

UNIT- 1

MERCHANT BANKING

1.1 MERCHANT BANKING – AN INTRODUCTION

Merchant banking is an essential sector of the financial services industry that is crucial to business expansion and the smooth execution of intricate financial transactions. In India, merchant banks play a crucial role in helping companies with mergers and acquisitions, underwriting, and advising services, all of which greatly advance the country's economy. These organizations act as go-betweens for issuers and investors, offering specialized financial services that are not available through ordinary banks. Through their proficiency in financial management, merchant banks assist businesses in maximizing their capital structure, increasing their market value, and accomplishing strategic goals.

1.2 HISTORY OF MERCHANT BANKING IN INDIA

The inception of merchant banking in India can be traced back to the early 1960s when the need for sophisticated financial advisory services became apparent. The establishment of the Industrial Finance Corporation of India (IFCI) in 1948 marked the beginning of formal merchant banking activities. Initially, these services were limited to developmental and financial institutions, but the landscape began to change with the introduction of the Industrial Credit and Investment Corporation of India (ICICI) in 1955 and the Industrial Development Bank of India (IDBI) in 1964.

When commercial banks and international banks began to enter the market in the 1970s and set up specialized merchant banking sections, the idea of merchant banking gained traction.

In 1967, the Reserve Bank of India (RBI) granted license to 'The National Grindlays Bank' to perform the services relating to issue management. On the recommendation of Banking commission, State Bank of India (SBI) became the first Indian Bank to start with the merchant banking activities in 1972-73.

The 1980s and 1990s saw significant regulatory developments with the establishment of the Securities and Exchange Board of India (SEBI) in 1988. SEBI introduced stringent guidelines for merchant bankers, ensuring transparency and investor protection. The liberalization of the Indian economy in the early 1990s further spurred the growth of merchant banking, attracting numerous private-sector players. Today, merchant banks play a crucial role in the Indian financial market, offering a wide array of services that cater to the complex needs of modern businesses.

1.3 DEFINITION OF MERCHANT BANKING

According to SEBI, a merchant banker is defined as any person engaged in the business of issue management, which includes arranging for the selling, buying, or subscribing to securities, or acting as a manager, consultant, advisor, or providing corporate advisory services related to such issue management.

1.4 OBJECTIVES OF MERCHANT BANKING

The main objectives of merchant banking are to facilitate capital formation, assist businesses in raising funds, and provide specialized financial advice. This includes helping companies issue securities, managing public offerings, advising on mergers and acquisitions, and offering corporate restructuring services. Merchant banks also play a crucial role in project financing and promoting economic development.

- **Capital Formation:**

Merchant banks assist companies in raising money through a number of strategies, such as private placements, financial instruments like bonds, and equity issuance like initial public offerings (IPOs). They act as intermediaries, connecting companies with investors seeking to fund their operations.

- **Issue Management:**

They help businesses maximize investor confidence and ensure regulatory compliance by managing and structuring securities offerings.

- **Underwriting:**

Merchant banks guarantee the sale of securities in an IPO, taking on the risk of unsold shares. This helps companies raise funds by mitigating the risk for investors.

- **Advisory Services:**

They offer expert advice on various financial matters, including mergers and acquisitions, corporate restructuring, and strategic planning.

- **Project Financing:**

Merchant banks play an important role in financing large-scale projects, assisting businesses in obtaining capital and navigating the complex financial environment.

- **Economic Development:**

Merchant banks help a country's economic development by facilitating capital generation and promoting company expansion..

- **Other Objectives:**

They may also assist in loan syndication, portfolio management, and providing advisory services to both corporate and individual investors.

1.5 FUNCTIONS OF MERCHANT BANKING

Bankers have almost all functions which help any industry to deal in securities market & raising finance. Some of them are as under:

- i. **Raising finance:**

Merchant bankers supports industries to collect funding through debenture issuances, stocks, bank loans, etc. Both domestic and foreign markets are used. The funds generated by this may be used to launch a new project or company, or also to extend and modernize the current enterprise.

- ii. **Promotional activities:**

Merchant bankers perform the role of industrial business promoters. They allow developers to create innovations, define ventures, produce feasibility studies, receive permits from public bodies, and opportunities. At times,

merchant bankers may also assist with technological, and joint projects.

iii. **Project management:**

In the project management cycle, they assist corporates in a variety of areas. They guide the position of the plant, the writing of the plant study, feasibility reports, and the project finance preparation, sources of support, policy benefits, and concessions.

iv. **Advice on modernization and expansion:**

Advice on amalgamation, mergers, partnerships, international alliances, market diversification, up-gradation of technologies, joint ventures, etc.

v. **Managing public issue:**

They serve as consultants on the terminology, form, and timing of corporate securities issues and helps them to be tailored to customers and provides the issuing companies with transparency and versatility.

vi. **Credit syndication:**

They offer professional services during project planning, loan applications required to collect short- and longterm credit from various institutions and companies, etc.

vii. **Special assistance to entrepreneurs and small companies:**

They offer guidance and resources for market prospects for start-ups and small businesses, discounts, grants, and government policy, and help them make the best of this opportunity open to them.

viii. **Portfolio management services:**

They give guidance on investment choices to customers, typically institutional investors. They purchase and sell shares and offer fund investment services for them.

1.6 REASONS FOR GROWTH OF MERCHANT BANKING

i. **Globalization:**

After the 1991 reforms, the Indian economy saw a drastic change as it opened gates for foreign companies. It helped in getting funds from abroad; thus, it led to the growth of merchant banks.

ii. **Elevated competition:**

Because of the globalization of the economy, the market scenarios became lucrative, and business options became favorable for various individuals. This pivoted the Indian corporate sector, and a huge expansion was seen in this sector. This motivated the Merchant Bankers to play an important role by offering specialized services to corporate.

iii. **Switch in consumer trends:**

There was a huge transformation in the industrial and corporate sectors because of the foreign players in the market. The major benefit was that the Indian masses started getting better quality products as the Indian companies also started working on quality to match the foreign products. In such prevailing environments, financial products and instruments became more prominent.

iv. **Government Reforms :**

Government intervention was reduced, and privatization was increased. It also raised the limits of investment and lessened direct interventions that led to an increase in the proposition of foreign players.

v. **Demand for Funds:**

Industries started expanding which increased gap of supply and demand. All financial institutions had experienced constrain of resources to meet ever increasing demands from corporate sector enterprises. In such circumstances corporate sector had the only

vi. **Public Savings:**

There was high Public Savings untapped which was channelized by the Merchant Bankers in the system.

vii. **Skilful Agency:**

A merchant banker with their good skills, updated information and knowledge provide this service to the corporate units and advise them on

such requirement to be complied with for raising funds from the capital market under different enactment viz. companies act, income tax act, foreign exchange regulation act, securities contracts corporate laws and regulations.

1.7 ROLE OF MERCHANT BANKERS

Merchant Bankers are playing key roles in assisting start ups in India which are going to be the back bone of India's powerful infrastructure in time to come. They are assisting start ups in many ways such as :

(i) **Valuation of Start ups :**

MB's prepare valuation reports for start ups on the basis of future earnings and on that basis start ups are able to raise funds from the investors since this valuation gives bench mark about the value of that business to the investors.

(ii) **Fund Raising Support:**

Fund raising to Start Ups in the form of Angel Capital, Seed Capital, Venture Capital, Leverage Capital and Private Equity; Merchant Bankers (MB) supports their clients in procuring funds via the issuance of debenture, bank loans, shares, etc.

(iii) **Promotional & Management Activities:**

Merchant Banker's activities play a pivotal role as a promoter of industrial enterprises. They provide assistance to entrepreneurs in conceiving ideas, pinpointing projects, preparation of feasibility reports availing government permission, and incentive, etc.

(iv) **Project Management:**

Merchant bankers use several ways to render their service to start ups in financial related project management.

Challenges

(a) **Challenges**

(i) Stringent compliance and Reporting Requirements;

- (ii) Handling Investors Grievances during Pre-& post funding requirement;
- (iii) The Funding Process could be investigated by the Board and Other Regulatory authorities.
- (v) The MB could not receive start-up funding
- (vi) The MB will always have the risk of mixed chance of success

Opportunities:

- (i) Underwriting of Debt and Equity
- (ii) Placement and Distribution
- (iii) Corporate Advisory Services
- (iv) Cross Border Financing
- (v) Portfolio Management Services

QUESTION & ANSWER

1. What is Merchant Banking ? Explain
2. State the objectives of Merchant Banking
3. Give in detail the functions of Merchant Banking in India
4. Write in brief the role of Merchant Banking
5. State the Challenges and opportunities faced by the Merchant bankers in trading

SERA INVESTMENTS & FINANCE INDIA LIMITED (SERA)

1.2 SERA AND SEBI GUIDELINES

➤ SERA – AN INTRODUCTION

- SEBI Guidelines and Regulations Applicable to SERA
- RECOGNITION BY SEBI ON MERCHANT BANKERS
- CONDITIONS BY SEBI
- CLASSIFICATION OF MERCHANT BANKERS BY SEBI
- Capital structure decision

1.2.1 INTRODUCTION

SERA Investments & Finance India Limited (SERA) is subject to guidelines and regulations set by the Securities and Exchange Board of India (SEBI). These regulations cover various aspects of company operations, including listing obligations, disclosure requirements, and compliance with the Prevention of Money Laundering Act.

1.2.2 SEBI Guidelines and Regulations Applicable to SERA:

- **Listing Obligations and Disclosure Requirements:**

SERA, as a listed company, is subject to the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. These regulations govern the company's obligations regarding disclosures, including those related to share transfers, capital restructuring, and other material events.

- **Issue of Capital and Disclosure Requirements:**

SERA is also governed by the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. This regulation outlines the guidelines for issuing capital and making disclosures related to the same.

- **Anti-Money Laundering (AML) Standards:**

As a securities market intermediary, SERA is required to comply with the SEBI's guidelines on AML standards and combating the financing of terrorism (CFT) under the Prevention of Money Laundering Act, 2002.

- **Other SEBI Regulations:**

SERA may be subject to various other SEBI regulations depending on its specific activities, such as those related to employee stock options, share-based benefits, and other areas.

Specific Examples of SERA's Compliance with SEBI Regulations:

- **Disclosure of Capital Restructuring:**

SERA complies with the SEBI regulation regarding disclosures of capital restructuring, where changes exceeding 2% of the total paid-up share capital require disclosure within one month of the change.

- **Compliance Certificate for Share Transfers:**

SERA has issued a compliance certificate confirming that it maintains all activities related to both physical and electronic share transfers, as required by Regulation 7(3) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

- **Annual Secretarial Compliance Report:**

SERA is required to submit an annual secretarial compliance report, as specified in Regulation 24A of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

- **Disclosure of Warrants Allotment:**

SERA has disclosed the allotment of warrants under a preferential issue in accordance with Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Key Points about SEBI Regulations:

- SEBI regulations aim to protect investors and ensure fair and transparent operations in the securities market.
- SEBI continuously updates and amends its regulations to adapt to the evolving market landscape.
- Compliance with SEBI regulations is crucial for listed companies to maintain their listing status and avoid penalties.

SEBI has made the following reforms for the Merchant banker.

- Multiple categories of merchant banker will be abolished and there will be only one equity merchant banker.
- The merchant banker is allowed to perform underwriting activity. For performing portfolio manager, the merchant banker has to seek separate registration from SEBI.
- A merchant banker cannot undertake the function of a non banking financial company, such as accepting deposits, financing others' business, etc.
- A merchant banker has to confine himself only to capital market activities.

1.2.3. Recognition by SEBI on merchant bankers:

SEBI will grant recognition a merchant banker after taking into account the following aspects.

- Professional competence of merchant bankers.
- Their capital adequacy.
- Track record, experience and general reputation of merchant bankers.
- Adequacy and quality of personal employed by them and also the available infrastructure.

After considering the above aspects, SEBI will grant permission for the merchant banker to start functioning.

1.2.4 Conditions by SEBI have laid for merchant bankers:

SEBI the following conditions on the merchant bankers, for conducting their operations. They are:

- a. SEBI will give authorization for a merchant banker to operate for 3 years only. Without SEBI's authorization, merchant bankers cannot operate.
- b. The minimum net worth of merchant banker should be Rs. 1 crore.
- c. Merchant banker has to pay authorization fee, annual fee and renewal fee.
- d. All issue of shares must be managed by one authorized merchant banker. It should be the lead manager.
- e. The responsibility of the lead manager will be clearly indicated by SEBI.
- f. Lead managers are responsible for allotment of securities, refunds, etc.,
- g. Merchant banker will submit to SEBI all returns and send reports regarding the issue of shares.
- h. A code of conduct for merchant bankers will be given by SEBI which has to be followed by them.
- i. Any violation by the merchant banker will lead to the revocation of authorization by SEBI.

1.2.5 Conditions by SEBI pertaining to pre issue obligations:

Recent regulations by SEBI on Merchant bankers with regard to pre issue obligations involve the following;

1. Registration
2. Capital structure decision
3. Public issue
4. Rights issue
5. Prospectus, etc.,

1. Registration:

All merchant bankers must compulsorily register themselves with SEBI.

1.2.6 Classification of Merchant Bankers by SEBI

SEBI has classified merchant bankers under categories. They are given below:

- Issue Management
 1. Prospectus
 2. Financial structure
 3. Tie up of finance.
 4. Allotment of securities
 5. Refund of subscription

- Underwriters
 1. Advisory
 2. Consultancy
 3. CoManager
 4. Portfolio Manager

- Consultants to issue
- Mobilisation of foreign funds.

QUESTIONS & ANSWERS

1. Write the SEBI Guidelines and Regulations Applicable to SERA
2. Give the conditions by SEBI pertaining to pre issue obligations
3. State the criteria under which the recognition on merchant bankers
4. State the Classification of Merchant Bankers by SEBI

SEBI – GUIDELINES & OTCEI

1.3 INTRODUCTION

SEBI guidelines are a set of rules and regulations formulated by the Securities and Exchange Board of India (SEBI) to protect investors in the securities market and promote fair and transparent practices. These guidelines cover various aspects of the market, including the functioning of stock exchanges, brokers, listed companies, and mutual funds.

1.3.1 ROLE OF SEBI:

1. Investor Protection:

SEBI guidelines aim to safeguard investors from fraudulent activities, market manipulation, and unethical practices. This includes preventing unfair trade practices, regulating takeovers and acquisitions, promoting investor education, and establishing the Investor Protection Fund.

2. Regulation of Market Participants:

SEBI regulates various market participants, including stock exchanges, brokers, sub-brokers, portfolio managers, investment advisors, and asset management companies (AMCs).

3. Disclosure Requirements:

SEBI mandates that companies provide accurate, timely, and transparent information about their financial performance and operations to the public. This includes disclosures related to public offerings, takeovers, and other material events.

4. Fair Trading Practices:

SEBI prohibits fraudulent and unfair trade practices in securities and provides a framework for detecting and preventing such practices. This includes insider trading regulations and requirements for fair trading practices.

5. Monitoring and Enforcement:

SEBI monitors the securities market and enforces its regulations to ensure compliance by market participants. This includes taking action against those who violate regulations and conducting investigations into potential violations.

6. Specific Regulations:

SEBI has specific regulations for different areas of the market, such as mutual funds, takeovers, and substantial acquisition of shares. For example, the Securities and Exchange Board of India Regulations, 1996 provides guidelines for managing mutual funds in India.

7. Protecting Investors in the Indian Market:

SEBI's guidelines are designed to ensure that investors in the Indian market are treated fairly and that their interests are protected. This includes protecting investors from fraudulent activities and market manipulation, as well as ensuring that companies provide accurate and timely information.

1.3.2 POWERS OF SEBI

1. Quasi-Legislative:

SEBI can create and modify rules and regulations for the securities market. This includes regulations related to listing obligations, trading practices, and disclosure requirements.

2. Quasi-Judicial:

SEBI can act as a tribunal to adjudicate disputes within the securities market, conduct hearings, and render judgments. This allows them to resolve disputes between market participants, investors, and intermediaries.

3. Quasi-Executive:

SEBI has the authority to enforce its regulations, conduct investigations, and impose penalties. They can inspect the books of accounts of stock exchanges and intermediaries, and take enforcement actions against those who violate securities laws.

4. Specific Powers:

(i) Registration and Regulation:

SEBI registers and regulates various market intermediaries, including brokers, merchant bankers, and portfolio managers.

(ii) Monitoring and Investigation:

They monitor market activity to detect potential malpractices and conduct investigations into violations.

(iii) Investor Protection:

SEBI aims to protect investor interests by enforcing regulations, promoting fair practices, and addressing investor complaints.

(iv) Promoting Fair Practices:

SEBI strives to ensure fair and ethical behavior in the securities sector. (v) Market

Development:

SEBI plays a role in promoting the growth and development of the securities market.

(vi) Investor Education:

SEBI provides investor education and awareness programs to inform the public about the securities market.

1.3.3 OTCEI – INTRODUCTION

The Over-the-Counter Exchange of India (OTCEI) is an electronic stock exchange designed to help small and medium-sized firms access capital markets without a traditional trading floor. It utilizes modern technology for transactions, offers benefits such as cost-effective fundraising for companies and safeguards for investors, including transparency and liquidity. The OTCEI facilitates a national network for the trading of various securities, including exclusively listed equities, listed debt instruments, and government securities.

1.3.3 Objectives of OTCEI

- (1) Use of Modern Technology: It is an electronically operated stock exchange.
- (2) Restrictions for other stocks: Stocks and shares listed in other stock exchanges will not be listed in the OTCEI and similarly, stock listed in OTCEI will not be listed in other stock exchanges.
- (3) Minimum issued capital requirements: Minimum issued equity capital should be Rs.30 lakhs, out of which minimum public offer should be Rs.20 lakhs.
- (4) Restrictions for large companies: No company with the issued equity share capital of more than Rs.25 crores is permitted for listing.
- (5) Base Capital requirement for members: Members will be required to maintain a minimum base capital of Rs. 4 lakhs to trade on the permitted or on listed segment.
- (6) All India network: The network of counters links OTCEI members, located in different parts of the country.
- (7) Satellite facility: The satellite required for OTCEI for its operations is jointly held with Press Trust of India
- (8) Computerization of transactions: Computers at each counter enable the dealers to enter various transactions or queries or quotes through a central OTCEI computer, using telecommunication links.

1.3.4 Role of OTCEI in Merchant Banking

1. Assisting and guiding small companies to raise funds from the capital market in a cost effective manner
2. Providing a convenient and an efficient avenue of capital market investments for small investors
3. Strengthening investors' confidence in the financial market by offering them the two-way best prices to them
4. Ensuring transparency, redressing investors complaints and unifying the country securities market to cover even those places which do not have a stock exchange
5. Acting as a launch pad to an IPO
6. Providing liquidity advantage to the securities traded
7. Promoting organized trading in Unlisted Securities
8. Providing a source of valuation for securities traded OTCEI

1.3.5 Benefits of OTCEI:

1.3.5.1 Benefits to Companies

1. **Negotiability:** The Company can negotiate the issue price with the sponsors who have to market the issue. It provides an opportunity for fair pricing of an issue through negotiation with the sponsors.
2. **Fixation of premium:** In consultation with the sponsors, the company can fix an optimum level of premium on issue with minimum risk of non-subscription of the issue.
3. **Savings in costs:** Lots of costs associated with public issue of capital are saved through this mode. It provides an opportunity to companies to raise funds through capital market instruments at an extremely low cost as compared to a public issue. The method of sponsors placing the scrip's with members who in turn will offload the scrip's to public will obviate the need for a public issue and its associated costs.

4. No take-over threat: OTCEI lists scrip's even with 40 percent of the capital offered for public trading. The limit has now been brought down to 20 percent in the case of closely held companies and new companies. As a result, the present management of the companies are saved of threats of takeover if they restrict public offer.

5. Large access: Accessing a large pool of captive investor base through the OTCEI's computerized network is made possible for companies.

6. Other benefits:

a. Helpful to small companies

b. Shares of all unlisted companies can now be traded on OTCEI

c. Platform for issuers and first-level investors like financial institutions, state level financial corporations, Foreign Institutional Investors, etc.

d. System for defining benchmark for securities e. Increasing business for the market constituents

1.3.5.2 Benefits to investors

1. **Safety:** OTCEI scrip uses less electronic trading that ensure safety of transactions of the investor. For instance, every investor in a OTCEI is given an free OTC Card. This code is allotted on a permanent basis and should be used in all OTC transactions and applications of OTC issues. This card provides for the safety and security of the investors investments.

2. **Transparency:** OTC screens at every OTC counter display the best buy/sell prices. The exact trading prices are printed in the trading documents for confirmations. This protects the investor interest and there by minimize disputes.

3. **Liquidity:** A great advantage of the OTC is that the scrip's traded are liquid. This is because there are at least two market-makers who indulge in continuous buying and selling. This enables investors to buy and sell the scrip's any time

4. **Appraisal:** OTC members sponsor each scrip listed in an OTC counter. The sponsor makes an appraisal of the scrip's for investor worthiness. This ensures quality of investments.

5. **Access:** Every OTC counter serves as a single window to the entire OTC exchange throughout the country and throughout the world too. Therefore, buying and selling may be resorted to from any part of the world. It offers the facility of faster deal settlement for investors across the counters spread over the entire country.

6. **Transfer:** It is important that OTC shares are transferable within 7 days, where the consolidated holdings of the scrip's do not exceed 0.5 percent of the issued capital of the company.

7. **Allotment:** Allotment is completed in all respects within a matter of 35 days and trading begins immediately thereafter.

8. **Other benefits :**

a. Derivatives such as futures and options, forward contracts on stock, and other forms of forward transactions and stock lending are allowed on OTCEI

b. Scrip less trading makes dealings simpler and easier

c. Market-making system in OTC Exchange gives sufficient opportunities for the investors to exit

d. Acts as a benchmark to value securities

e. Creating an exit option for illiquid stocks/venture capitalists f. Shuffling portfolios for the investors

g. Organizing and broad-basing trading in the existing market

1.3.5.3 Benefits to Financial System

The OTCEIs role has been laudable in as far as it helps contribute improving the financial system of India in the following ways:

1. National network of OTCEI operations facilitates the integration of capital market in the country.

2. Boon to closely-held companies as they are encouraged to go public because scrip's can be listed even if only 40 percent of capital (now a minimum of 20 percent in case of closely held and new companies) is offered for public trading.
3. Facilities wider dispersal of economic activities by encouraging small companies and small investors.
4. Promoting savings and investments by offering easier avenues for raising capital.
5. Providing over-all stimulation to venture capital activities thereby promoting entrepreneurship.
6. Market-making assistance by the sponsors on the OTCEI that helps in making appraised future projections in the issue documents which in turn helps prospective investors in determining the usefulness of the issues for investment purposes, promoting investment environment in general.
7. Those members of the OTCEI who did not have multiple memberships can now have an opportunity to trade in some of the large capital index stocks.
8. Encourage venture capital activities and boost entrepreneurship

1.3.6 Difference between Stock exchange and OTCEI

Basis of Difference	Stock Exchange	OTCEI
Structure	A centralized, regulated marketplace with specific trading rules and listing requirements.	A decentralized electronic platform where trading occurs through broker-dealer networks, not a physical exchange
Companies	Established companies need to be registered in stock exchange to meet their requirements	Catered to small and medium-sized companies that couldn't meet the listing requirements of stock exchanges.
Transparency	Offers high levels of	While still offering some

	transparency and liquidity due to centralized trading and standardized rules	transparency, it was lesser than stock exchanges.
Purpose	Facilitates the trading of securities, provides a platform for companies to raise capital, and helps investors buy and sell shares.	Provided an alternative market for smaller companies to raise capital and investors to trade their shares
Minimum Paid capital	In the case of minimum paid capital the regular stock exchange accepts up to Rs. 5 Crores	In the case of minimum paid capital OTCEI is more than 30 Lakhs

Questions & Answers

1. Give the objectives of SEBI
2. State the role of SEBI
3. State the objectives of OTCEI
4. Explain in brief the benefits of OTCEI
5. Differentiate Stock exchange with OTCEI

UNIT 2

ISSUE MANAGEMENT

2.1 INTRODUCTION:

The SEBI has issued Disclosure and Investor Protection (DIP) guidelines as ground rules relating to new issue procedure/activities. The purposes for which SEBI has framed the DIP guidelines are

- To protect the interest of investors
- For the orderly growth and development of the securities market.
- For removing inadequacies and deficiencies in the system.

These guidelines are in addition to the company law requirements in relation to issues of capital/securities.

2.1.2 PRE- ISSUE MANAGEMENT & POST – ISSUE MANAGEMENT

Pre issue management is time bound programme and concerned with following:

- 1) Issue of shares
- 2) Marketing, Coordination and underwriting of the issue.
- 3) Pricing of issues

Post issue management is concerned with following:

- 1) Collection of application forms and amount received
- 2) Scrutinising application
- 3) Deciding allotment procedure
- 4) Mailing of share certificates/refund or allotment orders

2.1.3 PRE ISSUE STRUCTURING:

Pre issue organizing is one of the elements of issue administration which incorporates the accompanying capacities:

- Issue of offers.

- Marketing and Coordination.
- Underwriting of the issue.
- Pricing of issue.

2.1.4 PROCEDURE FOR ISSUE:

2.1.4.1 Applicability

These procedures/activities are applicable for issue of securities:

- * Public issues and offers for sale by listed/unlisted companies and
- * Rights issue (i.e., an issue of capital under sec.81 (1) of the companies act to the existing shareholder through a letter of offer) by listed companies, except in cases where the aggregate value of securities including premium is less than ` 50 lakh.

The issue procedure, the subject matter of DIP guidelines deals with the following:-

1. Eligibility norms
2. Pricing of issues
3. Promoters contribution and lock-in requirements
4. Indian Depository Receipts (IDR)
5. Issue advertisement
6. Issue of Debt Instruments
7. Book building
8. Green shoe option
9. Initial Public offer through stock exchange online system (EIPO)
10. Preferential issues
11. Qualified Institutional Placement

2.1.4.2 FILING OF OFFER DOCUMENT

In the following cases, a draft prospectus/letter of offer should be filed with the SEBI through a merchant Banker at least 30 days prior to filing it with the Registrar of companies:-

- Public issue of securities by any company
- Any type of securities by a listed company through a rights issue in excess of 50 lakh
- Before filing the draft prospectus with the Registrar of companies, the lead merchant banker/issuer should carry out any changes specified by the SEBI on the draft prospectus/letter of offer.

The SEBI may specify changes only after receipt of in principle approval from the exchanges on which the proposed securities are to be listed.

2.1.4.3 Eligibility Norms

An initial public offering for sale of equity shares or any other security convertible into equity shares can be made by an unlisted company subject to fulfillment of all the following conditions:

- During each of the preceding 3 full years, the company should have Net tangible assets of at least ` 3 crore. Out of these net tangible assets 50% should be in monetary assets.
- The company should have made distributable profits for at least 3 out of the immediately preceding 5 years.
- The company must have a net worth (total of paid up equity capital and free reserves excluding revaluation reserves minus total of accumulated losses and deferred expenditure not written off) of at least ` 1 crore in each of the preceding 3 full years.
- In case of change of its name, the company should have at least 50% of the revenue from the new activity mentioned in the suggested new name in the preceding full year.
- Total of the proposed issue and all previous issues in the same financial year, should not exceed 5 times its pre-issue net worth.

An unlisted company which does not fulfill any of these five conditions can issue shares if it satisfies alternatively the following two conditions.

- It issues through book building process. At least 50% of the net offer is allotted to a Qualified Institutional Buyer (QIB) like a public financial institution, banks, mutual funds, FIIs, development finance institutions, VCFs, a foreign venture capital investor registered with SEBI, SIDCs, Insurance Companies or banks/ financial institutions participate in the project to an extent of 15% of which 10% should come from the appraises.
- The minimum post issue capital of the issuer would be 10 crores or there would be a compulsory market making for at least 2 years from the date of listing of the shares. The number of prospective allottees should not be less than 1000.

2.1.5 PUBLIC ISSUE BY LISTED COMPANIES

All listed companies can issue shares/convertible securities provided

- Issue size in a financial year does not exceed 5 times their pre issue net worth as per the audited balance sheet of the last financial year.
- If the name of the issuer company is changed within the last one year, the revenue from the activity suggested by the new name should not be less than 50% of the total revenue in the preceding one full year.

If the above two conditions are not satisfied, a listed company can make a public issue through the book building process with the same conditions as applicable to unlisted companies.

Listed companies can also raise funds through Qualified Institutional placement.

Exemptions

The above norms for listed and unlisted companies are not applicable in the following cases.

* Private/Public sector banks

*Infrastructure companies whose project has been appraised by a PFI/IDFC/ILFS or a bank which was earlier a PFI and also not less than 5% of the project cost has been financed by any of the appraising institutions jointly/severally.

* Rights issue by a listed company.

2.1.6 ISSUE OF A DEBT INSTRUMENT

A convertible debt instrument means an instrument/security which creates/acknowledges indebtedness. It includes debentures, bonds and other securities.

Conditions for issue of a Debt Instrument

The following conditions should be satisfied on the date of filing the draft offer document with SEBI and also on the date of filing the final offer document with the ROCs/designated stock exchange:

- i. The offer document should disclose credit rating obtained from at least two SEBI registered credit rating agency.
- ii. The issuer company should not be in the RBI's defaulters list.
- iii. In case of debentures, the issuer company should not be in default for more than six months in the payment of interest and repayment of principal.
- iv. The issuing company should disclose in the offer document all credit ratings obtained during the 3 years preceding the public/ rights issue for any listed security.

QUESTIONS & ANSWER

1. Explain Pre issue management
2. Give the pre issue structuring
3. Explain the procedure for issue
4. State the filing of offer document

INITIAL PUBLIC OFFERING (IPO)

2. 2 INTRODUCTION

When companies grow and need to raise capital, they often turn to the public markets. One of the most common methods for doing so is through an Initial Public Offering, commonly known as an IPO. Understanding what an IPO is, how it works, and its potential benefits and risks is crucial for anyone considering investing in the stock market.

IPO stands for Initial Public Offering. It is the process by which a private company offers shares of its stock to the public for the first time. This transition from a private to a public company is a significant milestone and usually involves rigorous regulatory scrutiny.

When a company goes public, it sells its shares on a stock exchange, making them available for purchase by the general public. The primary goal of an IPO is to raise capital to fund expansion, pay off debt, and/or achieve other business objectives

2.2.1 E-IPO

In merchant banking, an e-IPO, or electronic initial public offering, refers to the process of a private company offering its shares to the public for the first time through an online platform. This digital approach streamlines the traditional IPO process by allowing investors to apply and potentially subscribe to shares online, often through broker platforms or specialized e-IPO services.

- **Digital Application:**

Instead of paper-based applications, investors apply for IPO shares online using their Demat and trading accounts.

- **Online Platforms:**

Investors utilize online platforms like broker websites or mobile apps to apply, often through ASBA (Application Supported by Blocked Amount).

- **Reduced Time & Effort:**

E-IPOs aim to reduce the time and effort required for both the company issuing shares and investors applying for them, compared to traditional methods.

- **Increased Accuracy:**

Online applications and digital processing can lead to higher data accuracy and reduced errors.

2.2.2 WORKINGS OF IPO:

The process of launching an IPO is complex and involves several steps:

1. Preparation :

The company must prepare financial statements, business plans, and other essential documents. They often hire investment banks to underwrite the IPO and help set the initial price of the shares.

2. Regulatory Approval :

The company must file a registration statement with regulatory authorities, such as the Securities and Exchange Board of India (SEBI) in India or the Securities and Exchange Commission (SEC) in the United States. This document contains detailed information about the company's financials, business model, and risks.

3. Marketing :

The company and its underwriters conduct a "roadshow," where they meet with potential investors to generate interest in the IPO.

4. Pricing :

Based on the demand from investors, the company and its underwriters determine the final offering price of the shares.

5. Going Public :

Once the shares are priced, they are listed on a stock exchange, and the company officially becomes a public entity.

2.2.3 TYPES OF IPOs

There are two primary types of IPOs:

1. Fixed Price Offering :

In this type of IPO, the company sets a fixed price at which its shares will be offered to the public. Investors know the price in advance and can subscribe to the IPO at that price.

2. Book Building Offering :

In a book building offering, the company provides a price band within which investors can bid for the shares. The final price is determined based on the bids received during the IPO process.

2.2.4 ADVANTAGES OF IPOS

Investing in IPOs can offer several potential benefits:

1. Growth Opportunities :

IPOs allow investors to participate in the early growth stages of a company. If the company performs well, the value of its shares can increase significantly over time.

2. Liquidity :

Once a company goes public, its shares are traded on a stock exchange, providing liquidity to the investors. They can buy and sell shares easily, depending on market conditions.

3. Transparency :

Public companies are required to disclose their financials and other critical information regularly. This transparency allows investors to make informed decisions.

4. Potential for High Returns :

IPOs have the potential to provide substantial returns, especially if the company is in a high-growth industry. However, it's essential to remember that investing in IPOs also comes with risks.

2.2.5 ROLE OF MERCHANT BANKERS IN E-IPO:

Merchant Bankers play an important role in investing in IPO. They are

- **Advisory:**

Merchant bankers advise companies on the entire IPO process, including whether to pursue an e-IPO.

- **Regulatory Compliance:**

They ensure the company complies with all relevant regulations and legal requirements from SEBI and other bodies.

- **Underwriting:**

They may act as underwriters, guaranteeing a certain number of shares will be purchased if not sold to the public.

- **Registrar & Issue Management:**

They coordinate with the IPO registrar to manage the application process and share allotment.

- **Listing:**

Merchant bankers help with the listing of the company's shares on the stock exchange after the IPO.

2.2.5 STEPS IN THE E-IPO PROCESS:

E-IPO has the following steps in issue:

1. Company decides to go public:

The company, with the guidance of its merchant bankers, decides to launch an IPO.

2. Appointing merchant bankers:

The company appoints merchant bankers to manage the IPO process.

3. Drafting the offer document:

Merchant bankers help prepare the offer document (DRHP/RHP) containing details about the company, its financials, and the IPO details.

4. Regulatory approvals:

The merchant banker ensures the company obtains necessary approvals from SEBI and other relevant bodies.

5. Online application process:

Investors apply for shares through online platforms provided by brokers or other financial institutions.

6. Allotment and listing:

Shares are allotted to investors, and the company's shares are listed on the stock exchange

2.2.6 HOW TO INVEST IN AN IPO?

Investing in an IPO involves a few steps:

1. Open a DematAccount :

To invest in an IPO, a Demat account should be opened , where your shares will reside electronically.

2. Research the IPO :

Before investing, thoroughly research the company, its business model, financial health, and the risks involved.

3. Apply for the IPO :

An IPO can be applied via ASBA (Application Supported by Blocked Amount) route and the same can be done through the Banking platforms like bob World or bob World Internet. Alternatively, IPO can also be opened through stockbroker or online trading platform. While applying, we have to enter details like the number of shares you want to bid for and the price which we are willing to pay (in case of a book- building IPO).

4. Wait for Allotment :

After the IPO closes, the company will allot shares to investors based on demand. If the IPO is oversubscribed, we may receive fewer shares than we applied for.

5. Listing Day :

Once the shares are allotted, they will be credited to your Demat account. we can then trade them on the stock exchange after the company is listed.

2.2.7 PROS & CONS OF IPO:

PROS	CONS
One of the biggest advantages of an IPO is the monetary aspect. The new capital generated by the IPO opens doors for many companies to utilize the money for finance research, capital expenditure etc.	The transactional procedures of an IPO are expensive. A significant amount is spent on completing the legal and associated formalities
Public image of the company improves. A publicly traded company is more visible and there's a good chance that lenders would give more preference to publicly traded corporations than privately-owned companies.	Company's proprietor may lose potential control over the company. The owners need to be careful as a lot of information about the company becomes public, and accessible to the competitors.

2.2.8 REASONS FOR THE COMPANIES OFFERING IPO

- A company files an IPO to raise capital that can be used for clearing off debts, R&D, business expansion etc.
- There are many reasons for a company to offer an IPO. One of the main reasons is its quest to expand and grab more eyeballs of the public. This way it can attract more customers and lead to possible mergers and acquisitions in the future.
- As a company gets listed on the stock exchange, it adds credibility to the company.

2.2.9 CONCLUSION

An IPO is a gateway for companies to raise capital and for investors to participate in the potential growth of these companies. While IPOs can offer lucrative opportunities, they also carry risks. Investors should conduct thorough research and consider their risk tolerance before investing in any IPO.

By understanding the basics of IPOs, how they work, and their benefits, we can make informed investment decisions and potentially reap the rewards of investing in emerging companies.

In essence, an e-IPO is the digital evolution of the IPO process, where merchant bankers play a crucial role in guiding the company through the complexities of going public.

QUESTION & ANSWERS

1. What is E- IPO
2. Give the workings of IPO
3. Steps in the E-IPO process
4. Steps involved in investing in IPO
5. State the pros & cons OF IPO

ADVERTISING STRATEGIES

2.3.1 INTRODUCTION

An advertising strategy can be defined as a step by step plan to reach your customers and to convince them to buy your products. A well-planned advertising strategy not only conveys the benefits of your product but will also persuade your customers to choose your product over the outcomes of your competitors.

Advertising is a method of promoting your product or service. The purpose of advertising is to reach people who are willing to pay to buy your product and service. And a strategy is a step by step plan to persuade your customers to choose your product and service over the product or services of your competitors.

An effective advertising strategy gives you maximum return on investment. Therefore, it is necessary to choose the right advertising strategy to promote your products and services. The advertising strategy that worked for you in the past doesn't have to also work for you at present because people change their perception changes that cause the change in requirement.

2.3.2 IMPORTANCE OF ADVERTISING STRATEGIES

An advertising strategy is important for any business mainly because

- It assists in managing advertising budgets effectively. Rather than spending money haphazardly, a well-outlined strategy ensures every rupee is used optimally for maximum return on investment.
- Furthermore, an advertising strategy is tailored to help a business reach its specific objectives. Whether it's increasing brand awareness, acquiring new customers, or fostering customer loyalty, a targeted strategy supports achieving these goals.
- The role an advertising strategy plays in connecting with the target audience. It's not just about reaching a vast audience; it's about reaching the right people.
- A good strategy helps to identify and speak directly to your target customers, using messages that resonate with them and induce the desired actions.

- Lastly, a comprehensive advertising strategy is directly linked to achieving revenue targets. It outlines a roadmap to convert market leads into loyal customers, thus impacting the bottom line positively.

By guiding product positioning, pricing, distribution, and communication, it provides a holistic approach that is instrumental in driving sales growth. In short, an advertising strategy is a key to scaling your business sustainably and profitably.

2.3.3 STEPS TO CREATE ADVERTISING STRATEGIES

Creating an advertising strategy is a creative process. We need to understand the business and the target audience to create an effective advertising strategy that maximises the sales of the product. The steps to follow to an effective advertising strategy for the business are:

1. Determine the purpose of advertising

The first step is to determine the purpose of advertising. There can be different purposes for which we want to advertise. For example, to boost the sales, to promote the newly launched product, to attract foot traffic in the store, to increase traffic on the website, to make people aware of the benefits of the product.

Having the clarity of the purpose of advertising is a step forward in the direction of creating an effective advertising strategy. We can select media platforms on which we want to advertise our product and services and can also decide how much we want to spend on your advertising campaign.

2. Determine your target audience

The second and even a crucial step in creating an effective advertising strategy is to determine the audience that we want to target using our advertising strategy. Knowing the audience that we need to focus on making our advertising strategy more effective. Create content that will grab the attention of our target audience.

It is a complex process to identify the target audience. The target customer is a person who will ultimately buy our product. To determine the target audience we have create a profile of the customer who will buy the product. Next, we should evaluate the influence of the people around your target customer, such as family members,

colleagues, friends, etc. who will influence the decision of your target customer. For Instance, if the business is selling cars, then the target audience will be the people with regular income, people who have a stable job or who run a successful business. The decision of these people will be influenced by the people they are working with, their friends, their children, and their spouse. Therefore creating an advertising strategy, can be done by targeting this group of people.

3. Decide your advertising budget size

The next important step is to determine the budget for the advertising campaign. It is essential to decide your advertising budget before deciding on the advertising strategy. The strategies will be ineffective if it does not match the budget.

Sometimes a low budget advertising can do wonders for the business if we choose the right strategy that fits our budget.

4. Selecting media for advertising and deciding the schedule

Once you have determined the product and target audience, the next step that is required to take is to choose the type of media that we need to use to reach the audience. There are many advertising media such as

1. Print media – Newspapers, magazines, pamphlets, posters, banners, etc.
2. Digital media – website advertising, social media advertising, world wide web, email advertising, youtube ads, Television ads.
3. Direct mails
4. Word of mouth
5. Outdoor advertising – billboards, advertising on public transportation like public buses and cabs.
6. Trade shows.
7. Radio advertising

All of these advertising mediums have their advantages and disadvantages. So we need to choose one or a group of advertising mediums to implement which will best suit the strategy. For example, if the target audience is older people than

advertisement medium like television ads and newspaper ads will be the right choice of medium to advertise the product.

Therefore, the right advertising medium can help increase the return on investment on your advertising strategy.

5. Implementation of the advertising program

The next step is to implement your advertising strategy as planned. The implementation of advertising strategies is referred to as an advertising campaign. An advertising campaign is a different concept from an advertising strategy, but an advertising strategy is used as guidelines to create an advertising campaign. As it is crucial to achieving across the board consistency. It is essential to achieve consistency when you are advertising your product through several advertising mediums. Even one slogan, image, or a music track can also create the coherency of the advertisement on different advertising platforms.

6. Measure the effectiveness of advertising

The last step is to measure the effectiveness of the advertising strategy. Whether the advertising strategy was successful or not will depend on the return on investment that is implemented in an advertising strategy.

2.3.4 TYPES OF ADVERTISING STRATEGIES

The following are the different types of advertising strategies.

1. Seasonal advertising

This type of advertising strategy is used for the advertising of seasonal products or advertising of your business or products during a particular season. Several huge companies swear by this advertising strategy and advertise their products right before the beginning of the season and through the season. This advertising strategy proves to be beneficial as it provides a high return on investment. Because companies spend their money on advertisements when there is a need for their products in the market rather than wasting money on ads throughout the year.

For example, during important festivals like Diwali, Dussehra, Christmas, companies like Amazon and Flipkart run heavy advertising, which results in the revenue generation of millions to these companies. Seasonal advertising is not only

adopted by giant companies, but it is also popularly used by small businesses to attract customers.

2. Social media advertising

Social media advertising is one of the most popular advertising strategies used by companies to advertise their products and services and to stay in touch with their customers. Companies create their social media handles on different social media platforms like Facebook, Instagram, etc. and share information about their business on these platforms. People can not only learn about the products and services offered by companies but can also interact with the markets through these platforms.

Companies run their advertising campaigns on these platforms and also take the help of social media personalities to promote their products. For example, Olay company advertise their face cream with the help of social media influencers and mobile companies like Redmi and Oppo also support the latest models of their mobile phones on their social media handles and even with the help of social media influencers.

Social media has become the first choice of advertising of both small as well as large businesses. Businesses are not required to spend millions on advertising using social media advertising strategies like they are required to pay when promoting their business on other advertising platforms.

Moreover, using social media advertising, they can learn about the response of people towards their advertising campaign and can make changes as per their reaction.

3. Ownership advertising

In an ownership advertising strategy, you make your customers participate in your ad campaign. For example, coke asked their customers to share their selfies with a coke bottle on their social media platforms and tag them in their posts.

In this way, they indirectly made people buy their product, and by sharing on their social media platform, they make their customers advocate their product to their friends and family.

4. Modeling the advertising strategy

The modeling advertising strategy is when companies make the use of celebrities or renowned personalities to advertise their products. It is an effective advertising strategy as the followers of the superstar will be influenced to buy your product.

5. Utility advertising strategy

The utility advertising strategy is a unique advertising strategy where you advertise your product by helping people achieve their goals.

6. Evocation advertising strategy

This type of advertising strategy to attract the attention of people by evoking strong emotions in them. We need to create a positive image of the brand and product by connecting with people at an emotional level.

Therefore, many companies are making use of advertisements that reminds them of their parents or children or pets. In this way, they leave a mark in the minds of people. This strategy is useful if you want to make the brand accessible.

QUESTIONS & ANSWERS

1. What is advertising Strategy?
2. Give the importance of advertising strategies
3. Give the steps to create advertising strategies
4. Give the types of advertising strategies

UNIT - III

MERGES & ACQUISITIONS

3.1 INTRODUCTION

Mergers and Acquisitions have emerged as transformative business strategies in the Indian economic landscape, reshaping industries and fostering innovation. At its core, mergers involve the integration of two companies into a single entity, while acquisitions refer to one company taking control over another. Together, these strategies drive growth, create synergies, and enhance competitiveness in an increasingly dynamic marketplace.

3.1.1 MERGERS:

Mergers and Acquisitions are strategic corporate actions that businesses undertake to achieve growth, gain competitive advantages, or drive value creation. While often discussed together, mergers and acquisitions have distinct definitions and implications in the corporate world.

3.1.2 ACQUISITIONS:

An **acquisition**, on the other hand, happens when one company takes control of another. This can involve purchasing a majority stake or acquiring the entire business. Acquisitions can be either friendly or hostile, depending on whether the target company agrees to the deal. A well-known acquisition in India is Walmart's takeover of Flipkart, which helped Walmart enter the Indian e-commerce market.

3.1.3 REASONS FOR MERGERS AND ACQUISITIONS:

Companies pursue mergers and acquisitions for several strategic reasons, including:

1. **Market Expansion:**

Merger & Acquisitions enables businesses to enter new geographical regions, tap into different customer bases, and expand their market share. For example, Reliance Industries acquired the retail, wholesale, logistics and warehousing businesses of Future Group.

2. **Cost Expansion:**

Consolidation often results in economies of scale, reducing production costs, streamlining operations, and enhancing profitability.

3. **Diversification:**

By acquiring companies in different sectors, businesses reduce risk and ensure a steady revenue flow even in volatile markets. This trend can be seen in Zomato's acquisition of grocery delivery company Blinkit (formerly known as Grofers). The acquisition greatly benefited Zomato, leading to 169% returns in the trailing year.

4. **Access to Technology & Talent:**

M&A helps organizations acquire cutting-edge technology, intellectual property, and skilled workforce without building these capabilities from scratch. For example, in F.Y. 2023-2024, Tata Motors announced a strategic partnership with Tesla Inc. whereby Tesla's advanced battery technology and autonomous driving features could be introduced into Tata Motors' EV lineup in India, in exchange for a 20% stake valued at USD 2 billion.

3.1.4 DIFFERENCE BETWEEN MERGER & ACQUISITION:

Mergers and acquisitions differ across several dimensions, including their operational goals, legal requirements, and financial implications. Below is a detailed table explaining these differences:

Merger	Acquisition
Combining two companies into a single, unified entity.	One company takes control of another by purchasing its shares or assets.
To achieve mutual growth by sharing resources and market opportunities.	To expand market presence, gain assets, or eliminate competition.
Involves mutual agreement and shareholder approval from both entities..	The acquiring company gains ownership, which can be friendly or hostile.

Ownership is typically shared between the merged companies.	The acquiring company retains control; the target company loses autonomy
Requires integration of organizational cultures and systems.	The target company often adopts the culture and processes of the acquirer.
Usually, companies of similar size merge.	The acquiring company is generally larger and financially stronger.
Often viewed as a collaborative growth strategy with shared benefits.	Can lead to financial domination by the acquiring company over the acquired.
Vodafone & Idea Cellular (merger to form Vodafone Idea).	Walmart acquiring Flipkart for market entry into India.

3.1.5 TYPES OF MERGER:

1. Horizontal Merger;

- A horizontal merger occurs when two companies operating in the same industry and often as direct competitors combine forces.
- **Objective:** To gain market share, eliminate competition, and achieve economies of scale.
- **Example:** The merger of Vodafone India and Idea Cellular to create Vodafone Idea aimed to strengthen their position in the telecom market.

2. Vertical Merger:

- A vertical merger involves the combination of companies operating at different levels of the supply chain (e.g., a supplier and a buyer).
- **Objective:** To ensure better control over the supply chain, reduce costs, and improve efficiency.
- **Example:** Reliance Industries' acquisition of Den Networks and Hathway Cable to expand its Jio broadband services.

3. Conglomerate Merger:

- A conglomerate merger happens between companies from completely unrelated industries.
- **Objective:** To diversify business operations and mitigate risks associated with a single market.
- **Example:** The Tata Group's acquisition of Tetley Tea, which diversified its operations into the beverage sector.

4. Market Extension Merger;

- Combines companies offering similar products in different geographical markets.

- **Objective:** To expand market reach and access new customer bases.
- **Example:** Airtel acquiring Zain Telecom's African operations.

5. Product Extension Merger:

- Involves companies that deal with related products merging to expand their product lines.
- **Objective:** To offer complementary products and enhance market penetration.
- **Example:** Facebook's acquisition of Instagram to broaden its social media portfolio.

3.1.6 TYPES OF ACQUISITIONS:

1. Friendly Acquisitions:

- These are mutually agreed deals where the acquiring and target companies collaborate on the transaction.
- **Example:** Tata Steel's acquisition of Bhushan Steel to enhance its production capacity.

2. Hostile Takeover:

- Occur when the acquiring company takes control of the target company without its consent, often by purchasing a majority of its shares.
- **Example:** L&T's hostile takeover of Mindtree.

3. Reverse Merger:

- In this scenario, a private company acquires a public company to bypass the lengthy IPO process and become publicly traded.
- **Example:** The reverse merger of Vedanta Resources into Sterlite Industries.

3.1.6 THEORIES OF MERGERS & ACQUISITIONS:

3.1.6.1 EFFICIENCY THEORY:

- Suggests that M&A transactions are driven by the desire to increase operational efficiency.
- **Focus:** Cost reduction, revenue enhancement, and resource optimization.
- **Example:** Companies merging to reduce redundant departments and cut costs.

3.1.6.2 MONOPOLY THEORY:

- Argues that M&As are often pursued to eliminate competition and gain a dominant market position.
- **Focus:** Market power and the ability to influence pricing and industry standards.
- **Example:** The acquisition of WhatsApp by Facebook to dominate the messaging space.

3.1.6.3 VALUATION THEORY:

- Suggests that companies engage in M&A when the target company's market value is lower than its perceived intrinsic value.
- **Focus:** Acquiring undervalued businesses to create financial gains.
- **Example:** Reliance Industries acquiring multiple startups to tap into high-growth sectors.

3.1.7 MERGER & ACQUISITION PROCESS:

Merger and Acquisition process is a multifaceted journey that requires meticulous planning and execution. Each phase of the process plays a vital role in ensuring the success of the transaction, minimizing risks, and maximizing value. Here's a step-by-step breakdown of the key stages involved:

1. Strategic Planning:

- Define clear goals: market expansion, cost efficiency, or diversification.
- Identify potential target companies.
- Assess alignment with long-term business strategies.

2. Due Diligence:

- Financial performance, including revenue and debt.
- Legal compliance and potential liabilities.
- Market position, competition, and operational efficiency.

3. Valuation & Negotiation:

- Assess the company's intrinsic and market value.
- Negotiate terms such as purchase price, payment structure, and contingencies.

4. Legal & Regulatory Approvals:

Securing necessary permissions from governing bodies to ensure compliance with local and international laws

- Review by legal teams for compliance with corporate, tax, and antitrust laws.
- Obtain approvals from regulatory bodies like National Company Law Tribunal, SEBI, RBI, or the Competition Commission of India (CCI).

5. Integration Planning:

- Define integration objectives and timelines.
- Plan the merging of HR, IT, operations, and finance systems

6. Post Merger acquisition :

- Align organizational cultures and team structures.
- Monitor and evaluate the performance of the combined entity.
- Address stakeholder concerns and maintain morale.

3.1.8 BENEFITS OF MERGER:

3.1.8.1 INCREASED MARKET SHARE:

- Align organizational cultures and team structures.
- Monitor and evaluate the performance of the combined entity.
- Address stakeholder concerns and maintain morale.

2. OPERATIONAL STRETEGIES:

- Combining resources and expertise leads to cost savings, improved efficiency, and higher productivity.
- Example: The Vodafone-Idea merger achieved economies of scale in operations.

3. ENHANCED FINANCIAL PERFORMANCE:

- M&A enables companies to leverage combined assets for greater profitability and improved cash flow.
- Example: HDFC Bank and HDFC Limited merger enhanced their financial services portfolio.

3.1.9 ADVANTAGES & DISADVANTAGES OF MERGER & ACQUISITION:

ADVANTAGES	DISADVANTAGES
Economies of Scale: Cost reduction through shared resources and streamlined operations.	Cultural Clashes: Differences in organizational cultures can disrupt operations.
Access to New Markets: Entering untapped geographical or demographic markets.	High Costs: Significant financial investment for valuations, legal fees, and integrations.
Improved Competitiveness: Enhanced ability to compete in global or local markets.	Regulatory Hurdles: Compliance with complex legal and antitrust requirements can take a significant period of time to obtain approvals, causing delays in closing deals.

3.1.10 TRENDS IN RECENT MERGERS & ACQUISITIONS:

INDUSTRY ACQUISITION:

M&A deals in India are becoming more common in sectors such as e-commerce, banking, and FMCG, as companies look to diversify and expand their offerings.

CROSS BORDER ACQUISITION:

Increasingly, Indian companies are acquiring foreign firms to access international markets and new technologies. For instance, Tata Group's acquisition of Air India was a major step toward reviving the airline and increasing global market reach.

STRATEGIC ALLIANCES;

Companies are forming alliances through mergers and acquisitions to enhance competitive advantages, such as better financial performance and market entry in new regions.

PORTFOLIO MANAGEMENT SERVICES

3.2.1 INTRODUCTION

Investment Portfolios consist of investments across stocks, fixed-income instruments, commodities, real estate and gold. Investors must select suitable investments to attain financial goals based on risk tolerance. However, novice investors cannot gauge their risk profile and may not have the knowledge and time to pick suitable investments to build their portfolios. People who need help constructing an investment portfolio can opt for portfolio management services.

3.2.2 DEFINITIONS:

Portfolio Management Services (PMS) refers to an investment service where professional portfolio managers manage an individual's investments to align with their financial goals. Unlike mutual funds where money of investment are pooled into shared fund, PMS provides direct ownership of stocks and other assets in the investor's name. This allows for a highly customized investment approach tailored to individual risk tolerance, preferences, and objectives.

3.2.3 OBJECTIVES OF PMS:

Capital appreciation: Many investors opt for PMS to earn higher returns from a professionally managed portfolio. The focus remains on risk-adjusted returns from investments.

Regular income: Many people opt for PMS to get a steady income. The main objective of the portfolio manager is the protection of capital and consistent benefits from investments.

Liquidity: Many investors opt for PMS to convert their investments into cash as soon as possible. It is vital if they need money to start a business. In such cases, the portfolio manager builds customised portfolios to cater to clients' liquidity needs.

Tax Planning: PMS focuses on tax planning to increase the after-tax return of investments. It helps to construct a portfolio after looking into the tax efficiency of investments. In simple terms, PMS offers the twin advantages of capital appreciation and higher after-tax returns from investments.

3.2.4 TYPES OF PORTFOLIO MANAGEMENT SERVICES:

PMS in India is classified into three primary categories based on the degree of control and investor involvement:

1. DISCRETIONARY PMS:

- The Discretionary Portfolio Management Services portfolio manager has complete control over the portfolio and can adopt any strategy to achieve investment objectives.
- Investment Decisions are entirely at the portfolio manager's discretion, and the clients don't have much of a say in investment decisions.
- In this type of PMS services, the portfolio manager has complete autonomy to make investment decisions on behalf of the investor.
- This type is ideal for investors who prefer professional management with minimal involvement.

2. NON-DISCRETIONARY PMS:

- Under Non-Discretionary Portfolio Management Services, the portfolio manager gives investment ideas. However, clients decide whether to take up these investment ideas while the execution of trades rests with the portfolio manager.
- In Non-Discretionary Portfolio Management Services, the fund manager suggests investment strategies and works according to the direction given by the client.
- In non-discretionary PMS, the portfolio manager provides recommendations, but the final decision to buy or sell rests with the investors themselves.
- This type of PMS is suitable for investors seeking expert advice while retaining decision-making authority.

3. ADVISORY PMS:

- In Advisory PMS, the portfolio manager offers investment advice, and the investor executes transactions independently.
- This type of PMS is useful for experienced investors looking for guidance but wanting full control over their investments.

4. ACTIVE PMS:

- Active Portfolio Management focuses on generating higher returns than any other index. The portfolio manager actively manages the investment portfolio, and the research team picks the requisite securities.
- Investors who have a higher risk appetite and seek higher capital gains opt for Active Portfolio Management.
- The portfolio manager selects undervalued stocks and sells them at a higher price when they realize their true potential. Moreover, the portfolio manager diversifies the portfolio across investment options to mitigate investment risk.

5. PASSIVE PMS:

- Passive Portfolio Management involves mimicking the performance of a market index such as the Nifty 50. The fund manager tracks and replicates the stock market index portfolio to give investors returns in line with the index it tracks.
- Passive Portfolio Management focuses on index funds which are mutual funds that mimic market index portfolios. Moreover, the Passive Portfolio Management strategy involves lower transaction costs as the portfolio manager doesn't churn the portfolio frequently compared to Active Portfolio Management.

3.2.5 FEATURES OF PMS:

1. CUSTOMISATION:

Investment strategies are personalized based on the investor's goals, financial situation, and risk profile.

2. TRANSPERANCY:

NAV helps investors track the performance of the mutual fund scheme. If the NAV increases over time, it indicates that the fund's investments are growing in value.

3. HIGHER MINIMUM INVESTMENT THRESHOLD:

When comparing performance of different mutual funds, investors often look at their NAVs. However, it's important to note that a higher NAV doesn't necessarily mean a better-performing fund. It's the percentage increase in NAV that matters

4. **ACTIVE PORTFOLIO MANAGEMENT:** Some mutual funds distribute dividends to their investors. NAV plays a role in calculating how much each investor receives per share when dividends are distributed.

3.2.6 BENEFITS OF PMS:

1. **Expert Management:** Professional portfolio managers leverage their expertise to design and execute strategies that aim to deliver superior returns.
2. **Personalization:** PMS adapts to individual goals and preferences, offering a bespoke investment approach.
3. **Diversification:** By investing across various asset classes and sectors, PMS minimizes risk while optimizing returns.
4. **Tax Efficiency:** Portfolio managers consider tax implications during investment decisions, potentially enhancing post-tax returns.

3.2.7 CONSIDERATIONS BEFORE OPTING FOR PMS:

- **Cost:** PMS typically involves higher management and performance fees compared to mutual funds.
- **Market Risks:** Investments are subject to market volatility, necessitating a long-term investment horizon.
- **Provider Evaluation:** Assess the PMS provider's track record, investment philosophy, and reputation before opting for PMS services.

3.2.8 REGULATORY FRAMEWORK OF PMS IN INDIA:

PMS in India comes under the purview of the Securities and Exchange Board of India (SEBI) to ensure transparency, accountability, and investor protection. Key regulations include:

1. **Registration:** All PMS providers must register with SEBI.
2. **Minimum Investment Requirement:** SEBI mandates a Rs.50 lakhs minimum investment, targeting high net worth investors capable of managing associated risks.
3. **Disclosure Obligations:** PMS providers must regularly update investors with performance reports, fees, and risk disclosures.
4. **Custodian Engagement:** An independent custodian is required to hold investor assets to eliminate conflicts of interest
5. **Compliance Monitoring:** Each PMS provider is required to appoint a compliance officer to ensure adherence to SEBI regulations.

3.2.9 RISK ASSOCIATED WITH PMS:

While PMS offers numerous benefits, investors should consider associated risks before investing

- **Market Risk:** Exposure to market fluctuations and macroeconomic changes can impact portfolio performance.
- **Concentration Risk:** Focused portfolios may amplify risks if specific investments underperform.
- **Liquidity Risk:** Investments in less liquid assets, such as small-cap stocks, may face challenges during unfavourable market conditions.
- **Managerial Risk:** Portfolio performance depends significantly on the skill and expertise of the portfolio manager

3.2.10 CONCLUSION:

Portfolio management focuses on developing investment strategies to help investors attain their financial goals based on the investment horizon and risk profile. Portfolio managers build customised portfolios to match clients' requirements of capital appreciation, regular income or liquidity.

CREDIT SYNDICATION

3.3.1 INTRODUCTION:

Credit syndication in merchant banking involves facilitating large loans for clients by organizing a group of financial institutions (a syndicate) to provide the funds. Merchant banks act as intermediaries, assessing the project's viability, structuring the loan, and coordinating with various lenders. This process is especially useful when a single institution cannot provide the full loan amount needed by a borrower.

- Credit syndication is a method of raising large loans where multiple lenders (a syndicate) pool their resources to finance a single borrower.
- Merchant banks play a crucial role in this process, acting as the lead arranger or facilitator.

3.3.2 ROLE OF MERCHANT BANKS IN CREDIT SYNDICATION:

1. Project Assessment:

Merchant banks first evaluate the project's feasibility, ensuring it meets the criteria for financing.

2. Structuring the Loan:

They help determine the optimal capital structure, the amount of promoter contribution, and the loan amount to be raised from the syndicate.

3. Identifying Lenders:

Merchant banks identify suitable financial institutions, banks, or other lending agencies to participate in the syndicate.

4. Coordination and Negotiation:

They coordinate with lenders, handle legal formalities, and negotiate loan

terms on behalf of the borrower.

5. Monitoring and Follow-up:

Merchant banks also monitor the loan disbursement process and ensure compliance with the loan agreement.

3.3.3 CREDIT SYNDICATION ACT:

1. Estimating the total costs.
2. Drawing a financing plan for the total project cost-conforming to the requirements of the promoters and their collaborators. Financial institutions and banks, government agencies and underwriters.
3. Preparing loan application for financial assistance from term lenders/financial institutions/banks and monitoring their progress including the pre-sanction negotiations.
4. Selecting the institutions and banks for participation in financing.
5. Follow-up of the term loan application with the financial institutions and banks and obtaining the satisfaction for their respective share of participation.
6. Arranging bridge finance.
7. Assisting in completion of formalities for drawl of term finance sanctioned by institution expediting legal documentation formalities drawing up inter-se agreements etc. prescribed by the participating financial institutions and banks.
8. Assessing the working capital requirements.

3.3.4 BENEFITS OF CREDIT SYNDICATION:

- **Access to Larger Loans:**

It enables borrowers to access substantial funding that might not be available from a single lender.

- **Risk Diversification:**

Lenders can share the risk associated with the loan by participating in a syndicate.

- **Expertise and Efficiency:**

Merchant banks bring their expertise in structuring loans and managing the syndication process, ensuring efficiency and adherence to regulations.

Examples of Credit Syndication:

- Large infrastructure projects like building a metro system often require syndicated loans.
- Companies undertaking major expansions or acquisitions may also rely on credit syndication.

In essence, credit syndication allows borrowers to access substantial funding for large projects by leveraging the collective resources and expertise of a group of lenders, with merchant banks playing a key role in facilitating the process.

CREDIT RATING

3.4 .1 INTRODUCTION

A credit rating is an opinion of a particular credit agency regarding the ability and willingness an entity (government, business, or individual) to fulfill its financial obligations in completeness and within the established due dates. A credit rating also signifies the likelihood a debtor will default. It is also representative of the credit risk carried by a debt instrument – whether a loan or a bond issuance.

A credit agency evaluates the credit rating of a debtor by analyzing the qualitative and quantitative attributes of the entity in question. The information may be sourced from internal information provided by the entity, such as audited financial statements, annual reports, as well as external information such as analyst reports, published news articles, overall industry analysis, and projections.

A credit agency is not involved in the transaction of the deal and, therefore, is deemed to provide an independent and impartial opinion of the credit risk carried by a particular entity seeking to raise money through loans or bond issuance.

3.4.2 TYPES OF CREDIT RATINGS:

Each credit agency uses its own terminology to determine credit ratings. That said, the notations are strikingly similar among the three credit agencies. Ratings are bracketed into two groups: investment grade and speculative grade.

1. **Investment grade** ratings mean the investment is considered solid by the rating agency, and the issuer is likely to honor the terms of repayment. Such investments are typically less competitively priced in comparison to speculative grade investments.
2. **Speculative grade** investments are high risk and, therefore, offer higher interest rates to reflect the quality of the investments.

3.4.3. USERS OF CREDIT RATINGS

Credit ratings are used by investors, intermediaries such as investment banks, issuers of debt, and businesses and corporations.

- Both **institutional and individual investors** use credit ratings to assess the risk related to investing in a specific issuance, ideally in the context of their entire portfolio.
- **Intermediaries** such as investment bankers utilize credit ratings to evaluate credit risk and further derive pricing of debt issues.
- **Debt issuers** such as corporations, governments, municipalities, etc., use credit ratings as an independent evaluation of their creditworthiness and credit risk associated with their debt issuance. The ratings can, to some extent, provide prospective investors with an idea of the quality of the instrument and what kind of interest rate they should be expecting from it.
- **Businesses and corporations** that are looking to evaluate the risk involved with a certain counterparty transaction also use credit ratings. They can help entities that are looking to participate in partnerships or ventures with other businesses evaluate the viability of the proposition.

3.4.4 CREDIT SCORE:

A credit rating is used to determine an entity's creditworthiness, wherein an entity could be an individual, a business, a corporation or a sovereign country. In case of a loan, the rating is used to establish whether a loan should be rendered in the first place. If the process goes further, it helps in deciding the term of the loan such as dates of repayment, interest rate, etc.

In the case of bond issuance, the credit rating indicates the worthiness of the corporation or sovereign country's ability to repay the bond payments in due time. It helps the investor evaluate whether to invest in the bond or not.

A credit score, however, is strictly for indicating an individual's personal credit health. It indicates the individual's ability to undertake a certain load and his or her ability to honor the terms and conditions of the loan, including the interest rate and dates of repayment. A credit score for individuals is used by banks, credit card companies, and other lending institutions that serve individuals.

3.4.5 FACTORS AFFECTING CREDIT RATING:

- **Financial Performance:** Credit rating agencies in India closely assess an entity's financial performance, including profitability, cash flow, debt level, and liquidity. Strong financial indicators indicate a higher likelihood of meeting financial obligations, resulting in a favourable rating.
- **Industry Risks:** The creditworthiness of an entity can be influenced by the risks associated with its industry. The rating agencies consider competition, regulatory environment, market dynamics, and potential disruptions. Industries with stable and predictable cash flows tend to receive higher credit ratings.
- **Economic Conditions:** The overall economic conditions, both at a global and domestic level, play a crucial role in determining their ratings. Factors like GDP growth, inflation, employment rates, and interest rate trends are analysed to assess the impact on an entity's financial stability and ability to repay debts.
- **Management Quality:** The competence and stability of an entity's management team are evaluated by the rating agencies. Factors such as strategic planning, risk management practices, corporate governance, and experience navigating industry challenges contribute to the rating assessment.
- **External Support:** The availability of external support, such as government guarantees or backup lines of credit, can impact the ratings. These support mechanisms provide an additional layer of assurance to creditors, reducing the perceived risk and potentially leading to higher credit ratings.

3.4.6 BENEFITS OF CREDIT RATING:

The beneficiaries of Credit rating are investors, companies and intermediaries benefited in the following ways:-

3.4.6.1 BENEFITS TO INVESTORS

1. Assessing Bankruptcy: By rating a financial instrument, credit rating agencies provide a sort of security to investors against the bankruptcy of the issuing company. By knowing the business's financial strength, investors can decide whether they want to make an investment. Highly rated instruments provide investors with peace of mind against the bankruptcy of the company.

2. Understanding Risk: Credit rating offers investors a rating that is easily understood. Investors can gauge the risk of an instrument before investing their money. Without a proper rating symbol, investing in market instruments would be like a shot in the dark.

3. Increases Investor Confidence: The rating of an instrument indicates how reliable the company that issued it is. As credit rating agencies are independent of businesses and have no transaction or connection between them, this gives greater credibility to the agency's rating, thereby attracting investors and increasing their confidence.

4. Eliminates Middlemen: Investors mostly seek the advice of brokers, merchant bankers, investment agencies, and portfolio managers to make investment decisions. However, assessed instruments rated by credit rating agencies give investors the freedom to make decisions independent of these financial intermediaries. They can determine the creditworthiness of the issuer company and make investment decisions by themselves.

5. Provides Flexibility: Many credit-rated instruments are available in the market at any given time. Investors can choose to invest in instruments according to their risk appetite, using the ratings assigned by credit rating agencies.

3.4.6.2 BENEFITS TO COMPANIES

1. Lowers Borrowing Cost: A company that has issued a high-rating instrument can cut borrowing costs by quoting low interest rates. Investors prefer to invest in secured securities, like fixed deposits, bonds, and debentures, even though they yield lower returns.

2. Frequent Borrowing: If the issuing company has a highly rated credit

instrument, it can approach investors more frequently and obtain finances, whether individuals or agencies. Investors of all sizes are drawn towards higher-rated instruments. They prioritise timely payments over the risky possibility of higher returns.

3. Boosts Brand Image: An issuing business does not just enjoy frequent and low-cost borrowing but also the credibility of having highly rated instruments. A healthy credit rating can be used as an advertising tool to appeal to lenders, creditors, and customers. Even the end consumer is more encouraged to buy from businesses with highly rated credit instruments.

4. Access to Funds: Positive credit ratings encourage the investor and the business to grow. With seamless access to credit, they can launch new initiatives or expand their business. With highly rated credit products, the issuing company can easily apply for loans from banks and other lenders and pursue its goals.

5. Cost Reduction: Finally, good credit ratings attract investors and raise funds more easily than poorly rated instruments. This means that businesses can cut costs of luring investors and reduce public matters expenses. They will be more independent of spending on conferences and media events and reallocate funds to core initiatives.

3.4.7 CONCLUSION

There are various functions and benefits of credit rating agencies in India. They maintain market credibility by assigning risk to instruments for better decision-making. A low credit rating indicates poor creditworthiness, whereas a high one indicates excellent creditworthiness. As the majority of investors lean on assured returns, credit ratings become the pivotal influencer that provides an independent evaluation of a company's creditworthiness. This helps small and gullible investors make wise decisions by themselves without relying on financial intermediaries for advice.

It also helps the company maintain a healthy credit rating, which improves brand value and market credibility and lowers the cost of borrowing. Without credit rating agencies, there would be no market transparency, and investors would have to rely on intermediaries.

QUESTION AND ANSWERS:

1. What is credit rating
2. Give the importance of credit rating
3. State the factors affecting credit rating
4. State the benefits of credit rating.

BUSINESS VALUATION

3.5.1 INTRODUCTION:

In the financial ecosystem, a Merchant Banker Valuation report plays a pivotal role, especially for businesses seeking to raise capital. This report, prepared by licensed professionals, provides an estimated fair market value of a company's shares or securities. It serves as a critical tool for investors, ensuring that transactions occur at fair values based on a thorough analysis of a company's financial health and future growth prospects.

A business valuation is the process of determining the economic value of a business. It's also known as a company valuation. All business areas are analyzed during the valuation process to determine its worth and the value of its departments or units.

3.5.2 IMPORTANCE OF MERCHANT BANKER VALUATION

A Merchant Banker Valuation report is essential for multiple reasons:

- **Attracting Investors:** A comprehensive valuation helps startups and companies attract venture capitalists and private equity investors.
- **Compliance:** It ensures adherence to regulatory requirements for raising capital.
- **Negotiation Tool:** Assists in negotiations during mergers, acquisitions, or investment deals.
- **Risk Assessment:** Provides investors with insights into potential risks and returns.
- **Transparency and Credibility:** Enhances trust among stakeholders by providing an independent assessment of the company's value.

3.5.3 CIRCUMSTANCES UNDER WHICH MERCHANT BANKING VALUATION IS REQUIRED

- **Issuance of the Equity Shares or the Convertible Securities at the Premium:** If in the case where a company plans to issue the equity shares or the convertible instruments at the price which is higher than the face value of such instruments a valuation prepared by a registered value with Insolvency and Bankruptcy Board of India is essential. This report helps in determining the fair market value of the securities.
- **To raise the investments from the foreign shareholders:** in the cases where certain companies seek investment from the foreign shareholder, then in such a circumstance, a valuation report for complying under the provisions of the income tax act is essential..
- **Investors:** The investors who are seeking to invest in a start-up rely upon a valuation report prepared by a Merchant Banker. These reports help them in assessing the potential return and risk on their investments. These valuation report provides valuable insight into the projected growth and the worth of the company to make better-informed decisions.

3.5.4 CIRCUMSTANCES UNDER WHICH MERCHANT BANKING VALUATION IS NOT REQUIRED:

- **For the issuance of the Equity Shares at the Face Value:** If a company issues their shares to the general public at their face value but not at a premium, then in such a circumstance, a Merchant Banker Valuation report is not required.
- **Rights Issue:** The companies who are raising the securities through rights issue are not required to obtain a Merchant Banker Valuation report.
- **Valuation Report for Internal Use:** The companies that are performing the internal valuations for assessing their strategies or drafting of their policies are not required to involve a registered values or Merchant Banker, though such reports are not valid for the regulatory compliance.

Under section 11UA of the Income Tax Act, obtaining a Merchant Banker is not mandatory in order to avail the benefits under this section. Since this section offers tax benefits to the start-ups, the start-ups choose to get the valuation report for:

- **Transparency:** We have discussed the importance of having a Merchant Banker Valuation report for the investor. A valuation report prepared by an IBBI-registered valuer can enhance the credibility and transparency to potential investors.
- **Tool for the Negotiation:** These valuations report can serve as the assisting tool for the negotiations. These valuation report provides the benchmark for negotiating the investment amount and investment terms.

3.5.5 BENEFITS OF BUSINESS VALUATION REPORTS :

- **Ensuring the Regulatory Compliances:** The valuation reports prepared by the SEBI-registered Merchant Banker guide in the issuance of the equity shares at the premium under the specific conditions specified under the Income Tax Act, 1961. The valuation report prepared by the Merchant Banker ensures compliance with the provisions of the regulations such as the Income Tax Act, 1961.
- **Accelerates Credibility:** The valuation report prepared by the Merchant Banker enhances credibility amongst the stakeholders by providing an in-depth analysis of the startup organisation and its financial structure
- **Provides Transparency:** The valuation report prepared by a Merchant Banker ensures the companies in providing the right amount of transparency by providing an independent assessment of the value
- **Assist in making the Investment Decisions:** The valuation reports prepared by a Merchant Banker assist in taking investment-related decisions by assessing the risks associated with the company's return on investment.
- **Growth of the Company:** The valuation reports prepared by the Merchant Bankers assist the companies that intend to be acquired, merged or enter into strategic partnerships, which ultimately assist them in the overall growth of the company.

- **Acts as a Serving Tool:** The valuation report prepared by a Merchant Banker acts as the negotiation tool for the terms and the investment amount
- **Mitigation of the Risks:** The valuation report prepared by the Merchant Bankers assists in the mitigation of the risk of any issue related to the value of the asset.

3.5.6 CONTENT OF BUSINESS VALUATION REPORT:

- **Executive Summary:** The executive summary of the valuation report incorporates the purpose of the valuation. The executive summary of the report consists of the scope of the report, the purpose of preparing the report, the date of valuation, the date of the report and the key findings of the report.
- **Background of the Organisation:** A brief description and the background of the organization and the assets that are being valued. The background information that an ideal valuation report must include the description of the business, the area of the operation of the business, the description of the services of the organisation, the historical background of the company, the list of the shareholders and the board of the directors of the company and the schedule of the governance and the management of the company.
- **Analysis of the Industry:** An industrial landscape must be provided in the Merchant Banker Valuation report. These analyses are usually related to economic conditions, technology, consumer trends and market conditions. The important information required for the issuance of A Merchant Banker are:
 - Projected and Current Challenges in the Target Market
 - Historical Market Price
 - A Detailed Analysis of the Overview of the Industry
 - The market size of the competition
 - Growth trends over the course of years in the regulatory environment
 - The pattern of challenges in the Target Market

- **Financial Analysis of the Company:** The valuation must contain a detailed analysis of the financial position of the company. The information must be related to the financial ratios, details of the financial transaction, details of the issued shares, the past performance of the company, projected financial analysis of the company and the financial information of the company, such as the cash flow statement or the balance sheet.
- **Valuation Methodology:** The next important piece of information that must be encapsulated in the Merchant Banker Valuation Report is the methodology used for the purpose of valuation and the procedure used for calculating the worth of the company. The approaches that can be used for calculating the Valuation are the Market Approach, Cost of Asset Approach, Discounted Cash Flow, Comparable Company Analysis or the Precedent Transaction Approach.
- **Summary of the Valuation:** Lastly, the valuation report must consist of the summary and the final outcome of the issuance of the report. Followed by the official stamp and signature of the Merchant Banker.
- **Appendices:** The supporting documents of the valuation report which are required to act as the restriction, caveat or disclaimer, are to be attached along with the Merchant Banker Valuation Report. These appendices can be:
 - The Calculated Worksheet
 - Report of the conducted market research
 - Index of the Terms and the Abbreviations used in the preparation.
 - A Financial Statement of the company

3.5.7 CONSEQUENCES OF AN INACCURATE VALUATION REPORT:

Merchant Bankers are considered as the agents working for the government and it is always considered that an accurate informed valuation report is being prepared by them, so a Merchant Banker has to face legal consequences for the preparation of a wrong valuation report and these can include:

- For non-compliance with the provisions of the Income Tax Act, Stricter Penalties can be imposed
- Loss of reputation of the company and the Credibility of the Merchant Banker
- Withholding approval of the issuance of the shares
- Any sort of the Financial Implications

3.5.8 CONCLUSION

A Merchant Banker Valuation Report holds great significance in terms of the corporate laws and the working of the corporation swiftly. Therefore, a Merchant Banker Valuation Report should be sought in every case and by every organisation at any level to avail lot of tax benefits are also associated with the valuation report prepared by a Merchant Banker.

QUESTION AND ANSWERS:

1. What is Merchant Banker Valuation?
2. Give the content of the Business Valuation report
3. State the significance importance of Business valuation report
4. State the consequence of inaccurate business valuation report.

UNIT 4

LEASING AND HIRE PURCHASE AGREEMENT

4.1 INTRODUCTION

Leasing and hire purchase are both methods of acquiring assets, but they differ primarily in ownership transfer. In leasing, the lessee uses the asset for a specified period by paying rentals, but ownership remains with the lessor. In hire purchase, the hirer makes installment payments and eventually owns the asset after all payments are made.

4.1.1 LEASING – MEANING:

Leasing is a contractual agreement where an owner (lessor) grants another party (lessee) the right to use an asset for a specified period in exchange for periodic payments (rentals). It's essentially a form of financing where the lessee gets to use an asset without initially purchasing it. The lease agreement outlines the terms, conditions, and obligations of both parties.

4.1.2 ELEMENTS OF LEASING:

a) **A Valid Contract of Leasing:**

A leasing arrangement is undertaken by entering into a valid contract between the lessor and the lessee. Both the parties must be competent to contract. The lessor must have clear and undisputed title to the assets to be leased. The agreement must satisfy the essentials of a valid contract as per the Indian Contract Act.

b) **Delivery of Goods:**

The movable property, generally termed as 'goods' must be delivered by the lessor to the lessee. Delivery of the goods may be either actual delivery or constructive delivery.

c) **Purpose:**

Goods are delivered to the lessee with the specific purpose of using them for his specified lawful activity throughout the lease period.

d) **Consideration:**

The lessee undertakes to pay to lessor regularly lease rental, as consideration for the use of the goods.

e) **Return of the Goods:**

The goods must be returned to the lessor exactly in the same form, after the lease period is over.

f) **Ownership:**

The lessor, after handing over possession of the leased asset, remains owner of the asset throughout the lease period and even thereafter

4.1.3 BENEFITS OF LEASING:

The benefits of Leasing agreements are

a) **Convenience in case of short-term need:**

If the capital asset is needed for a short period only, for example for a year or two, leasing is a very convenient and appropriate method of acquiring. It dispenses with the formalities and expenses incurred in purchasing the asset and selling it soon after the need is over.

b) **No Risk of Technological Obsolescence:**

In case of owning the asset, the firm bears the risk of the asset becoming obsolete. In the present age of technological innovations, risks in owning an asset with outdated and old technology cannot be ignored. With such equipments, the firm cannot compete with its competitors and will incur heavy losses. Leasing provides a shield against all these hazards by shifting the risk of obsolescence of equipment to the lessor. This is true of operating leases which are for short duration and cancellable at the option of the lessee. The lessee can cancel an old lease agreement and enter into a new one in case a technologically superior product is available in the market. It is true that lease rentals for such equipments tend to be higher, but this disadvantage is more than off-set by the benefits the lessee derives by passing on the risk of obsolescence to the lessor.

c) **Efficient Maintenance Services:**

Under operating or full service lease, the lessee avails of the maintenance and other services provided by the lessor, who is well equipped, qualified and experienced to provide such services efficiently. Of course, the lessee pays for such services in the form of higher rentals.

d) **Low Administrative and Transactions Costs:**

Many leasing companies specialise in leasing a few types of equipments, machines or vehicles only. They can easily bargain with the suppliers/manufacturers etc. and acquire the assets at better prices and can economise in other administrative expenses also. The lessee may get a concession in lease rent on the basis of the economies derived by the lessor.

e) **Debt-Equity Ratio remains unchanged:**

When an asset is acquired on lease basis, lease rentals are shown as an expense in the firm's profit and loss account. Neither the leased asset nor the liability under the lease agreement are shown in the Balance Sheet. Hence the debt-equity ratio remains unaffected as compared to a firm which buys the asset with borrowed funds.

4.1.4 TYPES OF LEASING :

a) **OPERATING LEASE:**

In Operating lease, the lessor not only leases the asset of which he remains the owner throughout, but also undertakes to provide services attached to such assets, e.g., maintenance, repairs, technical advice, etc. Such lease is also called service lease. Computers, office equipments, automobiles and trucks are the typical capital assets which are leased under operating lease arrangement.

The main features of an operating lease are as follows:

i) The lease contract is generally for a period which is considerably shorter than the useful life of the leased asset. For example, a machine may be acquired on lease for a period of 5 years, while its useful life may be 10 years.

ii) The lessor does not, therefore, recover the full cost of the asset from one lessee only. The leased asset is returned back to the lessor at the end of the lease period and is, thereafter, leased again to another lessee for another lease period.

b) FINANCIAL LEASE:

In case of a financial lease, the lessor remains the owner of the leased asset during the lease period, but does not undertake its necessary maintenance. The rental received by the lessor fully amortises the cost of the equipment and earns a profit for him. These leases are non-cancellable. Ultimately, the ownership of the leased asset may be transferred to the lessee at an agreed price. The lessor thus acts as a financier only and earns a return on his investment in the leased asset by way of rentals. Financial leases are for the major part of the useful life of the asset.

c) SALE AND LEASE BACK:

This is another type of lease arrangement wherein the lessee who already owns the assets, sells the same to the lessor, and thereafter takes the same asset from him on lease basis. This is called 'Sale and Lease Back arrangement'. Under this arrangement, the lessee immediately recovers the value of his already owned assets from the lessor. Thereafter, the lessee makes payment of the lease rentals periodically as usual. Such a lease arrangement enhances the liquid resources of the lessee immediately, which can be utilised otherwise to meet his working capital requirements or to purchase another asset on cash payment basis. This type of lease is an alternative to a mortgage of the assets.

d) LEVEARED LEASE:

In case of an ordinary lease, the lessor purchases the asset with an appropriate mix of debt and equity. But the creditor (i.e., supplier of the debt funds) does not have recourse to the lessee. In other words, in case the lessor defaults in making repayment of the debt, the creditor cannot claim the same from the lessee. He will have recourse to the lessor only. Leveraged lease is just opposite to the above. In such case, the creditor remains entitled to have recourse to the lessee, i.e., he can recover his claims from the lessee also. The lease rental is

assigned to the creditor. The lessee is required to pay the lease rental directly to the creditor of the lessor. Generally this transaction is undertaken through a trustee, who receives the lease rental and appropriates it as debt service component to the creditor and the balance amount to the lessor.

e) **DOMESTIC AND INTERNATIONAL LEASE:**

This classification is based on the domicile of the parties to a lease contract. If all the parties, viz. equipment supplier, lessor and the lessee are residing in the same country, the lease is called domestic lease. If they are residing in different countries, it is called international lease. If the lessor and the lessee are domiciled in the same country and equipment is imported from another country, it is called import lease. If the lessor and lessee are domiciled in different countries, the lease is called cross-border lease. In such cases, the equipment supplier may be the resident of any country. In case of international lease, there are two additional risks, i.e., country risk and currency risk.

Difference between Financial Lease and Operating Lease:

BENCHMARK	FINANCE LEASE	OPERATING LEASE
Meaning	A commercial contract in which the lessor allows the lessee to use an asset in favour of regular payments for a usually long period.	A commercial contract in which the lessor allows the lessee to use an asset in favour of regular payments for a usually short period.
Duration	It is a long-term contract	It is a short-term contract
Owner	Ownership is transferred to the lessee (owner of an asset that is rented or leased).	Ownership remains with the lessor (legal owner of the asset).
Alternative name	Capital lease	Rental lease
The risk of obsolescence lies on the part of the	Lessee	Lessor
Maintenance	Lessee	Lessor
Cancellation of	Can only be done on the	Can be done at any time.

the lease	occurrence of a specific event.	
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4.1.6 FEATURES OF LEASING

The key features of leasing:

- Leasing allows the lessee to use an asset without having to purchase it outright. The lessee enjoys the benefits and functionality of the asset during the lease term.
- It is a temporary arrangement, typically for a fixed period of time. The lease contract specifies the duration for which the asset can be used.
- The lessee makes regular payments to the lessor for the use of the asset. These payments can be structured as monthly or quarterly instalments, depending on the terms of the lease agreement.
- Leasing provides flexibility to businesses and individuals as they can acquire assets without a large upfront investment. It allows them to use the latest equipment or technology without the burden of ownership.
- The lessor often retains responsibility for the maintenance and repairs of the leased asset. This relieves the lessee from the costs and hassles associated with upkeep and allows them to focus on using the asset.
- Leasing can offer potential tax benefits. Depending on the jurisdiction and specific lease structure, businesses may be able to deduct lease payments as operating expenses.
- It is applicable to various types of assets, including vehicles, machinery, office equipment, technology hardware, and even real estate.
- Businesses can transfer the risks associated with ownership, such as asset depreciation and obsolescence, to the lessor. This is beneficial when dealing with assets that have a high rate of technological advancement.

4.1.7 ADVANTAGES OF LEASE FINANCING

A. To Lessor: The following are the benefits of lease financing from the perspective of the lessor:

- **Regularly Assured Income:** Lessors receive lease rentals by leasing an asset for the duration of the lease, which is a guaranteed and consistent source of income.
- **Ownership Preservation:** In a finance lease, the lessor transfers all risk and rewards associated with ownership to the lessee without transferring asset's ownership, so the lessor retains ownership.
- **Tax Advantage:** Because the lessor owns the asset, the lessor receives a tax benefit in the form of depreciation on the leased asset.
- **Profitability is high:** Leasing is a highly profitable business because the rate of return on lease rentals is much higher than the interest paid on the asset's financing.
- **Growth Possibilities:** There is a lot of room for growth here. Because leasing is one of the most cost-effective forms of financing, demand for it is steadily increasing. Even amid a depression, economic growth can be maintained. As a result, leasing has a much higher growth potential than other types of businesses.

B. To Lessee: The following are the benefits of lease financing from the perspective of the lessee:

- **Capital Goods Utilization:** A business will not have to spend a lot of money to acquire an asset, but it will have to pay small monthly or annual rentals to use it. The business can use its funds for other productive purpose.
- **Tax Advantages:** Lease payments can be deducted as a business expense, allowing a company to benefit from a tax advantage.
- **Cheaper:** Leasing is a form of financing that is less expensive than almost all other options.

- **Technical Support: Regarding** the leased asset, the lessee receives some form of technical support from the lessor.
- **Friendly to Inflation:** Leasing is inflation-friendly because the lessee is required to pay a fixed amount of rent each year, even if the asset's cost rises.
- **Ownership:** After the primary period has expired, the lessor offers the lessee the opportunity to purchase the assets for a small fee.

4.1.8 DISADVANTAGES OF LEASE FINANCING

A. To Lessor: The following are the disadvantages of lease financing from the perspective of the lessor:

- **In the event of inflation, it is unprofitable:** Every year, the lessee receives a fixed amount of lease rental, which they cannot increase even if the asset's cost rises. So, it is unprofitable during inflation.
- **Taxation twice:** It is possible to be charged sales tax twice: The first is when the asset is purchased, and the second is when the asset is leased.
- **Greater Risk of Asset Damage:** As the ownership is not transferred, the lessee treats the asset carelessly, and there is a great chance that it will not be usable after the primary lease period ends.

B. To Lessee: The following are the disadvantages of lease financing from the perspective of the lessee:

- **Compulsion:** Finance leases are non-cancelable, and lessees must pay lease rentals even if they do not intend to use the asset.
- **Ownership:** Unless the lessee decides to purchase the asset at the end of the lease agreement, the lessee will not become the owner of the asset.
- **Costly:** Lease financing is more expensive than other types of financing because the lessee is responsible for both the lease rental and the expenses associated with asset ownership.

- **Asset Understatement:** As the lessee is not the owner of the asset, it cannot be included in the balance sheet, resulting in an understatement of the lessee's asset.

4.1.9 CONTENT IN LEASE AGREEMENT:

1) Nature of the Lease: This clause specifies the nature of the lease (i.e., operating lease, financial lease or a leveraged lease) and the names of the parties to the Agreement.

2) Description of the Asset: This clause gives the description of the equipment to be leased, its make, model, size, specification etc.

3) Duration of Lease Period: This clause specifies the period for which the asset is leased, which is called the primary period. The clause generally also gives an option to the lessee to renew the agreement for a further period. The second term of the lease is known as secondary period.

4) Lease Rentals: This clause specifies the lease rental payable by the lessee, which is fixed by taking into consideration the cost of funds, depreciation, repairs, profit expected, and risk involved in the lease transaction etc. The rent may be payable monthly or quarterly. The quantum of such rental, the time within which it is payable and the consequences of failure to pay the same are stipulated in this clause.

5) Delivery and Re-delivery: This clause mentions when and how the leased equipment would be delivered to the lessee and how it will be delivered back to the lessor on the completion of the lease period.

6) Right to Use: This clause allows the lessee to make proper and lawful use of the equipment.

7) Repairs and Maintenance: Usually this clause states that the lessee shall maintain and repair the equipment and keep it in good and working condition. The cost of such maintenance shall be borne by the lessee.

8) Alterations/Additions to Equipment: This clause states that the lessee shall not make any alterations or additions to the equipment or remove it from the premises without the written consent of the lessor.

9) Right to Inspect Equipment: This clause gives the lessor the right to enter

the premises of the lessee and to inspect the equipment as and when he desires.

10) **Damage to Equipment:** It is usual to stipulate that the lessee will bear all risks, losses, damages, theft or destruction of the equipment as long as it is in his custody.

4.2 HIRE PURCHASE AGREEMENT:

Hire purchase is another method of acquiring a capital asset for use, without paying its price immediately. Under hire purchase arrangement goods are let on hire, the hirer (user) is allowed to pay the purchase price in instalments and enjoys an option to purchase the goods after all the instalments have been paid. Thus the ownership in the asset is passed on to the hirer on payment of the last instalment. The amount and number of instalments is fixed at the time of delivering the asset to the hirer. If the hirer makes default in making payment of any instalment, the seller is entitled to recover the asset from the hirer. The hirer may, on his own also, return the asset to the hiree without any commitment to pay the remaining instalments. The instalments for this purpose are treated as hire charges. Thus, the property in the asset remains vested in the seller (hiree) till, the right of purchase is exercised by the hirer after making payment of all the instalments.

4.2.1 PROCESS OF HIRE PURCHASE :

The hire purchase transaction takes place in the following manner:

- i) The seller (hiree) purchases the asset from the supplier/manufacturer and hires it to the hirer who is required to make a cash down payment of, say 20- 25% of the cost of the asset.
- ii) The balance of the cost price of the asset with interest thereon is payable in equated monthly instalments either in advance or in arrears, over a predetermined period which ranges between 36 months to 48 months.
- iii) Sometimes, in place of cash down payment, a fixed deposit is required to be

made with the seller and the entire amount of the cost is recovered through EMIs. The amount of FDR plus interest is returned to the hirer on payment of the last instalment.

iv) Each instalment comprises of the (a) cost of the asset, and (b) interest thereon. Interest is computed on the basis of a flat rate of interest. Thereafter the effective rate of interest is applied to the reducing balance of the original cost of asset to find out the interest component of each instalment. The effective rate of

interest happens to be higher than the flat rate of interest.

v) The hirer is entitled to terminate the hire purchase contract by giving due notice to the seller (hiree).

4.2.2 FEATURES OF HIRE PURCHASE

Hire Purchase has several key features:

- The asset ownership is transferred to the buyer only after the final installment is paid.
- Buyer pays for the asset in regular installments, which includes both the principal amount and the interest.
- Asset itself serves as security. In case the buyer fails to pay installments, the seller can repossess the asset.
- The buyer has the option to buy the asset at any time by paying the remaining installments in one go.
- Interest is charged over unpaid balance instead of the original price of the asset.
- Until the final payment is made, the maintenance of asset remains the responsibility of the buyer, not the seller.
- Buyer can terminate agreements at any time before taking ownership of the asset.

4.2.3 ADVANTAGES OF HIRE PURCHASE :

- Hire purchase agreements allow companies with insufficient working capital to obtain assets that they need.
- They can be more tax-efficient than standard loans because the payments are booked as expenses (though any savings will be offset by any tax benefits from depreciation).
- Businesses that need to retain cash but require expensive machinery, e.g., for construction, manufacturing, or transport, might use hire purchase agreements. So might startups that have little collateral with which to establish lines of credit.
- A hire purchase agreement can enhance a company's return on capital employed (ROCE) and return on assets (ROA). That's because the company doesn't need to use as much debt to pay for assets.

4.2.4 DISADVANTAGES OF HIRE PURCHASE AGREEMENT

- Hire purchase agreements usually prove to be more expensive in the long run than paying the full cost for an asset at the outset. That's due to interest costs. For businesses, they can also mean more administrative complexity.
- In addition, hire purchase agreements may tempt individuals and companies to buy goods that are way beyond their means.
- They may be paying a very high interest rate
- Hire purchase buyers can return the goods, rendering the original agreement void, as long as they have made the required minimum payments up to the time of return.

4.2.5 DIFFERENCE BETWEEN HIRE PURCHASE AND LEASING

Feature	Hire Purchase	Leasing
Ownership	The asset ownership is transferred to the hirer at the end of the payment term upon completion of all installments.	The asset ownership remains with the lessor throughout the lease term.
Payment Structure	The cost of the asset is divided into equal installments, including interest, that hirer pays over a specific period.	The lessee makes periodic payments for the use of the asset without any intention of ownership transfer.
Duration	The payment term is relatively longer and can range from months to years.	The lease term is usually shorter and can be customized according to the lessee's requirements.
Upfront Cost	The hirer typically pays a down payment upfront, which is a percentage of the asset's total cost.	Leasing may require a smaller upfront payment compared to hire purchase.
Maintenance	The hirer is responsible for the maintenance and repairs of the asset.	The lessor often retains responsibility for the maintenance and repairs of the leased asset.
Risk and Ownership Transfer	The hirer assumes the risk of asset ownership, including depreciation and obsolescence.	The lessor retains ownership and assumes the risk associated with the asset, reducing the lessee's risk exposure.
Return or Upgrade	The hirer can return the asset if they can no longer make payments or choose to upgrade to a different asset by entering into a new agreement.	The lessee has options to return the asset, extend the lease, purchase the asset at a predetermined price, or lease a new upgraded asset.

Tax Benefits	The hirer may be eligible for tax benefits such as depreciation and interest deductions.	The lessor may be eligible for tax benefits, and the lessee may have the advantage of deducting lease payments as operating expenses.
Financing	Hire purchase is a form of financing where the hirer gradually pays for the asset over time.	Leasing is a contractual arrangement for the use of an asset without ownership transfer.
Asset Type	Hire purchase can be used for various types of assets, including vehicles, appliances, and equipment.	Leasing can be applied to a wide range of assets, including vehicles, machinery, office equipment, technology hardware, and real estate.

Questions and Answers

- 1) Explain the concepts of Leasing and Hire Purchase and point out the differences between the two.
- 2) Differentiate between Operating Lease and Finance Lease.
- 3) Why is sale and lease back prepared and when?
- 4) Discuss the main advantages of leasing an asset instead of buying it.
- 5) Explain the main clauses in a Lease Agreement.

UNIT - V

CONSUMER CREDIT AND CREDIT CARD

5.1.1 INTRODUCTION:

Consumer credit, or consumer debt, is personal debt taken on to purchase goods and services. Although any type of personal loan could be labeled consumer credit, the term is more often used to describe unsecured debt of smaller amounts.

5.1.2 WORKING OF CONSUMER CREDIT:

Consumer credit use reflects the portion of a family or individual's spending that goes to goods and services that depreciate quickly. It includes necessities such as food and discretionary purchases such as cosmetics or dry cleaning services.

Consumer credit use from month to month is closely measured by economists because it is considered an indicator of economic growth or contraction.

If consumers overall are willing to borrow and confident they can repay their debts on time, the economy gets a boost. If consumers cut back on their spending, they are indicating concerns about their own financial stability in the near future. The economy will contract.

5.1.3 TYPES OF CONSUMER CREDIT FINANCE:

Consumer credit in finance is extended by lenders to enable consumers to make purchases immediately and pay off the balance over time with interest. It is broadly divided into two classifications: installment credit and revolving credit.

Installment credit:

Installment credit is a loan of a defined amount issued in a lump sum, and is then repaid for a set period of time. Payments are usually made monthly in equal installments.²

Installment credit can be used for a variety of reasons, including major purchases such as major appliances, cars, and furniture. Installment credit usually offers lower interest rates than revolving credit. In some cases,

Revolving credit:

Revolving credit, which includes credit cards, may be used for any purchase. The credit is "revolving" in the sense that the line of credit remains open and can be used up to the maximum limit repeatedly, as long as the borrower keeps paying a minimum monthly payment on time.

5.1.4 ADVANTAGES OF CONSUMER CREDIT :

Consumer credit allows consumers to get an advance on income to buy products and services. In an emergency, such as a car breakdown, consumer credit can help you get the funds you need.

Credit cards are a commonly accepted form of payment, so using this type of revolving credit can be convenient. Banks and financial institutions, department stores, and many other businesses offer consumer credit. Many credit cards also provide rewards such as cash back or travel points.

5.1.5 DISADVANTAGES OF CONSUMER CREDIT:

The main disadvantage of using revolving consumer credit is the cost to consumers who fail to pay off their entire balances every month and continue to accrue additional interest charges from month to month.

5.2 CREDIT CARD**5.2.1 CREDIT CARD - INTRODUCTION:**

A credit card is given by the banker to the customer in which the name of the customer is embossed in block letters. The name of the bank and the date of issue and expiry are also mentioned on the face of the card. The reverse side of the card will bear the specimen signature of the customer. A list of vendors or sellers will be given by the banker to the customers. A credit card is a thin plastic card, usually 3 1/8 inches x 2 1/8 inches in size that contains identification information such as signature or picture or both and authorizes the person named on it to charge for purchases or services to his account. In addition to this, the card can be used in automated teller machines for withdrawing cash and the machine stores the information and also transactions through electronic data processing system.

5.2.2 TYPES OF CREDIT CARDS:

1. Charge card in this card, the cardholder has to make full payment of the charge by the due date. Unlike other credit cards, here dues are not allowed to carry forward. It is meant for people who spend responsibly.

2. Debit Card: A debit card is different from credit card. Debit card is issued by a bank. The following are the differences between credit and debit cards:

3. Deferred debit card: When a debit card carries the benefit of the credit card, allowing the payment after certain period, it is called deferred debit card. Credit Card

Debit Card

1 It is issued by an agency such as Master or Visa

2. A debit card is issued by a bank in which the customer has an account.

3. A credit card allows certain period for making payment for the purchases made which may vary from 30 to 45 days. 2. The bank account in a debit card is debited immediately the moment the card is used. They have no credit period.

4 Affinity card: A card offered by two organizations of which one is a lending institution and the other a non-financial group. Here, schools, non-profit groups, airlines, petroleum companies issue affinity cards. These cards carry special discounts.

5. Standard Card: It is a normal credit card which carries limit on transactions, according to the credit worthiness of the card holder.

6. Classic card: A credit card issues by Visa, carrying the logo of Visa.

7. Gold card: A higher line of credit is given than a standard card. The income eligibility for getting this card is higher. Gold card is given to very rich customers or persons with high social status.

8. Platinum card: In order to distinguish credit cards belonging to certain companies, platinum credit cards are issued. Some companies use these to denote their best premium credit card.

Best Platinum credit card: Companies which set highest standard in customer service issue these cards. There is lowest interest rate for the outstanding, and the cards will have no annual fee or application fee and can be applied online in seconds.

10. Fleet Platinum credit card: It is a zero liability guarantee for purchases. It protects the credit card holder from any unauthorized use.

11. Next card platinum credit card: This is given to those with a good credit and it offers a low introductory rate.

12. Titanium card: A card which has a higher credit limit than a platinum card.

13. Secured card: A credit card is given to a card holder who has Savings deposit which will take care of his outstanding balance, in case of his default on payment.

14. Smart card: The revolution in Information Technology is responsible for the invention of Smart card. The development in semiconductors has advanced so much that computing power that was available in a computer matching a room size in the early days, is now available on a visiting card-sized plastic.

5.2.3 BENEFITS OF CREDIT CARD

Benefits of Credit Cards Benefits derived from credit card

The following persons derives benefits from the credit card system: (1) Customer (2) Seller (3) Wholesaler (4) Manufacturer (5) Commercial banks (6) Central bank (7) Government (8) Economy

1. Customer

- i. A customer can make purchases at any time
- ii. One need not carry cash for making purchases
- iii. In case of losing credit card, one can immediately inform the bank and prevent misuse by others
- iv. One can take benefit of lower prices by purchasing goods before the hike in prices.
- v. During inflation period, credit card benefits customers as the payments are made after one month from the date of purchase.

- vi. Railway ticket or Air ticket reservation can be done by using credit card even during night when banking facility is not available.
- vii. Credit card can be used even through computers and purchases can be made by sitting at home.
- viii. More customers will come forward to avail banking facility
- ix. At any point of time, the customer will be able to know the available credit even after purchases.
- x. Credit card can be used even for withdrawing cash through ATM (Automatic Teller Machine) up to a certain limit.
- xi. The holders of credit card are given insurance cover by the banks.

2. Seller:

The benefits to seller are as follows:

- i. Sales are affected throughout the year.
- ii. With increasing sales, the turnover of the seller increases.
- iii. The seller can go for competitive price as he can get credit from the bank.
- iv. Due to credit card facility, he can attract customers from far off places also.
- v. Durable goods can be sold easily through credit card.
- vi. Bad debts can be avoided as the bank arranges for payment under credit card.

3. Wholesaler:

- i. The wholesaler will be getting more orders from the retailer as the sales will go up due to credit card.
- ii. The wholesaler will be dealing products of different manufacturers due to credit extended by them
- iii. The wholesaler will also be given credit by the banks.

iv. The wholesaler will be able to place orders throughout the year and hence can get trade credit as well as cash credit from the manufacturers.

4. **Manufacturer**

- With orders continuously received from the wholesalers, the manufacturer can increase his production.
- Due to large scale production, the cost of production will come down and the manufacturer will be able to sell at a lower price.
- Since the orders are received throughout the year, there will be continuous production even for goods which are seasonal in nature.
Example: Manufacture of umbrellas.
- The manufacturer will also diversify his production due to the goodwill he has enjoyed due to increased production.
- The profit of the manufacturer will also increase and he will extend a higher commission to his wholesalers.

5. **Commercial banks**

Due to credit card facility

- i. More customers will avail the banking facility.
- ii. There will not be cash withdrawals from the bank as most of the customers use credit card for their purchase.
- iii. The bank, by extending credit to customer, retailer, wholesaler and manufacturer is able to earn interest on the credit.
- iv. The credit facility is extended only in the books of accounts and there will be no cash withdrawals. The account of the customer is debited for the purchases while the account of the seller is credited. Both the parties are given credit and the bank enjoys interest on the loan.
- v. All the transactions in the country are done through the banking system, as a result of which, the role of money lenders and other financiers is reduced.
- vi. The profit of the bank will also increase due to the extension of credit to different parties.

6. Central bank:

It is a national bank that provides financial and banking service for its country government and commercial banking system and issues currency. Central bank for India is Reserve Bank of India.

- i. A better control on the banking system is evolved by the Central bank.
- ii. During inflation, the Central bank can control the price level by instructing the head office of commercial banks to reduce the quantum of credit extended to customers under credit card. This will reduce the demand and thereby prices will come down.
- iii. Central bank is able to take instantaneous action on the economy as credit card provides information regarding purchases and sale in the country.
- iv. The activity of Non-Banking Financial Companies will also be reduced due to the credit card facility extended by commercial banks. So, the Central bank need not control NBFCS.
- v. By extending credit card facility to agriculturists, agricultural finance is improved and this relieves the farmers from the clutches of money lenders.

(7) **Government:** Whenever any sale is made, it is properly billed. That means sales tax; commercial tax due to the government will not be evaded.

- ii. It prevents the growth of unaccounted money as all transactions are recorded.
- iii. It improves the revenue of the government due to increase in production by the manufacturers.

8. **Economy:** Economy gets benefited in all its different sectors like primary, secondary and territory sectors.

REAL ESTATE FINANCING

5.3.1 INTRODUCTION

A real estate financing firm as the term suggests is an organization offering a plethora of financing solutions to Real Estate companies. Their unique approaches are designed to meet the financial needs across a real-estate project life-cycle, right from the inception till project closure. Such projects are capital intensive and each of the project phases, like deal sourcing, land acquisition, constructing, renovating, managing inventory require, meticulous planning and execution, which is what real estate financing firms excel at. Projects at nascent stages are very slippery and either require substantial collateral for loans or equity for funding. Once the project plan matures, a combination of loan and equity funding might fit right. Just like other Project Finances, loans for real estate projects too are obtained on the basis of future cash-flow and estimated operating expenditure. Whether the project would generate recurring revenue (commercial buildings like a hospital, School, hotel) also helps determine the span and structure of the funding

5.3.2 SERVICES RENDERED BY REAL ESTATE:

- **Land Acquisition Finance:** For a new real estate project that needs to start from scratch, many issues need to be dealt with, which if left unattended, can disrupt the project, such as solving past legal, social, or political disputes. Before correct funding can be sourced, these issues are often dealt with by a **Real estate Financing firm**. Land Acquisition finance is fundamental to real estate projects being built ground up. The solitary purpose of this finance is to purchase a building site only and expert foresight of a real-estate financing firm is considered paramount for gauging the true value of the land.
- **Pre-construction Finance:** Even though construction may not have begun, that does not mean there aren't any bills to pay. Pre-construction Finance caters to supporting developers before the influx of construction finance. This funding helps clear the preliminary tasks such as obtaining approvals and paperwork before construction can begin on the site. By offering this finance, a real-estate financing firm arranges continual cash flow and helps in the timely completion of the project. Since these loans are interim to the major chunk of the project, they are secured against tangibles, like alternate property as collateral.

- **Construction Finance:** This category of Real estate finance help builders start constructing commercial or residential premises. The funds can be utilized towards construction costs, paying suppliers, purchase of machinery, or adding to the working capital. These funds come in various forms of secured and unsecured loans against sales receivables. Construction finance comprises a large sum and hence the repayment conditions and tenor are generally kept flexible.
- **Refinance:** Through this service, a borrower can replace his existing loan with another, where the terms are even friendlier. Refinancing helps negotiate a better rate of interest, loan tenure, modify the terms and number of lenders, switch from floating to a fixed rate or vice versa, avail a top-up loan, etc.
- **Inventory Finance:** Real-estate projects need to purchase raw materials in bulk. But, the turn-around time for the inventory to convert to revenue is extremely long and until then, the inventory capital stays locked. To facilitate cash flow in the interim, inventory finance based on the stock-in-hand value can be availed through this service of a real estate financing firm.
- **Lease Rental Discounting:** This is typically a term loan, that's arranged by a real estate financing firm, on the basis of rental receipts as collateral. Loans in this category are sanctioned after close examination of the cash-flow and are repaid through rents. This is very popular among commercial projects that earn monthly rental.

5.3.4 BENEFITS OF REAL ESTATE FINANCING

- **Easy access to knowledgebase:** Companies and individuals gain access to the diverse expertise of representatives who are updated about the market changes and are always practicing innovative solutions to each unique problem.
- **Reduce overhead costs:** By not employing a full-time employee for financial needs, a company saves on perpetual payment of salaries and saves considerably on tax also.
- **Evade pressure:** The process of securing the right funds at the best rates could be stressful and tedious. One can be free of such burdens by hiring a reputed real-estate financing firm.

- Automated reporting: A real-estate financing firm also offers automated integrated tools that present great reports and insights on the basis of which ground-breaking measures could be adopted.
- Quicker Turnaround: Real Estate Financing firms operate on thoroughly researched and streamlined processes and hence they are more efficient and accurate. This helps closing deals at a quicker turnaround.
- Achieve client satisfaction: Amid this neck-to-neck competition, a company has to overly satisfy a client to stay afloat and win the largest morsel. To achieve this and ensure customer retention, most real-estate financing firms offer to process the back-end jobs also. What more can a client ask for? By choosing a good real-estate financing firm he can be relieved from all such worries and shift focus towards his larger personal and professional goals.

5.3.5 FACTORS AFFECTING REAL ESTATE FINANCE

Real estate finance companies consider the following factors before making any financial assistance for housing:

1. Loan Amount 2. Tenure 3. Administrative and processing costs, etc. 4. Pre-payment charges 5. Services 6. Value Addition 7. Sources of finance like HFC_s and Banks 8. EMI calculation methods:

1. The Loan Amount The amount of loan that any HFC decides to provide to a loan seeker depends on the following variables: 1. Customers repayment capacity 2. Rate of interest charged 3. Term of the loan

2. Tenure: Repayment it is done through EMI, which includes principal and the interest.

3. Administrative and processing cost: The effective cost of the loan depends on the type of method used by banks or finance companies. Based on the method, the principal component, which is paid monthly, is deducted from the outstanding principal amount. The two methods, which banks and finance companies generally follow, they are:

a. Monthly rest system Under this system, the principal amount is deducted every month from the outstanding amount, and the interest for the following month is calculated on the outstanding amount.

b. Annual rest system Under this system, although the principal amount is paid every month, it is accounted only at the end of the year. This is illustrated as follows: c. Fixed and Floating Rate Customers should check whether the rates offered are fixed or floating (varies with PLR). Floating rates are better in a falling rate scenario, but expensive in an increasing rate scenario. The borrower should check whether it is viable to shift the loan from fixed rate to the floating rate in a decreasing rate scenario by carrying out a cost benefit analysis.

4. Pre-payment Charges: This is an important factor to be considered, especially in situations where the ability to repay the loan matters. There are certain HVCs which charge prepayment, in case the loan is repaid before schedule. This pushes up the cost of fund of the borrower. Borrowers who desirous of repaying ahead of schedule should approach HFCs which do not have a pre-payment charge.

5. Value addition: The value addition includes the additional or supplementary services that HFCs provide, such as fast disbursals of loan, legal services, meeting with brokers, builders etc.,

BILL DISCOUNTING

5.4.1 INTRODUCTION:

Bill discounting is a type of invoice financing in which funds are issued against unpaid sale invoices. The financial institutions issue an advance to the seller at discounted rates. The business is not required to pledge any asset as collateral. The loan is advanced based on unpaid sale invoices. At the time of maturity of the invoice, the business will collect the payment from its customer and make the repayment to the financial institution. It is an easy way to improve cash flow in the organisation.

5.4.2 ADVANTAGES OF BILL DISCOUNTING

1. **Fast and easy-** The documentation required is very minimal. The financial institution grants loans within hours in case of emergencies.
2. **Collateral free-** No asset is required to be kept as collateral. The loan is granted against unpaid sale invoices.
3. **Cost-effective lending facility-** Bill discounting has two costs, i.e. service cost and discounting charge. The service fee is usually charged as a percentage of the annual turnover, and discounting charge is the cost of lending money. Despite these two charges, it is considered the most cost-effective lending facility by ensuring quick access to cash.
4. **Maintains confidentiality-** The business has complete control over its sales ledger, and the customer is nowhere in the loop in this type of financing.

5.4.3 DISADVANTAGES OF BILL DISCOUNTING

1. **Helps in improved cash flows-** Instant cash availability helps strengthen the business's momentum. By opting for bill discounting, a business has enough funds to run its operations smoothly and even carry out expansion activities.
2. **Improved customer trust-** When the customers know that they have time to make payments and the business is not solely dependent on that cash for its daily operations; they will trust you more. This will bring you more customers.
3. **Helps to shorten the cash cycle-** The time involved to complete the cycle of selling goods and releasing its money is an extended period. In this period,

one can undertake new projects to expand the business. One can trim this cash cycle by opting for invoice discounting.

4. **Helps to address emergencies-** Businesses usually face emergencies to change in market demand of their goods or services. One can promptly face these emergencies if cash access is easy. Increased demand can be met by increasing production as cash is readily available.
5. **Easy credit availability-** Nowadays, availing credit has become hassle-free with digital financial solutions. One can just upload the unpaid bills and avail funds by following a few simple steps. Easy credit availability helps to grow business.

5.4.4 TYPES OF BILL DISCOUNTING:

1. Disclosed Bill Discounting

This is also known as standard discounting. This financial instrument includes discounting of bills, money recovery, and a gamut of discounting processes.

In this case, the seller, buyer, and other stakeholders know about the discounting agency's inclusion in the trade agreement. The company is eligible to approach their client's customers to recover the bill money once the bill matures.

- **Benefit**

This is considered to be one of the fastest ways for businesses to discount their bills and access funds to maintain a steady cash flow.

- **Disadvantage**

The non-confidential nature of the transaction, coupled with the presence of a third party, may weaken the relationship between the other two parties – the seller and their clients.

2. Undisclosed Bill Discounting

Unlike disclosed bill discounting, the presence of a third party in the transaction is unknown to the seller and their clients. This is why it is also known as confidential discounting.

Here, the discounting agency or the lender handles different aspects of funding and recovery for their clients without informing their client's customers. As the due

date approaches, the customers are liable to make payments to a confidential and controlled account that the discounting company can access.

- **Benefit**

This approach enables businesses to establish stronger relationships with customers, as the presence of a third party is confidential.

- **Disadvantage**

Volatile undisclosed discounting rates in India are between 0.04 % and 3%, which change from lender to lender.

3. Full Turnover Bill Discounting

Some industry experts call it the whole turnover discounting. In this approach, businesses sell their sales ledger to the discounting agency. It is worth noting that many companies automate this process when they receive a bill of exchange, and they can immediately discount it for cash.

- **Benefit**

Again, this approach is one of the fastest ways businesses can discount their bills and create cash.

- **Disadvantage**

Some of the glaring downsides of deploying this solution include stringent credit checks, higher costs, and a plethora of legal complications, to name a few.

4. Partial Turnover Bill Discounting

Partial turnover discounting or selective discounting is part of the whole turnover bill discounting. Here, businesses control the receivables they want to sell to the discounting agency.

While full turnover discounting primarily focuses on continuity, this option is confidential and more control-driven.

- **Benefits**

Businesses have full control over their trade receivables. Further, they have the liberty to share only relevant information which they deem worth sharing with the invoicing company.

- **Disadvantage**

This discounting option can impact immediate cash flow as the drawer only receives a partial amount of the bill's value. Additionally, cash flow management can become a bit complicated compared to other bill discounting alternatives.

5. Letter of Credit-backed Bill Discounting

As the name suggests, LC-backed discounting primarily involves discounting agencies allocating funds against the letters of credit given to them by their buyers.

- **Benefit**

One of the main benefits of LC-backed discounting is the simple and straightforward process that requires minimal documentation.

- **Disadvantage**

Issuance of letters of credit can incur additional costs to the entire transaction. Additionally, LC-backed discounting is primarily suitable for international trade transactions and not for smaller domestic transactions

5.4.5 CONCLUSION

Businesses should realise the benefits and downsides of different types of bill discounting to make informed decisions and implement effective financial strategies to streamline their cash flow. While each billing discount type comes with its fair share of benefits and downsides, businesses should study the intricacies of all types of options to identify the most suitable solution for their unique requirements.

FACTORING

5.5.1 INTRODUCTION

Factoring is a form of debtor finance where a business sells its accounts receivables to a factor at a discount. This provides the business with cash for immediate operational needs.

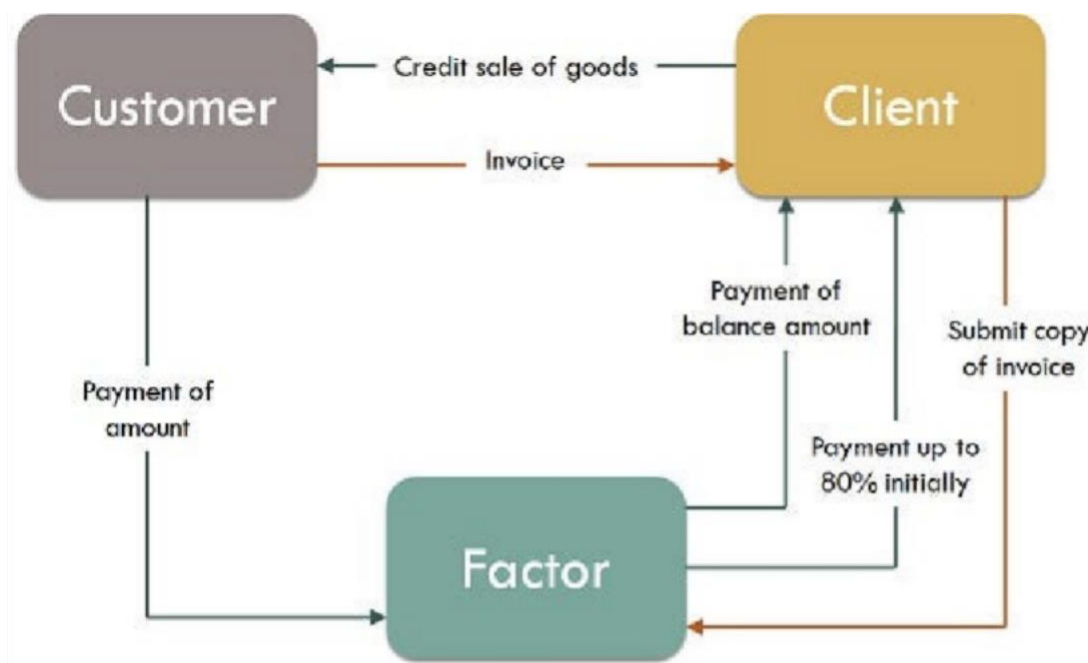
The third party factor purchases the accounts receivables – this means that when the receivables are paid by the debtor, the payment is made to the factor and not the business.

Factoring is largely used in industries like manufacturing, textiles and retail that rely on short term financing to manage cash flow; or have high seasonal demand and long credit periods from buyers.

5.5.2 WORKING OF FACTORING

Factoring involves three parties:

- Business/Client Firm
- Factor
- Debtor



The debtor owes money to the business/client firm, which is documented in an invoice. The debtor is expected to repay the business within a certain period of time.

If the business has short term cash requirements, it can sell this invoice to a factor at a discounted rate.

The factor purchases the invoice from the business in exchange for cash, which the business can use immediately, instead of waiting six months for the original invoice to mature.

When the invoice matures in six months, the vendor/debtor will repay the original amount to the factor and not to the business.

5.5.3 FUNCTIONS OF FACTOR:

A factor performs a number of functions for his client. These functions are:

- 1. MAINTENANCE OF SALES LEDGER:** A factor maintains sales ledger for his client firm. An invoice is sent by the client to the customer, a copy of which is marked to the factor. The client need not maintain individual sales ledgers for his customers. On the basis of the sales ledger, the factor reports to the client about the current status of his receivables, as also receipt of payments from the customers and as part of a package, may generate other useful information. With the help of these reports, the client firm can review its credit and collection policies more effectively.
- 2. COLLECTION OF ACCOUNTS RECEIVABLES:** Under factoring arrangement, a factor undertakes the responsibility of collecting the receivables for his client. Thus, the client firm is relieved of the rigours of collecting debts and is thereby enabled to concentrate on improving the purchase, production, marketing and other managerial aspects of the business. With the help of trained manpower backed by infrastructural facilities a factor systematically undertakes follow up measure and makes timely demand in the debtors to pay amounts. Normally, debtors are more responsive to demands or reminders from a factor as they would not like to go down in the esteem of credit institution as a factor.
- 3. CREDIT CONTROL AND CREDIT PROTECTION:** Another useful service rendered by a factor is credit control and protection. As a factor maintains extensive information records (generally computerized) about the financial standing and credit rating of individual customers and their track record of

payments, he is able to advise its client on whether to extend credit to a buyer or not and if it is to be extended the amount of the credit and the period there-for.

Further, the factor establishes credit limits for individual customers indicating the extent to which he is prepared to accept the client's receivables on such customers without recourse to the client. This specialized service of a factor assists clients to handle a far greater volume of business with confidence than would have been possible otherwise. In addition, factor provides credit protection to his client by purchasing without recourse to him every debt of approved customers (within the stipulated credit limit) and assumes the risk of default in payment by customers only in case of customers' financial inability to pay.

4. **ADVISORY FUNCTIONS:** At times, factors render certain advisory services to their clients. Thus, as a credit specialist a factor undertakes comprehensive studies of economic conditions and trends and thus is in a position to advise its clients of impending developments in their respective industries. Many factors employ individuals with extensive manufacturing experience who can even advise on work load analysis, machinery replacement programs and other technical aspects of a client's business. Factors also help their clients in choosing suitable sales agents/seasoned personnel because of their close relationship with various individuals and non-factored organizations. Thus, as a financial system combining all the related services, factoring offers a distinct solution to the problems posed by working capital tied in trade debts.

5.5.3 TYPES OF FACTORING:



a **Recourse and Non-recourse Factoring:** In this type of arrangement, the financial institution, can resort to the firm, when the debts are not recoverable. So, the credit risk associated with the trade debts are not assumed by the factor.

On the other hand, in non-recourse factoring, the factor cannot recourse to the firm, in case the debt turn out to be irrecoverable. If the agreement between the borrower and lender calls for “no recourse” it means the lender has no option to turn to the business owner for any shortfall between what the company owed the lender, and what the liquidated assets provided.

Disclosed and Undisclosed Factoring: The factoring in which the factor’s name is indicated in the invoice by the supplier of the goods or services asking the purchaser to pay the factor, is called disclosed factoring. Conversely, the form of factoring in which the name of the factor is not mentioned in the invoice issued by the manufacturer. In such a case, the factor maintains sales ledger of the client and the debt is realized in the name of the firm. However, the control is in the hands of the factor.

Domestic and Export Factoring: When the three parties to factoring, i.e. customer, client, and factor, reside in the same country, then this is called as domestic factoring. Export factoring, or otherwise known as cross-border factoring is one in which there are four parties involved, i.e. exporter (client), the importer (customer), export factor and import factor. This is also termed as the two-factor system.

Advance and Maturity Factoring: In advance factoring, the factor gives an advance to the client, against the uncollected receivables. In maturity factoring, the factoring agency does not provide any advance to the firm. Instead, the bank collects the sum from the customer and pays to the firm, either on the date on which the amount is collected from the customers or on a guaranteed payment date.

5.5.4 DRAWBACKS OF FACTORING

Factoring as a source of finance does also have its drawbacks – it reduces the business’s profit margin, since the business has to sell one of its assets at lower than cost.

Further, making debtors deal with a third party (the factor) may hinder the business’s relationship with them.

And lastly, – for a business to avail factoring as a source of finance, it has to have accounts receivable to sell in the first place! For businesses with no accounts receivable, factoring is completely out of reach.

Despite these drawbacks, factoring remains one of the most reliable and commonly used sources of short-term finance for businesses, especially startups.

5.5.5 ADVANTAGES OF FACTORING:

1. It is help to improve the current ratio. Improvement in the current ratio is an indication of improved liquidity. Enables better working capital management. This will enable the unit to offer better credit terms to its customers and increase orders.
2. It is increase in the turnover of stocks. The turnover of stock into cash is speeded up and this results in larger turnover on the same investment.
3. It ensures prompt payment and reduction in debt.
4. It helps to reduce the risk. Present risk in bills financing like finance against accommodation bills can be reduced to minimum.
5. It is help to avoid collection department. The client need not undertake any responsibility of collecting the dues from the buyers of the goods.

Advantages of Factoring

IMMEDIATE CASH INFLOW This type of finance shortens the cash collection cycle. It provides swift realization of cash by selling the receivables to a factor. Availability of liquid cash sometimes becomes a deciding factor for grabbing an opportunity or losing it. The cash boost provided by factoring is readily available for capital expenditures, securing a new order or meeting an unforeseen condition.

- **ATTENTION TOWARDS BUSINESS OPERATIONS AND GROWTH**

By selling off invoices, business managers can feel stress-free of the task of collection from the customers. Resources employed in the receivables department can be directed towards business operations, financial planning, and future growth.

- **EVASION OF BAD DEBTS:** Factoring is of two types – with recourse and without recourse. Under without recourse factoring, in case of bad debts, the loss is borne by the factor. Hence, the seller is under no obligation to the factor once it sells off its receivables.

- **SPEEDY ARRANGEMENT OF FINANCE:** Factors provide funds more rapidly than banking companies. Factoring companies offer quicker application, lesser documentation and swifter realization of funds as compared to other financial institutions.
- **NO REQUIREMENT OF COLLATERAL:** The advances are extended on the basis of the strength of accounts receivables and their credit healthiness. Unlike cash credit & overdraft, factors do not require any collateral security to be pledged/hypothecated. New businesses, startups can easily avail the advances provided they have strong receivables.
- **SALE NOT LOAN:** Factoring transaction is a transaction of sale, not a loan. Unlike other types of finances, factoring does not result in an increase in liabilities of the business. Hence, there are no adverse impacts on the financial ratios as well. It just involves the conversion of book debts into liquid cash.
- **CUSTOMER ANALYSIS:** Factors provide valuable advice and insights to the seller regarding the credit strength of the party from whom receivables are pending. It helps in negotiating better terms between the parties in future contracts.
- **REDUCED CURRENT LIABILITIES:** The amount received from the factoring is used to pay off the bank borrowing and other current liabilities comprising trade creditors. As a result, current liabilities are considerably reduced. The liquidity position of the firm is strengthened further.
- **OFF-BALANCE SHEET FINANCE:** When the factor purchases the clients' debts, the finance is provided off the balance sheet. In recourse factoring, the finance appears in the client's balance sheet only as a contingent liability. In recourse factoring, if the customer defaults in payment, the client has to make good the loss incurred by the factor.
- **HIGHER CREDIT STANDING:** With increased cash flows to the client, he is able to meet his liabilities promptly as and when they arise. The factor's acceptance of the client's receivables itself is the mark of high quality of the receivables factored. The problem of bad debts does not arise.

5.5.6 DISADVANTAGES OF FACTORING:

* **REDUCTION OF PROFIT:** The factor deducts a certain discount from the value of accounts receivable as fees for the services offered. Moreover, in certain cases, the factor also charges interest on the advance made. Consequently, profit of an entity is reduced by a significant margin.

* **RELIABILITY OF CUSTOMER'S CREDIT:** The factor assesses and evaluates credit wellness of the party who owes bills receivables. This is a critical factor which is outside the control of the seller. A factor may refuse to extend advances due to poor credit ratings of the concerned party.

* **EXHAUSTING OF COLLATERAL SECURITY:** Factoring exhausts bills receivables of an entity as the entity is no longer entitled to receive payments from them. The seller is no longer holding any control over the book debts. Hence, they can not be provided as collateral security while obtaining any other type of finance

* **PRESENCE OF CONTINGENT LIABILITY:** The liability of the seller is not completely waived in case of with recourse factoring. If a party fails to pay its debts to the factor, the factor is legally entitled to recover it from the seller. Thus, the seller is contingently liable to the factor for paying the debts in future in case of default. This situation would impact business operations and financial plans which are under execution.

* **HIGHER FINANCE CHARGES** Factors usually deduct 2% to 4% of the total amount involved as their fees for the duration of 45- 60 days. Computing it annually, the cost of finance turns out to be around 18% to 24% p.a. which is very higher than other sources of finance.

* **LOSS OF PERSONAL TOUCH** The buyer may not be willing to deal with a factor because of their professional nature and stringent methods. Factoring agencies even send notices at regular intervals to the buyer as a reminder of the debt. The buyer may develop a negative image of the seller through factoring. Loss of personal touch may lead him to consider switching vendors.

5.5.7 FEATURES OF FACTORING

1. Factoring is a high-risk area, and it may result in over dependence on factoring, mismanagement, over trading or even dishonesty on behalf of the clients.
2. It is uneconomical for small companies with less turnover.
3. The factoring is not suitable to the company's manufacturing and selling highly specialized items because the factor may not have sufficient expertise to assess the credit risk.
4. The developing countries such as India are not able to be well versed in factoring. The reason is lack of professionalism, non-acceptance of change and developed

expertise.

5.6.FORFEITING:

5.6.1 INTRODUCTION

Forfaiting is a means of financing that enables exporters to receive immediate cash by selling their medium and long-term receivables—the amount an importer owes the exporter—at a discount through an intermediary. The exporter eliminates risk by making the sale without recourse. It has no liability regarding the importer's possible default on the receivables. A forfaiter is typically a bank or a financial firm that specializes in export financing.

Forfaiting is a mechanism, in which an exporter surrenders his rights to receive payment against the goods delivered or services rendered to the importer, in exchange for the instant cash payment from a forfaiter. In this way, an exporter can easily turn a credit sale into cash sale, without recourse to him or his forfaiter.

5.6.2 FEATURES OF FORFEITING

- 1) It is a specific form of export trade finance.
- 2) Export receivables are discounted at a specific but fixed discount rate.
- 3) Debt instruments most commonly used in Forfaiting arrangement are a bill of exchange and a promissory note.
- 4) Payment in respect of export receivables which is further evidenced by bill of exchange or promissory notes, must be guaranteed by the importers' bank. The most usual form of guarantee attached to a Forfaiting agreement.
- 5) It is always without recourse to the seller (viz. Exporter).
- 6) Full value of export receivables i.e. 100 per cent of the contract value is taken into account.
- 7) Normally the export receivables carrying medium to long term maturities are considered.

5.6.3 COST OF FORFAITING SERVICES:

A Forfaiting service is subjected to various costs such as commitment fee, discount rate and documentation fee. Of these, discount rate, which is fixed, forms a larger portion of cost of Forfaiting service. The discount rate charged by the forfaiter is

based on the following elements:

1. A charge for the credit extended or finance provided. This is the main element and is roughly equivalent to the forfaiter's own costs of raising the money.
2. A charge based on the risk of interest rate and exchange rate movements in the currency in which the credit is extended.
3. A charge based on the sovereign risk, political risk and transfer risk e.g. the probability of a change of government and imposition of exchange controls preventing the discharge of the debt.
4. A charge based on the credit risk attached to the importer as well as avalor

5.6.4 DIFFERENCE BETWEEN FACTORING AND FORFAITING

The major differences between factoring and forfaiting are described below:

1. Factoring refers to a financial arrangement whereby the business sells its trade receivables to the factor (bank) and receives the cash payment. Forfaiting is a form of export financing in which the exporter sells the claim of trade receivables to the forfaiter and gets an immediate cash payment.
2. Factoring deals in the receivable that falls due within 90 days. On the other hand, Forfaiting deals in the accounts receivables whose maturity ranges from medium to long term.
3. Factoring involves the sale of receivables on ordinary goods. Conversely, the sale of receivables on capital goods are made in forfaiting.
4. Factoring provides 80-90% finance while forfaiting provides 100% financing of the value of export.
5. Factoring can be recourse or non-recourse. On the other hand, forfaiting is always nonrecourse.
6. Factoring cost is incurred by the seller or client. Forfaiting cost is incurred by the overseas buyer.
7. Forfaiting involves dealing with negotiable instruments like bills of exchange and promissory note which is not in the case of Factoring.

VENTURE CAPITAL

5.7.1 INTRODUCTION

Venture capital is money given to new businesses by investors. These businesses are usually small but have big growth plans. The money is not a loan. Startups do not have to repay it. Instead, investors get shares in the company. If the business grows, investors earn a profit. This type of funding is different from banks. Venture capital gives both money and advice. It helps startups grow fast. The goal is to support new ideas and build successful companies.

5.7.2 TYPES OF VENTURE CAPITAL

Venture Capital funding has multiple classes that distinguish the development stages of startup enterprises. The various types of venture capital provide distinct functions to assist business growth across different ranges.

1. Seed Capital

- This is the earliest form of VC funding.
- Startups use it for product development, research, or market validation.
- Investors take high risks as the business is in its idea stage.
- Example: A tech startup receives seed funding to build a prototype.

2. Early-Stage Capital

- Given to startups with a working product but no stable revenue.
- Helps in hiring talent, expanding operations, and refining business strategies.
- Typically involves **Series A** funding.
- Example: A new e-commerce company gets funding to launch marketing campaigns.

3. Expansion Capital (Growth-Stage Funding)

- Also called **Series B or C funding**.
- Startups use it to scale operations, enter new markets, or improve technology.
- At this stage, businesses have proven their model and have revenue.

- Example: A food delivery app expands to multiple cities with Series B funding.

4. Late-Stage Capital

- Provided to mature startups preparing for an **Initial Public Offering (IPO)**.
- Helps in large-scale expansion and boosting market presence.
- Usually involves **Series D or later** funding rounds.
- Example: A fintech company raises funds to expand internationally before an IPO.

5. Buyout or Acquisition Funding

- Used when one company buys another or when a Venture Capital firm takes over a business.
- Can be used for **management buyouts (MBOs)** or **leveraged buyouts (LBOs)**.
- Example: A VC firm acquires a struggling startup and restructures it for profitability.

6. Mezzanine Financing

- A mix of debt and equity financing.
- Helps businesses that are close to an IPO but need extra capital.
- Investors get the right to convert debt into equity if the startup performs well.
- Example: A tech startup takes mezzanine financing before going public.

5.7.3 WORKINGS OF VENTURE CAPITAL

Venture capital follows a structured process. Startup investors seek high-potential new businesses which they finance while demanding substantial financial gains through their investment. The process includes several steps:

1. Finding and Evaluating Startups

Startups become available to venture capitalists through networks of referrals and targeted pitch events as well as direct applications. They evaluate businesses based on:

- Market size and potential
- Product uniqueness
- Founders' experience
- Growth prospects
- Revenue model

2. Due Diligence

Investors research thoroughly before investing. They study:

- Financial records
- Market position and competition
- Legal issues
- Future growth strategy

3. Investment Agreement

The due diligence process enables startups to proceed to negotiations with investors about terms. The key points include:

- **Equity stake:** Percentage of company ownership given to the Venture Capital
- **Company valuation:** The worth of the startup before and after funding
- **Investor rights:** Board seats, voting power, or decision-making influence

4. Providing Funds and Support

Venture capitalists do more than provide money. They help startups with:

- Business strategy
- Hiring key employees
- Expanding market reach
- Setting up operations

5. Exit Strategy

VCs plan to exit and earn profits within 5-10 years. Common exit options include:

- **Initial Public Offering (IPO)** – The company goes public and sells shares.
- **Acquisition or Merger** – A larger company buys the startup.
- **Secondary Sale** – The VC sells its shares to another investor.

5.7.5 STAGES OF VENTURE CAPITAL

Venture Capital funding happens in different stages. Each stage depends on the startup's growth level.

1. Seed Funding

- The first investment to turn an idea into a product.
- The venture capital funds serve two purposes: product development and the selection of first team members.
- Startup incubators together with angel investors supply this funding source.

2. Early-Stage Funding (Series A & B)

- **Series A:** This funding targets product improvement and early market entry while establishing initial customer bases.
- **Series B:** This funding round supports business growth through operational expansion and marketing while enabling companies to add new team members.

3. Growth-Stage Funding (Series C & Beyond)

- **Series C:** Funds expansion into new markets or product lines.
- **Series D and later rounds:** Help startups grow internationally, acquire other businesses, or prepare for IPO.

4. Late-Stage or Pre-IPO Funding

- The last round of funding before the company goes public.
- Used for final operational improvements and market positioning.

5.7.6 BENEFITS OF VENTURE CAPITAL

- Venture capital enables startups to obtain substantial funds without needing to take out loans.
- Investors provide startups with valuable guidance as well as deep industry knowledge.
- Venture capital support enables startups to achieve rapid scaling.
- Market Expansion enables companies to penetrate new markets and expand their global presence.
- Startups avoid repayment obligations when they fail because venture capital funding operates differently than traditional loans.

5.7.7 CONCLUSION

Business innovation heavily relies on venture capital investments. Startups can achieve growth and compete in international markets through this assistance. The advantages of venture capital are considerable but potential risks exist. Founders need to assess if receiving venture capital funding matches their business requirements.