MODES OF RAISING CAPITAL IN INDIA

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I. ABSTRACT

The present paper discusses in great detail about the need and importance of Capital and raising of Capital by Companies in India. The paper will also elaborates about the various options for a Company in India to raise Capital. The paper also explains the types of Capital according to the needs of the Companies. The paper finally concludes by describing the various modes by a Company can raise Capital in India.

KeyWords: *Capital, Companies in India, types of Capital, raising of Capital.*

II. INTRODUCTION

No Every Company needs money to run its business. Money is required for every kind of business activities, whether it is trading, manufacturing, providing services, transportation or any other kind of business activities. Thus, capital is required for various factors of production in any industry be it manufacturing or service industry. The importance of need of capital has increased in the modern era due to following reasons:

- Business activities take place on a large scale in the present world, thus, needing lot of capital for effective functioning of companies.
- The various process involved in manufacturing of a products or delivery of services have become more and more complex over period of time.

Thus, with growing scales of production and increased complexities in the production, along with growth in size and volume of trade have led to increased importance of capital for a company. Thus, for efficient functioning of the business of a company, capital in adequate quantities shall be available with a company.

The various funding options which are available to Indian Companies for raising Capital in India have been tabulated in the following figure:

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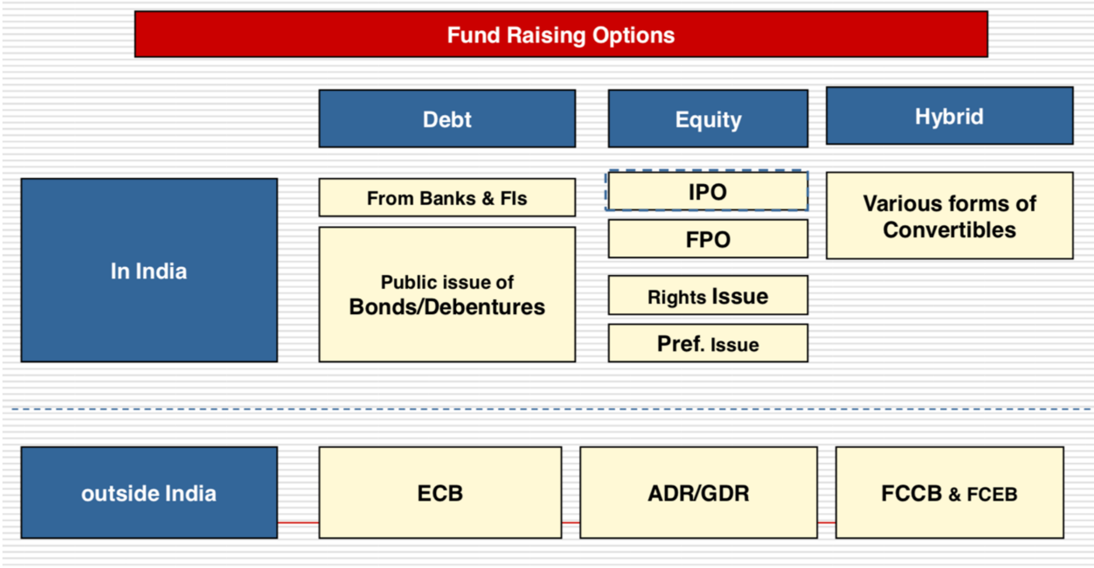

Figure 1: *Various options for Raising Capital by a Company.*[2]

III. TYPES OF CAPITAL NEED

The capital needs of a company can be divided majorly into 2 categories, which are:

- Based on the extent of permanence of capital need of a company, which can be further classified into:
  - Fixed Capital;
  - Working Capital.
- Based on the time period of requirement of capital by a company, which can be further classified into:
  - Long-Term Capital;
  - Medium-Term Capital;
  - Short-Term Capital.

[2] Neha Soni, "Initial Public Offerings (IPOs): Regulations and Process", available at http://www.icsi.edu/docs/portals/25/IPO.pdf, accessed on 20th May, 2019

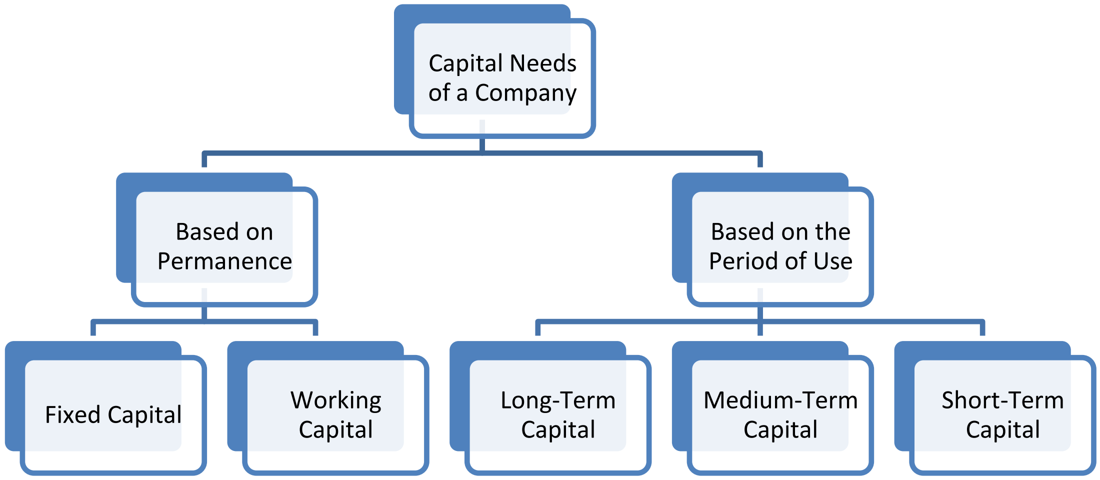

Figure 2: *Classification of Capital needs of a Company*

Fixed Capital and Working Capital

Fixed Capital is also called the long-term capital i.e. the money or funds which a company needs to create capital or long-term assets like land, machineries, building, furniture, equipment's, etc. As the fixed assets need capital commitment for considerably longer period of time and the investment made in fixed assets cannot be take out and put to any other use, thus it is called fixed capital.

Working Capital is also called as Circulating Capital or may also be called Revolving Capital because the investment in the assets are continuously recovered and reinvested. The Working Capital refer to such capital as a company may require for day-to-day functioning and expenses incurred on current assets. The requirement for working capital is for relatively shorter period, when compared with fixed capital and also that working capital can be withdrawn and does not remain fixed in capital assets. The working capital requirement varies from time to time and also from company to company.

Long-term, Medium-Term and Short-Term Capital

As the name suggests, the long-term capital requirement of a company refers to the capital needs of a company, which may be for more than 3 years. The long-term capital is required by company for making strategic decisions or development of capital assets for the company.

The medium-term capital needs of a company refers to such capital needs of a company, which may be for more than 1 year but less than 3 years. The medium-term capital needs of a company may be required for activities like expenditure on advertisements, modernisation of machinery, renovation of buildings, etc.

The short-term capital needs of a company refers to such capital needs of a company, which may be for less than a year. The short-term capital needs of a company usually related to meeting day-to-day expenditure of company and for financing the current assets of the company.

IV. MODES OF RAISING CAPITAL

There are a number of methods of raising capital by company and it is for the company to choose which is the best suited method for raising capital, which shall be based on the capitalisation, capital structure and capitalisation plan of the company. The various methods by which a company may raise capital on the basis of period of use are as follows:

- **Long-term Capital** needs of a company may be satisfied by:
  - Issue of shares: It is one of the most important mode by which a company may raise long-term capital. Issue of shares can be of 2 types, i.e., either Equity shares or Preference Shares. These shares are easily transferable and tradable and the liability of the shareholders are limited to the value of the share.
  - Issue of Debenture: The company may issue debenture for long-term requirements of the company. The debentures are in form of debt instruments having specific rate of interest. The debentures do not give any voting rights to its holder, unlike equity shares, and at the same time ensure a very effective instrument for raising capital from the public for the company.
  - Loans from Financial Institutions: The loans may be raised by a company from financial institution for long period of time against the security. These financial institution may have some degree of control over the management of the company, as they may nominate 1 or 2 directors to the board of directors (BoD) as nominee director. But the most advantageous factor of this method of raising capital is that the company may have access to capital at lower rate of interest than the market rate.

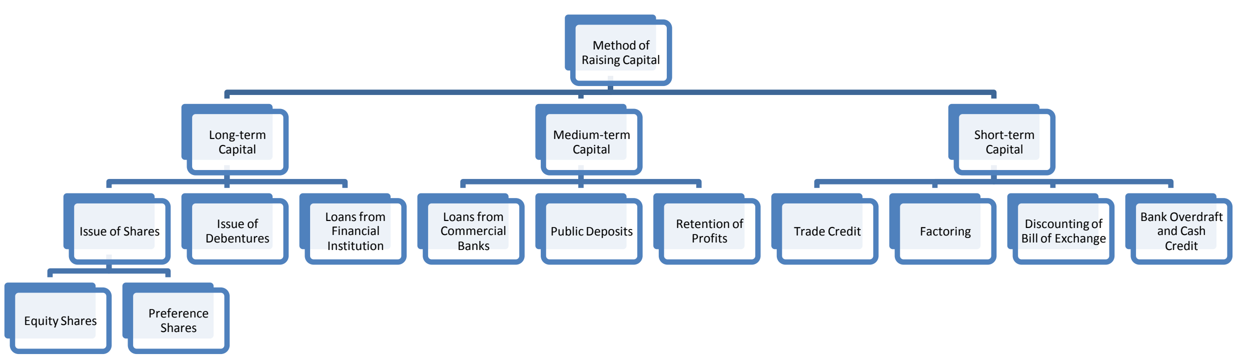

Figure 3: *Methods of raising Capital by Companies*

- **Medium-term Capital** needs of a company may be satisfied by:
  - Loans from Commercial Banks: A company may raise secured loans from commercial banks for its

medium-term requirements of modernisation of machinery or renovation of assets. The commercial banks have no interference in the management of the company, unlike the financial institution, and their role is limited to that of secured creditor.

  - Public Deposits: A company may invite its employees, general public and even its shareholders to deposit their saving with the company in return of higher rate of interest to then public when compared with banks. Section 73 and Section 76 of the Companies Act, 2013, provides for the provisions of public deposit.
  - Retention of Profits: The company earning profits may not transfer all of its profits to its shareholders in form of dividends, rather a part of profit may be transferred to the reserves and later may be utilised as additional capital by the company. This is termed as ploughing back of the profits or the reinvestment of the profits.

- **Short-term Capital** needs of a company may be satisfied by:
  - Trade Credit: It refers to the situation where a company buys various items like raw materials, machineries, spare parts of machines, etc. on credit from the suppliers, on a promise to pay back the supplier, the due amount within a specified period of time. Such trade credit is given by the supplier on trust basis and no security is needed for such company. The long term trade relations and the convention of business are the basis of trade credit.
  - Factoring: The amount which may be due from customers to a company due to credit sale by the company to the customer. Such dues remain outstanding till the debt is recovered from the customer-debtor. These book debts may be assigned to a bank for the purpose raising short term capital by a company and the bank takes over the responsibility of collecting the debt from the customer-debtor. This arrangement between a bank and a company may be termed as factoring.
  - Discounting Bill of Exchange: Bill of Exchange is a negotiable instrument, which can be used as a means to raise short-term capital by the company. These bill of exchanges held by a company may be discounted with a commercial bank on payment of charge that may be termed as bank discount.
  - Bank Overdraft and Cash Credit: A company usually for its day-to-day functioning may have an arrangement with a commercial bank in form of bank overdraft facility and cash credit. Such arrangement are meant to cater to the short-term capital needs of a company.

V.CONCLUSION

Every Company requires capital to run its business or start a new venture. This makes it very pragmatic to understand what are the Capital requirements of a Company and also what are various options for a Company to raise Capital. Thus, a Company has to work out its requirement of amount and type of Capital for itself and then opt for the mode of raising Capital which is most apt for its requirement.

The present paper has tried to discuss, the need for Capital for a Company, which is usually business activities or expansion. The paper also dealt with various option of raising Capital by a Company which could vary in the type of Capital Instrument which could either be equity, debt or hybrid. The paper also discussed the types of Capital needs of a Company, which are either on the basis of permanence (Fixed or Working Capital) or on the basis of period (Long/Medium/Short-Term) of requirement for the Company.