7 Major Sources of Long -Term Finance

For:
M.Com. (2nd Semester)

Prepared By:

Prof. K. S. Thakur
Jiwaji University, Gwalior

The major sources of long term capital are as follows:

1. Equity and Loans from Government
2. Loan from Public Financial Institutions
3. Public Deposits
4. Internal Sources
5. Capital Markets
6. Bonds
7. International Sources.

1. **Equity and Loans from the Government:**

We know the equity capital represents the interest free perpetual capital and as such, the right as well as control always go with the ownership of equity. In the case of public sector undertakings such right and control lies in the hands of Government or by a holding of apex bodies or partly by financial institutions and partly by the public.

2. **Loan from Public Financial Institutions:**

In 1967 when the IDBI was set up it was decided by the Government that no public sector undertaking will take any loans either from 1FC or from IDBI since routine Government funds must not serve the required purposes of the public sector. They are primarily meant for private sector undertakings.

3. Public Deposits:

Public deposit is a good source of finance for short-term working capital requirements of a private sector undertaking. In private sector undertaking, however, these are unsecured deposits taken for a short period, usually I to 3 years. But in public sector, they carry a hidden security.

4. Internal Sources:

Internal Sources is a very significant source of finance, it is needless to mention here that the primary source of finance for a firm should be its own source which is practiced by almost all the private sector undertakings.
A public sector undertaking should always go for such sources which arises out of the surplus of funds after meeting the costs and expenses and to reduce the claims on savings of the country. The internal sources consist of: Retained earnings, provision for depreciation etc.

5. Capital Market:

Raising of funds by issuing equity in a common source of finance both for the private and public sector undertakings. It will be significant only when the firm takes its place in the capital market for such purposes.

The Government, after liberalization, allowed the public sector undertakings to raise funds by issuing equity since it went down for partial disinvestment of equity. But it was found that most of the public sector undertakings was failed to raise necessary funds by issuing equity. That is, it was not a successful venture.

6. Bonds:

In 1985, the Finance Minister announced a scheme for flotation of bonds by the power sectors and telecommunication sectors.

The bonds may be issued for:

(i) Setting up new projects; or

(ii) For expansion and diversification of existing projects; or

(iii) Meeting capital expenditure for modernization

(iv) Augmenting the long-term resources for the requirements of working capital.

Moreover, the other significant features of the said scheme were as under:

(i) Bonds must not be redeemed before the expiry of 7 years but not later than 10 years;

(ii) Debt-equity ratio must not exceed 4:1;

(iii) There must not be any deduction of tax at source;

(iv) Interest on bonds income is qualified for deduction u/s 8OL of the Income-tax Act;

(v) The bonds are exempted from the wealth tax without any limit; and

(vi) Interest rate on bonds must not exceed 14%.

7. International Sources through Equity and Loans:

Raising of funds from foreign equity can be considered only when:

(i) The project is a very big one which requires foreign loan capital and the same is not accepted by the foreigners until and unless a foreign firm is associated with it;

(ii) The enterprise needs special technical knowledge, inputs etc. which cannot be secured.

However, the equity from the multinational companies may be considered from the standpoint of:

(i) Domestic managerial control,
(ii) Economic independence;
(iii) Ideology;
(iv) Micro grounds of financial needs; and
(v) Macro consideration of foreign exchange.


Thank you