# LONG TERM FINANCE

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# Long Term Sources of Finance

## Meaning:-

The Sources of Long Term Finance are those sources from where the funds are raised for a longer period of time, usually more than a year. Long term financing is required for modernization, expansion, diversification and development of business operations.

# Sources Of Long Term Finance

- Equity Shares Preference Shares
- Retained earnings
- Debentures or bonds
- Loans form banks and financial institutions
- Venture capital financing
- Lease financing

# Equity shares

- Which are not preference shares
- Also called ordinary shares and holders are real owners of the company.
- “A share is a share in the share capital of the co.”
- It can be issued at discount, premium or at face value.

# Features

* No claim on income
* No claim on assets
* Right to control Voting right
* Pre-emptive right
* Limited liability
* Transfer of shares

# Advantages

* Source of fixed capital
* No obligation for repayment
* No charge on assets
* Small nominal value such as Rs.10
* Ideal for adventurous investors
* Voting power
* Right to new shares

# Disadvantages

* High risk
* Due to pre-emptive right management of the co. may be concentrated in few hands
* No trading on equity

# Preference Shares

- Enjoys preferential rights over equity shares in - payment of dividend and - repayment of capital
- Considered as hybrid security

# Features

* Senior security compared to equity shares
* Dividend is not tax deductible
* Fixed return
* No voting right
* No charge on assets
* Flexible – redeemable and irredeemable
* Sinking fund provision can be used

# Types

- Cumulative and non cumulative
- Participating and non participating
- Redeemable and irredeemable
- Convertible and non convertible

# Advantages

* Appeal to cautious investors – who seek reasonable safety and return
* No obligation for dividend
* No interference in management
* No charge on assets
* Flexibility
* Variety

# Disadvantages

* Fixed obligation
* Limited appeal – not attractive to those who wants higher return
* Low return
* No voting rights

# Debentures

- A debenture is a certificate or document issued by a company under its seal as an acknowledgement of debt.
- Repayment is at winding up or maturity.
- Reward is known as interest at fixed rate.

# Features

- Debentures represents borrowed capital
- Interest on debentures is payable on a fixed rate
- Interest on debentures is an obligation to the co.
- Debenture holders are creditors to the company
- Debenture holders have no voting rights
- Debentures may involve a charge on assets of the co.
- flexibility

# Types of Debentures

- Naked or simple and secured or mortgaged
- Redeemable and irredeemable
- Convertible and non convertible
- Registered and bearer debentures
- First and second debentures

# Advantages

* No voting rights
* Fixed interest
* Debenture interest is an expense to the co.
* Can be redeemed
* Trading on equity is possible

# Disadvantages

* Interest is an obligation to the company
* Creates a charge on company's assets
* Common people can not buy debentures as they are of high denominations

# Shares v/s debentures

## Shares

- part of owned capital
- return is dividend
- variable rate of retrn
- voting rights, owners and control over mgt.
- can not redeem
- no priority at winding up

## Debentures

- part of borrowed capital
- return is interest
- fixed rate of return
- no voting rights, creditors and no control over mgt.
- can redeem
- priority over equity shares

# Venture capital

* It is often used for growth and expansion of new and young enterprises.
* Generally considered as high risky capital
* Venture capitalist will involve in the management of the enterprise.
* They generally support to proven technologies.

# Features

- Equity participation
- Long term investment
- Participation in management

# Process of venture financing

1) Deal origination – it is an active search for financiers
2) Screening – initial evaluation of all available venture capitalist
3) Risk analysis
4) Deal structuring – if both the parties are satisfied they negotiate the terms of investment
5) Post investment activities – venture capitalist can act as an owner

# Conditions of venture capital

* According to Govt. of India :-

1. Total investment should not exceed Rs.100 millions
2. New companies which incorporate some significant improvement over the existing one's in India
3. Should have qualified professionals

# Term Loan

- A term loan is granted on the basis of a formal agreement between the borrower and the lending institution on the basis of an asset as a security for a fixed period of time.
- In india commercial banks and specialized financial institutions like IDBI, ICICI, IFC, etc are providing term loans.

# Conditions of term loan lending

- An asset as a security
- Minimum working capital
- There will not be any additional debt
- Management should be effective

# Lease financing

- A lease is a contract between a lessor ie owner of the asset and the lessee, the user of the asset.
- Owner gives the right to use the asset over an agreed period of time for a consideration called lease rental.
- Lessor is the legal owner and he can claim the depreciation.

# Advantages of lease financing

**1.Leasing provides 100% financing:-**

* Lessee can avoid the payment for acquiring asset and even if he has no sufficient fund he can acquire asset by paying lease rental. He can use the fund for some other purposes.

2. **Leasing improves performance:-**

* Lessee has to pay lease rental for the asset which did not appeared in the balance sheet. Naturally the performance of the lessee will be improved.

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## 3. Leasing avoid cost of screening:-

* For a long term investment screening of all alternatives is an unavoidable part. But in leasing it is the duty of the lessor and therefore there is no such cost.

## 4. Convenience and flexibility:-

* It is very cenvenient for lessee because lessor will undertake all the requirements of the asset.

# Limitations of leasing

**1.Costly option:-**

Leasing company is a financial intermediary and he will charge heavy interest for lease financing.

**2. Loss of tax:-**

*Lessee can not claim depreciation in leasing because he is not the actual owner.*

# Contd….

**3. No ownership:-**

Leasing does not provide the advantages of ownership to the user.

**4. Loss of residual value:-**

The leased asset has to be returned to the lessor at the end of the lease period.

THANKS