five years, resulting in more than 12,217 hotel rooms and direct employment to 22,938 people.

STATE INDUSTRIAL DEVELOPMENT CORPORATION

- Incorporated under the Companies Act 1956 SIDCs were set up in different states as wholly-owned companies for promoting industrial development in their respective states.

The main functions of SIDCs are as follows:

- Providing term finance to all small, medium, and large industrial enterprises set up in the state,

- Underwriting and directly subscribing to shares, and debentures of industrial enterprises being set up in the state,
- Preparing feasibility studies, conducting market surveys and motivating private entrepreneurs to set up their industrial ventures in the state;
- Collaborating with private entrepreneurs to set up industrial ventures in the joint and assisted sector.