CHAPTER 4

SOURCES OF THE FINANCES OF THE MILL

4.1 Introduction

4.2 Sources of Long-term Finance

4.3 Specialised Financial Institutions

4.4 Commercial Banks

4.5 Internal Financing

4.6 Sources of Short-term Finance

4.7 Utilisation of Sources of Finance

4.8 Sources of Finance of the Mill

4.9 Uses of Funds by the Mill

CHAPTER 4

SOURCES OF THE FINANCES OF THE MILL

4.1 INTRODUCTION

Finance is the life blood of a business. The business unit cannot run efficiently, it does not have adequate finance to meet its requirements. The financial requirements of business can be classified into two categories as follows.

(1) Short-term financial requirements
(2) Long-term financial requirements

(1) <u>SHORT-TERM FINANCIAL REQUIREMENTS</u> :- Short term funds are required for meeting working capital needs. They are usually required for a period upto one year. They are raised from sources which can provide funds only for a short period quickly and at a reasonable cost.

(2) <u>LONG-TERM FINANCIAL REQUIREMENTS</u> :- The long term funds are required to a great extent for meeting the fixed capital requirements of the business. They are required for a period exceeding one year. They are sometimes classified as (a) intermediate or medium-term funds, and

(b) long-term funds. The medium-term funds required for a period between 3 and 5 years, while long-term funds are required for a period exceeding five years.

The short-term and long-term requirements of finance for a business unit can be fulfilled by different sources of finance by taking into consideration their merits and demerits.

4.2 SOURCES OF LONG-TERM FINANCE

The sources of long-term finance can be classified as follows :

(a) Share capital
(b) Debentures
(c) Public Deposits
(d) Lease Financing

(a) SHARE CAPITAL :- Issue of shares is the most common method of raising long term funds. A trading company cannot be incorporated by law, without having share capital. A company collects finance by issue of share as a first step in raising the capital and pays-off the amount of share capital in the last, if the company dissolves after meeting all the losses and paying-off all

the liabilities. Thus, it provides a cushion to absorb shocks sustained due to losses or other financial crisis because during its life time except redeemable preference shares cannot be refunded.

A public company can issue only two types of shares namely,

(1) Preference shares

(2) Equity shares

(1) PREFERENCE SHARES :- Preference shares are those shares which carry preference both in respect of dividend and also the return of capital in case of winding up of the company. These two rights must attach to a preference share. The rate of dividend on preference share is fixed. These shareholders get fixed rate of dividend before paying the dividend to equity shareholders.

Preference shares are of different types such as, cumulative and non-cumulative, participating and non-participating, redeemable and non-redeemable.

These shares are not a burden on the financial position of the company as the rate of dividend is fixed and that too, is at the discretion of the management. Company need not mort-gage the assets as in the case of debentures

or other loans. Company can trade on equity by issuing these shares. Redeemable preference shares can be redeemed at the option of the company.

(2) EQUITY SHARES :- Ordinary or equity shares may be regarded as the cornor-stone of financial structure. According to the Companies Act, 1956 shares which are not preference shares, are equity shares. In other words, the holders of such shares are the residual claimants and have no preference in capital as well as in the income of the company. They occupy a primary position in a company's financial structure. Only ordinary shareholders control the affairs of the company and enjoy the familiar range of benefits. They carry with them the responsibilities which are usually associated with ownership. Their fortunes rise and fall with the affluence of their company. Thus, ordinary shareholders provide the venture capital of the company.

The ordinary shares provide a cushion against the temporary unfavourable development as the dividends are not payable on these shares out of the available profits of the company and too on the discretion of the management. On the other hand, there is no fixed rate of dividend. Shareholders may get higher dividends in prosperity and nothing in

adversity. Moreover, the company cannot return the share capital during its life time and can use it freely without creating any charge on the assets of the company.

(b) <u>DEBENTURES</u> :- A debenture is a document issued by a company as an evidence of debt due from the company with or without charge on the assets of the company. It is a certificate issued by a company under its seal acknowledging a debt due by it to its holders.

Debentures can be of various types. Naked debentures are these which do not carry any charge on the assets of the company. Mortgage debentures are secured by a mortgage or charge on the whole or a part of the assets of the company while irredeemable debentures can be converted into equity shares of the company as per the terms of their issue while non-convertible debentures cannot be so converted obtaining of finance by issue of debentures is a loan which creates charge on the profits of the company issuing debentures, but if company requires funds for certain fixed period on a much lower rate than the rate of earnings of the company, debentures is a best security.

Moreover cautious investors who prefer a fixed income and security of investment as well as like

debentures. The interest on the debentures is to be paid by the company whether there is profit or not. Company sometimes is to create charge on the assets of the company to get funds.

Importance of Debentures :- The following points represent the importance of debenture capital in company finance.

(1) Through debentures, the company enables to raise the capital without giving any control to its holdings.

(2) There is certainty of finance for a specific period and the company can adjust its financial plan accordingly.

(3) The debenture holder is not allowed to cast his vote and is not included in the Board of the Directors.

(4) Some investors prefer to protect their investment with regular receipt of interest. These investors do not recognise the profit or the loss of the company. They rather prefer to save their investments.

(c) PUBLIC DEPOSITS :- Many companies accept deposits for short periods from their members, Directors and the general public. This mode of raising finance is becoming popular these days on account of bank credit becoming costly. The ccmpanies cannot accept deposits for a period of less than six months and more than 36 months. However, deposits up to 10 percent of the paidup capital and free reserves can be accepted for a minimum period of three months for meeting short-term requirements. Moreover, on and from Ist April 1979, a company cannot accept or renew deposits in excess of 35 percent of its paidup capital and free reserves as against the limit of 40 percent up to 31st March 1979. Deposits with trading and manufacturing companies have assumed prominence in recent years.

These deposits have been a traditional source of finance in India, but their growth in recent years has been phenomenal. The dear money policy followed by the Reserve Bank of India on the one hand, and easy access to public deposits at lower rates of interest on the other hand, have forced companies to resort to this type of financing. A fall in the seasonal expansion of credit to the commercial sector from year to year is made good by public deposits. Thus, big business houses like Tatas, Mafatlal, DEC, Bombay Dyeing and even small units solicit deposits in order to

survive and avoid large scale collapse owing to the paucity of funds[1].

MERITS :

(1) The deposits carry lower rate of interest.

(2) Financing through public deposits is simple without much of complicated formalities involved.

DEMERITS :

(1) Raising funds through public deposits is not a reliable and definite source of finance only companies having good reputation in the market can raise funds through the public deposits.

(2) This mode of financing sometimes puts the company into serious financial difficulties. Even a slight rumour that the company is not doing well may result in rush of the public to the company for getting premature payments of the deposits made by them.

(d) LEASE FINANCE :- Leasing involves the use of an asset without the desire to assume or intend to assume ownership. A firm acquiring an asset is called "Lessee" and the owner of the assets is called as "Lessor". The lesser gets a money rental at regular intervals for its

use from the lessee. It is not essential to purchase assets in order to use them. Assets may be rented. The provision for the use of major assets is covered in a provisions, rental payments, additional rents for purchase options, allocation of maintainance and other expenses and other features of agreement. Leasing may be regarded as medium term source of finance. There are different types of leases as follows, financial lease, operating lease, average lease, sale and lease back lease.

MERITS :

(1) It may permit more amortisation of the equipment.

(2) Cost of capital is lower.

(3) It frees working capital for more productive use.

(4) It permits hedging of business risks. The primarily the risk of obsolescence can be shifted on the lessor.

DEMERITS :

(1) It is not useful form of financing to a new company because it has to begin to pay rentals soon after entering into a lease contract, while generation of cash starts only after the gestation period.

(2) The lease may not get certain tax benefits and incentives, which he may get under any other form of financing e.g. incentives for backward area.

4.3 SPECIALISED FINANCIAL INSTITUTIONS

A large number of specialised financial institutions have been set up in the country after independence to meet the specific term financial needs of industrial enterprises. They are popularly known as "Development Banks". A development bank according to S. L. N. Sinha, "is a financial institution engaged in providing medium and long term assistance to business units in the form of loans, under writting investment, and guaranteed operations[2]. A development bank is essentially a development catalyst. It seeks to mobilise sources such as capital, technology, enterpreneural and managerial talents and channelise them into industrial activities in accordance with plan priorities. It has therefore, to shape its policies, procedures and functions in a way so as to cater to development needs of specific sectors as well as the economy in general.

The Indian financial institutions may be classified as follows.

(A) TERM LENDING INSTITUTIONS

[1] The Industrial Finance Corporation of India, 1948

[2] The National Industrial Development Corporation, 1954

[3] The Industrial Credit and Investment Corporation of India, 1955

[4] The Industrial Development Bank of India, 1964

[5] The Industrial Reconstruction Corporation of India, 1971.

(B) INVESTMENT INSTITUTIONS

[1] Life Insurance Corporation of India, 1956

[2] Unit Trust of India, 1964

[3] General Insurance Company, 1971

(C) STATE LEVEL INSTITUTIONS

[1] State Financial Corporation

[2] Industrial Investment Corporations

[3] State Industrial Development Corporations

(A) Term Lending Institutions

(a) The Industrial Finance Corporation of India : The IFCI was established under the Industrial Finance Corporation Act, on First July, 1948. Its total share capital was Rs. 10 crores. After the establishment of IDBI, the share capital is held by IDBI - 50 percent, by scheduled banks - 20 percent, by insurance companies - 22 percent, and

by co-operative banks - 8 percent. It provides assistance to limited companies, in public, private and co-operative sector organisations, to the extent of generally more than Rs. 30 lakhs. It provides both Rupee and foreign currency assistance. It udertakes guaranteeing of purchases and loans, undertaking of and subscribing to shares and debentures of the companies. The loans are secured. The assistance has mainly gone to sugar and cotton textile industries.

The assistance is provided in the following ways :

(a) Guaranteeing loans raised by industrial concerns which are repayable within a period not exceeding 25 years.

(b) Undertaking of the issue of stocks, shares, or debentures issued by industrial concerns.

(c) Granting loans or advances to or subscribing to debentures of industrial concerns repayable within a period not exceeding 25 years.

The corporation provides financial assistance for setting up new industrial projects, renovations, modernisation, expansion, diversification of existing ones.

During the year 1986-87, the Industrial Finance Corporation Act 1948, was amended. The Act has enlarged the

operations of the IFCI and raised its authorised capital considerably.

The purpose of IFCI is to supplement the flow of financial assistance from various sources and not to supplant them. This model is essential beneficial for the growth of new and small sized industrial concerns which find it extremely difficult to raise long-term capital from normal banking channels or capital market[3].

(b) <u>The National Industrial Development Corporation</u>

The NIDC was established on 20th October 1954. It has an authorised capital of Rs. 1 crore, entirely subscribed by the Government of India. It gets additional finance by way of grant for establishment, expenses and loans for projects from Government of India.

It takes up projects to fill a gap in industrial structure of the country. The project will be sold when it becomes profitable. It subscribes to the shares and debentures of the company, lends money, provides machinery, underwrites the shares and debentures and guarantees the loans and advances. It may nominate directors and appoint advisors in borrowing companies. It has undertaken several projects and lent for modernisation of cotton and jute

industries, establishing bio-gas plants, etc. Now it mainly a consulting agency and not financing agency.

(c) The Industrial Credit & Investment Corporation of India : The ICICI, was incorporated on 5th January, 1955. Its head office is in Bombay. It has branches at Calcutta, Madras, and Delhi. It deals exclusively with private sector. Its authorised capital is 25 crores. It gets additional finance by borrowing in foreign currency from foreign sources, mainly from the World Bank, bond issues, borrowing from the Government of India and from IDBI.

The objects of the corporation are to assist industrial enterprises in private sector by :

(a) Granting secured loans in Rupees, repayable over a period of 15 years.

(b) Making similar loans in foreign currencies for payments of imported capital equipments and technical services.

(c) Subscribing to equity and preference shares directly and undertaking public and private issue and offer of sale of industrial securities.

(d) Furnishing technical and administrative assistance to Indian industries.

So far, substantial portion of ICICI's assistance is claimed by Maharashtra and Gujrat States. Its assistance is mainly to metal and metal products, and machinery manufacturers.

It has relative freedom in the matter of assistance and type of business unit. Its financial performance has been good. It declares 10 to 12 percent dividend. The number of defaults is also comparatively less. It has obtained guidance from the World Bank. It has taken initiative in establishing Institute of Financial Management and Research in Madras, for executive training and research in finance.

(d) The Industrial Development Bank of India :- The IDBI was established on First July, 1964. It was wholly owned subsidiary of Reserve Bank of India, on 16th February, 1975. It was delinked from the Reserve Bank of India. It is an apex bank. Its authorised capital was raised to Rs. 100 crores and is entirely held by the Reserve Bank of India. It is permitted to undertake all types of financing and developmental roles, form of assistance and size and

types of units. It is exempted from payment of Income Tax and Corporation Taxes. It provides refinance and guide the companies activities. It holds 50 percent of share capital of IFCI and IRCI and in State Finance Corporations. Its investment is almost equal to the State contributions.

The bank has been assigned a special role in respect of the following matters :

(a) Planning, promoting, developing industries to fill the gaps in the industrial structure in India.

(b) Co-ordinating the working of the institutions engaged in financing, promoting or developing industries and assisting in the development of such institutions.

(c) Providing technical and administrative assistance for promotion, management, or expansion of industry.

(d) Undertaking markets and investment research and surveys as also techno-economic studies in connection with developments of industry.

The scheme of financial assistance operated by IDBI include Project Finance Scheme, Soft Loan Scheme, Technical Development Fund Scheme, Refinance of Industrial Loans,

Bills Rediscounting Scheme, Seed Capital Assistance Scheme, Subscription to Shares and Bonds. It has constituted Development Assistance Fund to provide assistance with prior approval of the Central Government, to concerns which fail to get assistance from other sources.

It is the largest development bank in the country. About 35 percent of the total assistance comes from the IDBI. It has remained mainly as a lending agency. The maturity period for direct loans is generally between 8 to 10 years, for refinanced loans between 3 to 25 years and for export credit between 6 months to 10 years.

(e) <u>The Industrial Reconstruction Corporation of India Limited</u> :- The IRCI was established in April 1971, under the Indian Companies Act. It was started to revive and revitalise industrial units which have closed down or likely to close down, but show the promise of being operated economically. It has to restructure the management, provide technical and managerial guidance, act as catalyst in securing assistance from other agencies, follow up actions, etc.

At the time when IRCI was established a very difficult industrial situation prevailed in West Bengal.

Thus, its establishment was a politico-economic decision. Though IRCI is an all India institution, its activities are concentrated mainly in West Bengal.

It has a share capital of Rs. 10 crores, of which 50 percent is held by IDBI, and the remaining by IFCI, ICICI, LIC, SBI and nationalised banks. It also gets interest free loan of Rs. 10 crores from the Government of India. It borrows from RBI, IDBI and also issues debentures.

It has given assistance to mainly labour incentive unit, nearly 80 percent of the assistance is to West Bengal.

(B) Investment Institutions

These are the institutions basically set up to provide the people an opportunity to save and invest. As the savings of the people are mobilised on a large scale, and they may be retained for a fairly long-term, these institutions are capable of lending funds on medium and long term. The Provident Funds are available only to the public sector. So we may consider only the following institutions.

(a) Life Insurance Corporation of India :- The LIC was established on First September, 1956 under the Life Insurance Corporation Act. The life insurance business was nationalised with effect from that day. Its capital was Rs. 5 crores. It collects premium from the assured. The funds so collected are available for investment. The pattern of its investments is fairly rigidly regulated by its Statute and by the guideline given by the Government of India. Only about 13 percent of its investments are available to private sector.

LIC is basically an investment institution and not a development institution. Its primary aim is to spread the message of Life Insurance and while pursuing this objective, the premiums from policy holders are received, which are in the nature of trust funds and invested and administered in the best interest of policy holders as per the guidelines of the Government[4].

The LIC invests in ordinary and preference shares of companies and in debentures and loans to companies. Major part of the investment in private sector is in the shares of existing companies. The LIC also undertakes underwriting along with other financial institutions. It invests in other financial institutions as well. It may invest more

and more in private sector and try to improve the company management and protect the interests of the investors.

(b) General Insurance Corporation of India : The General Insurance Corporation of India is formed on May 13, 1971 for the purpose of superitending and controlling the General Insurance business. It has following four subsidiaries, which operate throughout the country.

[1] National Insurance Company Limited, Calcutta
[2] The New India Assurance Company Limited, Bombay
[3] The Oriental Fire and General Insurance Company Limited, New Delhi
[4] United India Insurance Company Limited, Madras

The General Insurance Corporation of India and its four subsidiaries have been granting financial assistance to the industrial sector. The investment decisions of the General Insurance Corporation are governed by the guidelines issued by the Government of India. About 70 percent of the annual accretion to investible funds of the General Insurance Companies are required to be channelised into socially oriented sectors through investments in Central and State Government securities and in securities issued by

public financial undertakings. The rest of the funds are made available for investment in private sector.

(c) The Unit Trust of India :- The Unit Trust of India was established under the Unit Trust of India Act, 1963. It came into existence from First February, 1964 and started the sale of units from First July, 1964.

Its main objective was to enable small and medium investors to become owners of shares in a large number of companies and get large return and capital appreciation. The investment in Unit Linked Insurance Plan is considered as savings for deduction under section 80-C of the Income Tax Act, 1961 and income from units under Section 80-L of the same Act.

The objective of the Unit Trust of India is to stimulate and pool the savings of the middle and low income group and to enable them to share the benefits and prosperity of the rapidly growing industrialisation of the country.

The Trust sells units of Rs. 10 in value to the general public. As on June 30, 1983, the aggregate value of units sold was over Rs. 280 crores and the total number of

unit holders registered with the Trust was 7 lakhs. According to R. S. Bhatt, the then Chairman of the Unit Trust of India, referred to the Trust's endeavour to mobilise increasingly a large volume of savings of the community and channel these into productive investments, thus consisting in the growth and development of the economy[5].

(C) State Financial Corporations

In order to provide financial assistance to small scale industries and medium size industries almost all States have set up State Financial Corporations. These State Financial Corporations were established under State Finance Corporation Act, 1951 and established after 1951. The Tamil Nadu Industrial Investment Corporation Limited was set up in 1949 under the Indian Companies Act.

The State Finance Corporations are controlled both by Reserve Bank of India and the State Governments. They are refinanced by the Industrial Development Bank of India and the Reserve Bank of India conducts conferences of State Finance Corporations review their functions and discuss their problems. The authorised capital varies between Rs. 1 crore and Rs. 10 crores.

The State Finance Corporation provides assistance as follows :

(a) Granting loans or advance for periods not more than 20 years.

(b) Guaranteeing loans repayable within 20 years.

(c) Subscribing to debentures repayable within 20 years.

(d) Subscribing to shares and debentures.

State Finance Corporations have established Reserve Fund, they can issue debenture and borrow from the Reserve Bank of India and the State Government. They accept deposits and have refinance facility from the Industrial Development Bank of India.

Generally, State Finance Corporations have remained lending agencies and the investment and under writing are little. They provide assistance to small scale units to technicians, entrepreneurs and units in backward areas.

State Finance Corporations were established to fillin institutional structure in the supply of long-term funds to medium and small sized industrial units[6].

(a) State Industrial Investment Corporation and State Industrial Development Corporations :- These are established in almost every State. The State Finance Corporation co-ordinates the work of Industrial Investment Corporations and State Industrial Development Corporations. The Industrial Investment Corporation provides finance to medium and large projects in private sector and joint sector. They take up promotional work and finance projects in backward areas with State Finance Corporation. The Industrial Development Corporation tries to provide infrastructure facilities such as, arranging for land and introduce entrepreneurs to SFC and commercial bank. In some caes, they provide finance and even manage state enterprises.

4.4 COMMERCIAL BANKS

Commercial banks constitute quantitatively the most important group of financial intermediaries in India today. The commercial banking sector broadly consists of scheduled and non-scheduled banks.

Commercial banks in India, finance the industries in different ways such as, by way of loans and advances, purchase of shares and debentures of industrial concerns. Contribution of shares and bonds of the specialised

financial institutions, undertakings, underwriting the shares and debentures either independently or jointly with other banks and guaranteeing deffered payment.

Term lending by the commercial banks, is a phenomena particularly after the advent of the Second Five Year Plan. Commercial banks in India have expanded the area of their business activity and assumed the role of term institutional financers as well. In May 1975, the Reserve Bank of India urged the commercial banks to step up their term lending particularly in the following areas :

(a) Deffered export payment
(b) Agricultural sector
(c) Capital goods industries
(d) Small scale industries
(e) Industries in the industrially backward areas

Commercial banks have assisted industrial enterprises by

(a) granting term loans,
(b) subscribing to the shares and debentures of corporate enterprises
(c) underwriting security issues.

The commercial bank is the most important financial institution. In financing day-to-day transactions of the business world, it enables all other financial institutions to function and contribute directly to their activities[7].

4.5 INTERNAL FINANCING

A new company has only external sources of finance. However, an existing company can generate income through its internal sources. Two important sources of internal financing are depreciation and retained earnings.

(A) Depreciation as a Source of Finance : The word depreciation signifies decrease in the value of asset due to wear and tear, lapse of time, obsolescence, exhaustion and accident. There is lot of controversy among academicians and business executives regarding treatment of depreciation as a source of funds. The depreciation being a non-cash item of expense does not affect the working capital of the firm and as such, not at all a source of finance.

Validity of the above arguments cannot be questioned, but it can also not be denied that as a non-cash expense, depreciation does not represent any cash outlay with the result that part of the profits adjusted for

depreciation can be used by management to increase any of the current assets or pay taxes, dividend, etc.

(B) <u>Financing Through Retained Earnings</u> :- The retained earnings are the earnings of a concern, which are retained in the business. They constitute the sum total of those profits which have been realised over the years since incorporation and which have been reinvested in the business rather than distributed in the form of dividend. The accumulation of earnings is a dynamic process and takes several years, and it is accelerated with profits and decelerated with losses. The process of creating internal savings and their utilisation in business is referred to as ploughing back of profits.

This is strictly not a method of raising finance but refers to accumulation of profits by a company to finance its developmental activities or repay loans. It is also known as internal financing.

This method of raising finance for a company is very useful because on the one hand, it does not cost any thing to the company and on the other hand, it strengthens the financial position of the company.

4.6 SOURCES OF SHORT-TERM FINANCE

The short-term loans/credits are obtained for working capital requirements. The following are the important sources of short-term finance.

(a) Trade Credit :- The trade credit is a form of short-term financing common to almost all types of business firms. As a matter of fact, it is the largest source of short-term finance. In an advanced economy, most of the buyers are not required to pay for goods on delivery. They are allowed a short-term credit period before payment is due.

Trade credit arrangement is generally made available to the buyer on an informal basis without creating any charge on the assets. Trade credit arrangements usually, carry stipulation of allowing a cash discount to the buyer for prompt payments. The volume of trade credit and its popularity as a means of short-term financing depends on the factors such as :

(a) Terms of trade credit
(b) Reputation of the purchasing firm
(c) Financial position of the seller, and
(d) Volume of purchases to be made by the buyer.

The firm must balance the advantage of trade credit as a discretionary source of financing without any explicit cost against the cost of losing of cash discount, the possibility of deterioration in reputation if trade credit and the increased purchase price of the products.

(b) Commercial Banks :- The commercial banks provide only short-term credit to the business except medium term finance to some extent. Commercial banks make advances to the customers in the following forms :

i. Loans :- A loan is a kind of advance made with or without security. In the case of a loan, the banker makes a lumpsum payment to the borrower or credits his deposit account with the money advanced. It is given for a fixed period at an agreed rate of interest. Repayments may be made in instalments or at the expiry of a certain period. Loan may be a "term loan" or a "demand loan".

ii. Cash Credit :- A cash credit is an arrangement by which a banker allows his customers to borrow money up to a certain limit. Cash credit arrangements are usually made against the security of commodities hypothecated or pledged with the bank.

iii. Hypothecation :- In case of hypothecation, the possession of goods is not given to the bank. The goods

remain at the disposal and in the godown of the borrower. The bank is given access to goods whenever it so desires. Such an advance is granted by the bank only to a person in whose integrity and confidence is guaranteed.

iv. Pledge :- In case of the pledge, the goods are placed in the custody of the bank with its name on the godown, where they are stored. The borrower has no right to deal directly with them, without the knowledge of the bank.

v. Overdrafts :- The customer may be allowed to overdraw security, if he requires temporary accomodation. This bank credit is however, for a short term only.

vi. Bills Discounted & Purchased :- The banks also give advances to their customers by discounting their bills. The net amount after deducting the amount of discount is credited to the account of the customer. The bank may discount the bills with or without security from the debtor in addition to the personal security of one or more persons already liable on the bill.

(c) Accrual Accounts :- Accrual accounts are spontaneous sources of financing, since they are self generating. The most common accrual accounts are wages and

taxes. In both cases, the amount becomes due but is not paid immediately. The time lag between receipt of income and making payment for the expenditure incurred in earning that income helps the business in meeting some of its short term financial requirements.

4.7 UTILISATION OF SOURCES OF FINANCE

After having raised the finance through different sources, the next important task before the finance manager is the profitable deployment of the funds raised. The modern concept of finance function includes both raising of finance and its proper utilisation. The funds raised are utilised for purchasing fixed assets and current assets. The investment in the fixed assets is known as long-term investment and investment in current assets is known as short-term investment.

(a) Investment in Fixed Assets :- Fixed assets are those which are of a somewhat fixed or permanent nature (a life expectancy of more than one year) and are used by a business in its normal operations. They do not include items offered for sale. Fixed assets include building, machinery and equipments. Fixed assets management is the most important task which a management has to face in its day-to-day situations and is important for following reasons.

i. There is a risk involved in fixed assets because of their longer life.

ii. Fixed assets have usually a relatively high cost.

iii. Fixed assets create problem of acquisition and replacement. Acquisitions are addition to fixed assets. The main purpose of acquisition is to increase existing capacity. Replacements are the assets which take the place of existing assets with comparable capacity. The purchase of fixed assets is of particular significance to business firms because the amount involved is relatively large and represents commitments for relatively long period of time.

iv. There is greater tendency to make use of machines and invest more and more fixed assets. The use of efficient machinery is necessary for economies of scale, particularly in conditions of increasing competition. Due to the technological changes, the investment in fixed assets is likely to increase for old assets become outdated and may have to be replaced.

The decisions regarding investment in fixed assets is usually known as capital budgeting. Capital budgeting may be defined as the decision making process, by which a firm evaluates the purchase of major fixed assets including building, machinery and equipments. It is a process by which available cash and credit resources are allowed among competitive long-term investment opportunities, so as to promote the greatest profitability of the company over a period of time. It refers to the total process of generating, evaluating, selecting and following up on capital expenditure alternatives.

Usually, the long-term sources of finance such as, share capital, debentures, retained earnings are utilised for purchasing fixed assets. The firm must have some fixed assets without which it cannot carry its operations smoothly.

(b) Investment in Current Assets :- Every concern is required to invest some part of its funds in current assets. These assets are those which can be converted into cash within an accounting period (or operating cycle) and include cash, short-term securities, debtors, bills receivables and stock (inventory). The term investment in current assets refers to as gross working capital. The net

working capital refers to the difference between current assets and current liabilities. Every firm should maintain a sound working capital position and there should be optimum investment in working capital.

Usually, short term financial sources are utilised for investment in current assets. The usual sources of financing for current assets are the following.

i. Bank loan
ii. Public deposits
iii. Trade credit and other payable
iv. Provision for taxation
v. Depreciation provisions

After having studied sources of finance in general, the researcher will now proceed on the sources of finance of the Banahatti Co-operative Spinning Mills Limited, Banahatti.

4.8 SOURCES OF FINANCE OF THE MILL

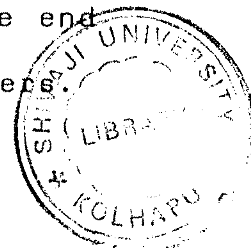
The different sources of finance used by the Banhatti Co-operative Spinning Mills Limited are mentioned below.

[a] <u>Share Capital</u> :- Share capital is a type of the primary source of raising finance of any kind of corporate or the co-operative enterprise. The Banhatti Spinning Mill has called a public meeting to collect opinions regarding the establishment of mill, either according to the Companies Act, 1957 or a Co-operative Act, and came to the decision that it will be according to the Co-operative Act.

Then initially, Rs. 10 lakhs were collected in the form of share capital from the promoters. The Belgaum Composite Registrar has registered the Banhatti Co-operative Spinning Mill Limited, under the registered number G/R/BG/3254/75 dated 3rd February, 1975 and formed first Board of Directors headed by promoters. The Chief Promoter rushed to Bangalore to prepare project ideas of spinning mill and Govt. encouraged providing Rs. 5 lakhs on 20th January 1976 as share capital and adjusted the prepared project report.

The company started its work with an authorised capital of Rs. 7 lakhs. In the year 1983-84, the company issued 75,844 shares of Rs. 500 each.

The paid up capital of the spinning mill at the end of 30-6-1990, was Rs. 3,99,54,000 with 3,542 share holders.



[b] Long-Term Loans :- The major agencies which have supplied long-term loans to the spinning mill are enumerated below.

1) IDBI, Bombay Rs. 1,62,00,000
2) IFCI, Bangalore Rs. 75,00,000
3) ICICI, Bombay Rs. 75,00,000

In the year 1985-86, the full loan sanctioned by the financial institutions was utilised by the spinning mill.

In the year 1983-84, the mill borrowed Rs. 250 lakhs as long-term finance in the form of normal loan (Rs. 160 lakhs) and concessional loan (Rs. 90 lakhs). This increased to Rs. 312 lakhs in 1986.

[c] Short-Term Loans :- The major supplier of short-term loan to the mill is Bijapur District Central Co-operative Bank. The mill had raised short-term loan through the following agencies.

1) Cotton Pledge Cash Credit
2) Year Pledge Cash Credit
3) Overdraft arrangement
4) Hypothecation loan

5) Loan arrangement

6) Bills Purchased and Bills Discount

7) Pledge Loan

8) Export Cotton Pledge Cash Credit

However, in the year 1984-85, the mill did not feel any need of finance for short term purpose.

[d] Deposits :- Another source of finance to the mill is deposits from traders and non-refundable deposits. These deposits were collected during the year 1985-86, 1986-87 and 1987-88.

[e] Retained Earnings :- Eventhough, the spinning mill has been registered in the year 1975, but the actual production started in January 1984. After that, in March 1984, the company started its commercial production. From the inception untill 1988-89, the mill ran in losses. But in the year 1989-90, it registered a profit of Rs. 1.78 lakhs. At the end of June 30th, the mill had reserves of Rs. 3,99,54,000, which is in excess of paid up capital. This situation strengthened the financial position of the mill.

TABLE 4.1 gives an idea of different sources of finance raised by the spinning mill during 1985 to 1990 and TABLE 4.2 shows the fixed and current assets during the same period.

TABLE 4.1 LONG-TERM & SHORT-TERM SOURCES OF FINANCE RAISED BY THE MILL

(Rs. in '000)

SOURCES OF FINANCE	1985	1986	1987	1988	1989	1990
LONG-TERM SOURCES (A)						
Paid up capital	38,009	38,302	39,934	39,943	39,954	39,954
Secured & Long-term loan	37,118	31,200	31,200	29,977	29,176	21,682
Reserves	142.35	204.35	164.13	156.60	173.20	209.22
Non-refundable deposits	-	1.20	1.10	1.10	-	-
% of Fixed Capital to Total Capital	-	92.93	96.08	89.39	89.84	87.08
TOTAL (A)	**75,269.35**	**69,707.35**	**71,299.23**	**70,077.70**	**69,303.20**	**61,845.22**
SHORT-TERM SOURCES (B)						
Cash Credit Loan	5,000	3,374.42	80.18	5,318.36	6,577.97	7,500
Current Liabilities & provisions	1,174.65	1,929.04	2,823.52	2,999.59	1,261.48	1,678.65
TOTAL (B)	**6,174.65**	**5,303.46**	**2,903.70**	**8,317.95**	**7,839.45**	**9,178.65**
TOTAL (A + B)	81,444	75,011.01	75,202.93	78,395.65	77,142.65	71,023.87

SOURCE : Computed from the Annual Reports of the mill

TABLE 4.2 FIXED & CURRENT ASSETS OF THE MILL

(Rs. in lakhs)

PARTICULARS	1985	1986	1987	1988	1989	1990
FIXED ASSETS (A)	916.77	1,001.36	1,076.74	1.118.99	1,139.89	971.35
Yearly increase	-	84.59	75.38	42.25	20.90	168.54
% to Total Assets	-	88	84	70	72	67
CURRENT ASSETS (B)						
Cash, Bank & P.O. balance	27.48	12.76	9.27	9.47	7.96	28.06
Accounts Receivables	13.86	15.45	42.41	75.32	72.79	47.39
Closing Stocks	117.39	107.13	154.94	382.55	367.24	408.61
Stores & Spares	-	-	-	-	-	-
Cotton Dept. Receivables	-	-	-	-	-	-
TOTAL B	158.73	135.34	206.62	467.34	447.99	484.06
Increase in Current Assets	-	-	71.28	260.72	-	36.07
Decrease in Current Assets	-	23.39	-	-	19.35	-
% to Total Assets	-	12	16	30	28	33
TOTAL (A + B)	1,075.50	1,136.70	1,283.36	1,586.33	1,587.88	1,455.41

SOURCE : Computed from the Annual Reports of the Mill

4.9 USES OF FUNDS BY THE MILL

The important problem constantly faced by the business management in general, and the financial management in particular, is from where the additional sources should the finance be obtained to fulfil the needs of the business enterprise and to take advantage of opportunities for profitable use and how the additional resources generated in the business should be invested in the best interest of the owners of the enterprise.

In the Banhatti Co-operative Spinning Mills Limited, during the period of study (1986-90), the major sources of financing is long-term loan, share capital and reserves. The proportion of short-term financing is less. It is noted from TABLE 4.3 that the proportion of fixed capital to total capital is 92.9 percent in 1986, 96 percent in 1987, 89.4 percent in 1988, 89.8 percent in 1989 and 87 percent in 1990. This shows fluctuating trend. The average proportion of fixed capital throughout the study period is 91 percent. The proportion of short-term capital during the study period is 9 percent on an average during the study period.

TABLE 4.3 PROPORTION OF LONG-TERM & SHORT-TERM CAPITAL

(Figures in percent)

	1986	1987	1988	1989	1990
Long-term	92.93	96.08	89.39	89.84	87.08
Short-term	7.07	3.92	10.61	10.16	12.92

SOURCE : Annual Reports of the mill

TABLE 4.4 INVESTMENT IN FIXED & CURRENT ASSETS

(Figures in percent)

INVESTMENT	1986	1987	1988	1989	1990
Fixed Assets	88	84	70	72	67
Current Assets	12	16	30	28	33

SOURCE : Annual Reports of the mill

It is noted from TABLE 4.4 above, that the major capital investment of the mill is in fixed assets, as compared to the current assets throughout the study period. The investment in fixed assets is 88 percent in 1986, 84 percent in 1987, 70 percent in 1988, 72 percent in 1989 and

67 percent in 1990. This shows a fluctuating trend of investment in fixed assets. Similarly, there is a capital investment of 12 percent in 1986, 16 percent in 1987, 30 percent in 1988, 28 percent in 1989 and 33 percent in 1990 in current assets. The proportion of capital investment in fixed and current assets shows that there is more investment in fixed assets that is, 76 percent on an average during the study period and an average investment in current assets as 24 percent.

Through out the study period, some portion of the long-term financial sources are utilised for investment in current assets. In 1986, 4.93 percent, in 1987 12.08 percent, in 1988 19.39 percent, in 1989 17.84 percent and in 1990 20.08 percent of long-term financial sources are used for current assets.

It is noted that on an average, 14.86 percent of the long-term financial sources are utilised for investment in current assets.

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