FINANCIAL MANAGEMENT – THEORY

TYPES OF FINANCE

Q-1 What are different financial needs of a business?

Ans. Business enterprises need funds to meet their different type of requirements. All needs can be grouped into the following three categories.

1. Long Term financial needs (for a period exceeding 5 to 10 years.) .

2. Medium term financial needs (for a period exceeding one year but not exceeding 5 years.

3. Short term financial needs (for not exceeding the accounting period i,e one year.

Q2. What are different sources from from where three types of finance can be raised in India.

(A) Long –term.

1 Equity share capital

2. Preference share capital

3 Retained earning

4. Debenture /bonds

5. Loan from financial institutions.

6. Loan from state financial corporation

7. Loan from commercial banks

8. Venture capital funding

9. Asset securitisation

10. International financing like euro issues ,foreign currency loans.

(B) Medium- term

1. Lease financing / Hire - purchase financing .

2. Preference share capital

3 Retained earning

4. Debenture /bonds

5. Loan from financial institutions.

6. Loan from state financial corporation

7. Loan from commercial banks

8. Venture capital funding

9 Asset securitisation

10. International financing like euro issues ,foreign currency loans.

(C) Short term .

1. Trade credit

2. Accrued expenses and deferred income

3. Commercial banks.

4. Fixed deposit for a period of 1 year or less.

5. Advances received from customers

6. Various short term provisions.

Q3. What do you undestand by Bridge Finance?.

1. Bridge finance refers to loan taken by a company normally from commercial banks for a short period,pending disbursement of loan sanctioned by financial institutions.

2. It takes time for financial institution to disburse loan to companies.

3. In order not to lose further time in starting their projects, arrange short term loans from commercial banks.

4. The bridge loans are repaid/ adjusted out of term loan as and when disbursed by the concerned institutions

5. It is secured by hypothecating moveable assets, personal guarantees and demand promissory notes.

6. The rate of interest is higher .

Q-4 What do u mean by venture capital financing.? what are methods of venture capital financing?

Ans. The venture capital financing refers to financing of new high risky venture promoted by qualified entrepreneur who lack experience and funds to give shape to their ideas.

Characteristic of venture capital funding.

1.equity finance in new company .

2. Long term investment

3. Overall resource support..

(A) Origin and growth of VCF in India.

1. It was responsibility of Developmental financial institutions such as IDBI, ICICI (Old name Technical development information corporation.) and the State Finance Corporation (SFC's).

2. In 1988, the Government of India announced guideline for VCF.

3. In 1996 the SEBI issued guide lines .these guidelines described a venture capital fund as a fund established in the form of a company or trust, which raises money through loans, donations ,issue of securities or units and make or proposes to make investment in accordance with the regulations.

4. Again this was amended in 2000 to fuel the growth of VCF activities in India. Some venture company operate as both investment and fund management other set up fund and function as an asset management companies.

(B) Methods of venture capital financing :

1. Equity Financing: VCF requires fund for longer period but no returns immediately. So generally provided by equity share capital. The equity contribution of VCF must be maximum 49% to make ownership with entrepreneur.

2. Conditional loan: Under this loan is repayable in the form of royalty. No interest is paid. How ever some financer make financing for high interest up to above 20%. Rate of royalty ranges from 2% to 15%

3. Income note. It is a hybrid. It has feature of both conventional loan and conditional loan. Both interest and loyalty is applicable. Rate of interest is low.

4. Perpetual Debenture: Interest is in three phase

(a) No interest

(b) Low interest up to particular level of sales

(c) High rate of interest is required to be paid.

Q5. What are factors a venture capitalist should consider before financing any risky project.?

1. Expertise of management team.

2. Level of technical skill to produce

3. New product and services.

4. Future prospect

5. Competition

6. Risk of Entrepreneur.

7. Exit routes

8. Board members

Q-6. What do you understand by debt securitisation?

Debt securitisation.

Securitisation is a process in which illiquid assets are pooled into marketable securities that can be sold to investors. These assets are generally secured by personal or real property such as automobiles, real estate, or equipments loans but in some cases are unsecured

The following example illustrates the process in a conceptual manner:

A finance company has issued a large number of car loans. It desires to raise further cash so as to be in a position to issue more loans. One way to achieve this goal is by selling all the existing loans, however, in the absence of a liquid secondary market for individual car loans, this may not be feasible. Instead, the company pools a large number of these loans and sells interest in the pool to investors. This process helps the company to raise finances and get the loans off its Balance sheet. These finances shall help the company disburse further loans. Similarly, the process is beneficial to the investors as it creates a liquid investment in a diversified pool of auto loans, which may be an attractive option to other fixed income instruments. The whole process is carried out in such a way, that the ultimate debtors- the car owners – may not be aware of the transaction. They shall continue making payments the way they were doing before, however, these payments shall reach the new investors instead of the company they (the car owners) had financed their car from.

The example provided above illustrates the general concept of securitisation as understood in common spoken English.

The process of securitisation is generally without recourse, i.e. the investor bears the credit risk or risk of default and the issuer is under an obligation to pay to investors only if the cash flows are received by him from the collateral. The issuer however, has a right to legal recourse in the event of default. The risk run by the investor can be further reduced through credit enhancement facilities like insurance, letters of credit and guarantees.

In India, the Reserve Bank of India had issued draft guidelines on securitisation of standard assets in April 2005. These guidelines were applicable to banks, financial institutions and non banking financial companies. The guidelines were suitably modified and brought into effect from February 2006.

Benefits to the Originator

i) The assets are shifted off the balance sheet, thus giving the originator recourse to off balance sheet funding.

ii) It converts illiquid assets to liquid portfolio.

iii) It facilitates better balance sheet management as assets are transferred off balance sheet facilitating satisfaction of capital adequacy norms.

iv) The originator's credit rating enhances.

For the investor securitisation opens up new investment avenues. Though the investor bears the credit risk, the securities are tied up to definite assets.

As compared to factoring or bill discounting which largely solve the problems of short term trade financing, securitisation helps to convert a stream of cash receivables into a source of long term finance.

Q-7. Explain lease finance

Leasing is a general contract between the owner and use of the asset over a specified period of time. The asset is purchased initially by the lessor (leasing company) and thereafter leased to the user (Lessee company) which pays a specified rent at periodical intervals. Thus, leasing is an alternative to the purchase of an asset out of own or borrowed funds. Moreover, lease finance can be arranged much faster as compared to term loans from financial institutions.

Q-8. Explain different type of short term sources of finance. There are various short term sources of finance available to meet short term needs of finance. These are following.

1. Trade credit.

2. Accrued Expenses and Deferred Income.

3. Advances from customers.

4. Commercial Paper.

5. Bank advances.

6. Financing of Export Trade by Banks.

7. Inter corporate Deposit.

8. Certificate of deposit.

9. Public Deposit.

Explanation;

1. Trade credit: It represents credit granted by suppliers of goods, etc. as an incident of sale. The usual duration of such credit is 15 to 9o days. It generates automatically in the course of business and is common to almost all business operations. It can be in the form of an ‘open account’ or ‘bills payable’.

Trade credit is preferred as a source of finance because it is without any explicit cost and till a business is a going concern it keeps on rotating. Another very important characteristic of trade credit is that it enhances automatically with the increase in the volume of business.

2. Accrued Expenses and Deferred Expenses: Accrued expenses represent liabilities which a company has to pay for the services which it has already received. Such expenses arise out of the day to day activities of the company and hence represent a spontaneous source of finance.

Deferred income, on the other hand, reflects the amount of funds received by a company in lieu of goods and services to be provided in the future. Since these receipts increase a company’s liquidity, they are also considered to be an important source of spontaneous finance.

3. Advance from customers: Manufacturers and contractors engaged in producing or constructing costly goods involving considerable length of manufacturing or construction time usually demand advance money from their customers at the time of accepting their orders for executing their contracts or supplying the goods. This is a cost free source of finance and really useful.

Commercial paper: A commercial paper is an unsecured money market instrument issued in the form of a promissory notes. RBI introduced the commercial paper scheme in the year 1989 with a view to enabling highly rated corporate borrowers to diversify their sources of short term borrowings and to provide an additional instrument to investors. Subsequently, in addition to the Corporate, Primary dealers and All India Financial Institutions have also been allowed to issue Commercial Papers.

All eligible issuers are required to get the credit rating from CRISIL-Credit rating Information Services of India Ltd. Or ICRA- Investment Information and Credit Rating Agency of India or CARE- The Credit Analysis and Research Ltd. Or the FITCH Ratings India Pvt Ltd or any such other credit rating agency as is specified by the Reserve Bank of India.

5. Bank Advances: Banks receive deposits from public for different periods at varying rates of interest. These funds are invested and lent in such a manner that when required, they may be called back. Lending results in gross revenues out of which costs , such as interest on deposits, administrative costs etc, are met and a reasonable profit is made. A bank's lending policy is not merely [profit motivated but has to also keep in mind the socio-economic development of the country.

6. Financing of Export Trade by Banks: Exports play an important role in accelerating the economic growth of developing countries like India. Of the several factors influencing export growth, credit is a very important factor which enables exporters in efficiently executing their export orders. The commercial banks provide short term export finance mainly by way of pre and post-shipment credit. Export finance is granted in Rupees as well as in foreign currency.

In view of the importance of export credit in maintaining the pace of export growth, RBI has initiated several measures in the recent years to ensure timely and hassle free flow of credit to the export sector. These measures, inter alia, include rationalization and liberalization of export credit interest rates, flexibility in repayment/prepayment of pre-shipment credit, special financial package for large value exporters, export finance for agricultural exports. Gold Card Scheme for exporters etc. Further, banks have been granted freedom by RBI to source funds from abroad without any limit for exclusively for the purpose of granting export credit in foreign currency, which has enabled banks to increase their lending's under export credit in foreign currency substantially during the last few years.

The advances by commercial banks for export financing are in the form of:

i. Pre-shipment finance, i.e. before shipment of goods

ii. Post-shipment finance, i.e. after shipment of goods.

7. Inter Corporate Deposit:

Q-9. What do you mean by Bank advances? What are different facilities provide by banks.?

Bank Advances: Banks receive deposits from public for different periods at varying rates of interest. These funds are invested and lent in such a manner that when required, they may be called back. Lending results in gross revenues out of which costs , such as interest on deposits, administrative costs etc, are met and a reasonable profit is made. A bank's lending policy is not merely [profit motivated but has to also keep in mind the socio-economic development of the country. Different facilities provided by banks are as follows:

1. Short term loans.

2. Overdraft

3. Clean overdraft

4. Cashg credit.

5. Advavce against goods.

6. Bills Purchased /Discounted:

7. Advance against documents of title goods.

8. Advance against supply of bills.

Short Term Loans: In a loan account, the entire advance is disbursed at one time either in cash or by transfer to the current account of the borrower. It is a single advance and given against securities like shares, government securities, life insurance policies and fixed deposit receipts etc. Except by way of interest and other charges no further adjustments are made in this account. Repayment under the loan account may be the full amounts or by way of schedule of repayments agreed upon as in case of term loans.

Overdraft: Under this facility, customers are allowed to withdraw in excess of credit balance standing in their Current Account. A fixed limit is therefore grated to the borrower within which the borrower is allowed to overdraw his account. Though overdrafts are repayable on demand, they generally continue for long periods by annual renewals of the limits. This is a convenient arrangement for the borrower as he is in a position to avail of the limit sanctioned , according to his requirements. Interest is charged on daily balances.

Since these accounts are operative like cash credit and current accounts, cheque books are provided.

Clean Overdrafts: Request for clean advances are entertained only from parties which are financially sound and reputed for their integrity. The bank has to rely upon the personal security of the borrowers. Therefore, while entertaining proposals for clean advances; banks exercise a good deal of restraint since they have no backing of any tangible security. If the parties are already enjoying secured advance facilities, this may be a point in favour and may be taken into account while screening such proposals. The turnover in the account, satisfactory dealings for considerable period and reputation in the market are some of the factors which the bank will normally see. As a safeguard, banks take guarantees from other persons who are credit worthy before granting this facility. A clean advance is generally granted for a short period and must not be continued for long.

Cash Credits: Cash Credit is an arrangement under which a customer is allowed an advance up to certain limit against credit granted by bank. Under this arrangement, a customer need not borrow the entire amount of advance at one time; he can only draw to the extent of his requirements and deposit his surplus funds in his account. Interest is not charged on the full amount of the advance but on the amount actually availed of by him.

Generally cash credit limits are sanctioned against the security of tradable goods by way of pledge or hypothecation. Though these accounts are repayable on demand, banks usually do not recall such advances, unless they are compelled to do so by adverse factors. Hypothecation is an equitable charge on movable goods for an amount of debt where neither possession nor ownership is passed on to the creditor. In case of pledge, the borrower delivers the goods to the creditor as security for repayment of debt. Since the banker, as creditor, is in possession of the goods, he is fully secured and in case of emergency he can fall back on the goods for realisation of his advance under proper notice to the borrower.

Advances against goods: Advances against goods occupy an important place in total bank credit. Goods are security have certain distinct advantages. The provide a reliable source of repayment. Advances against them are safe and liquid. Also, there is a quick turnover in goods, as they are in constant demand. So a banker accepts them as security. Generally goods are charged to the bank either by way of pledge or by way of hypothecation. The term ‘goods’ includes all forms of movables which are offered to the bank as security. They may be agricultural commodities or industrial raw materials or partly finished goods.

Bills Purchased/Discounted: These advances are allowed against the security of bills which may be clean or documentary. Bills are sometimes purchased from approved customers in whose favour limits are sanctioned. Before granting a limit the banker satisfies himself as to the credit worthiness of the drawer. Although the term ‘bills purchased’ gives the impression that the bank becomes the owner or purchaser of such bills, in actual practice the bank holds the bills only as security for the advance. The bank, in addition to the rights against the parties liable on the bills, can also exercise a pledge’s rights over the goods covered by the documents.

Usance bills maturing at a future date or sight are discounted by the banks for approved parties. When a bills is discounted, the borrower is paid the present worth. The bankers, however, collect the full amounts on maturity. The difference between these two amounts represents earnings of the bankers for the period. This item of income is called ‘discount’.

Sometimes, overdraft or cash credit limits are allowed against the security of bills. A suitable margin is usually maintained. Here the bill is not a primary security but only a collateral security. The banker in the case, does not become a party to the bill, but merely collects it as an agent for its customer.

When a banker purchases or discounts a bill, he advances against the bill; he has therefore to be very cautious and grant such facilities only to those customers who are creditworthy and have established a steady relationship with the bank. Credit reports are also compiled on the drawees.

Advance against documents of title to goods: A document becomes a document of title to goods when its possession is recognised by law or business custom as possession of the goods. These documents include a bill of lading, dock warehouse keeper’s certificate, railway receipt, etc. A person in possession of a document to goods can by endorsement or delivery (or both) of document, enable another person to take delivery of the goods in his right. An advance against the pledge of such documents is equivalent to an advance against the pledge of goods themselves.

Advance against supply of bills: Advances against bills for supply of goods to government or semi-government departments against firm orders after acceptance of tender fall under this category. The other type of bills which also come under this category are bills from contractors for work executed either wholly or partially under firm contracts entered into with the above mentioned Government agencies.

These bills are clean bills without being accompanied by any document of title of goods. But they evidence supply of goods directly to Governmental agencies. Sometimes these bills may be accompanied by inspection notes from representatives of government agencies for having inspected the goods before they are despatched. If bills are without the inspection report, banks like to examine them with the accepted tender or contract for verifying that the goods supplied under the bills strictly conform to the terms and conditions in the acceptance tender.

These supply bills represent debt in favour of suppliers/contractors, for the goods supplied to the government bodies or work executed under contract from the Government bodies. It is this debt that is assigned to the bank by endorsement of supply bills and executing irrevocable power of attorney in favour of the banks for receiving the amount of supply bills from the Government departments. The power of attorney has got to be registered with the Government department concerned. The banks also take separate letter from the suppliers/ contractors instructing the Government body to pay the amount of bills direct to the bank.

Supply bills do not enjoy the legal status of negotiable instruments because they are not bills of exchange. The security available to a banker is by way of assignment of debts represented by the supply bills.

Q10. What do you mean by Pre-shipment for export , i.e. Packing Credit facilities?

Ans: Its short term advance by bank to an exporter for the purpose of buying manufacturing processing Packing shipping goods to overseas buyer.

Condition:

- Firm Export order
- LC
- Advance must be settled within 180 days

Types of Packing Credit:

- Clean Packing Credit
- Packing credit against hypothecation of goods
- Packing credit against pledge of goods

- E.C.G.C. guarantee

- Forward exchange Contract

Q-11. Write short notes on following different sources of finances.

1. seed Capital Assistance.

2. Internal cash accrual.

3. Unsecured loans

4. Deferred payment gurantee.

5. Capital incentive..

Seed Capital Assistance: The Seed capital assistance scheme is designed by IDBI for professionally or technically qualified entrepreneurs and/persons possessing relevant experience, skills and entrepreneurial traits. All the projects eligible for financial assistance form IDBI, directly or indirectly through refinance are eligible under the scheme.

The Seed Capital Assistance is interest free but carries a service charge of one per cent per annum for the first five years and at increasing rate thereafter. However, IDBI will have the option to charge interest at such rate as may be determined by IDBI on the loan if the financial position and profitability of the company so permits during the currency of the loan. The repayment schedule is fixed depending upon the repaying capacity of the unit with an initial moratorium up to five years.

Internal Cash Accruals: Existing profit making companies which undertake an expansion/diversification programme may be permitted to invest a part of their accumulated reserves or cash profits for creation of capital assets. In such cases, past performance of the company permits the capital expenditure from within the company by way of disinvestment of working/invested funds. In other words, the surplus generated from operations, after meeting all the contractual, statutory and working requirements of funds, is available for further capital expenditure.

Unsecured Loans: Unsecured loans are typically provided by promoters to meet the promoters' contribution norm. These loans are subordinate to institutional loans. The rate of interest chargeable on these loans should be less than or equal to the rate of interest on institutional loans and interest can be paid only after payment of institutional dues. These loans cannot be repaid without the prior approval of financial institutions. Unsecured loans are considered as part of the equity for the purpose of calculating of debt equity ratio.

Deferred Payment Guarantee: Many a time suppliers of machinery provide deferred credit facility under which payment for the purchase of machinery can be made over a period of time. The entire cost of the machinery is financed and the company is not required to contribute any amount initially towards acquisition of the machinery. Normally, the supplier of machinery insists that bank guarantee should be furnished by the buyer. Such a facility does not have a moratorium period for repayment. Hence, it is advisable only for an existing profit making company.

Capital Incentives: The backward area development incentive available often determine the location of a new industrial unit. These incentives usually consist of a lump sum subsidy and exemption from or deferment of sales tax and octroi duty. The quantum of incentives is determined by the degree of backwardness of the location.

The special capital incentive in the form of a lump sum subsidy is a quantum sanctioned by the implementing agency as a percentage of the fixed capital investment subject to an overall ceiling. The amount forms a part of the long-term means of finance for the project. However, it may be mentioned that the viability of the project must not be dependent on the quantum and availability of incentives. Institutions, while appraising the project, assess the viability of the project per se, without considering the impact of incentives on the cash flows and profitability of the project.

Special capital incentives are sanctioned and released to the units only after they have complied with the requirements of the relevant scheme. The requirements may be classified into initial effective steps and final effective steps.

Q. 12. Write short notes on following different new instrument .

1 Deep Discount Bonds.

2. Secured premiums notes.

3. Zero interest fully convertable debentures.

4. Zero coupan bondsg

5. Double option Bonds.

6. Option Bonds

7. Inflation Bonds.

8. Floating Rate Bonds.

Deep Discount Bonds: Deep Discount Bonds is a form of Zero-interest bonds. These bonds are sold at a discounted value and on maturity face value is paid to the investors. In such bonds, there is no interest payout during lock in period.

IDBI was the first to issue a deep discount bond in India in January, 1992. The bond of a face value of Rs. 1 lakh was sold for Rs. 2,700 with a maturity period of 25 years. The investor could hold the bond for 25 years or seek redemption at the end of every five years with a specified maturity value as shown below:

Holding Period (Years)	5	10	15	20	25
Maturity Value (Rs.)	5,700	12,000	25,000	50,000	1,00,000
Annual rate of interest (%)	16.12	16.09	15.99	15.71	15.54

The investor can sell the bonds in stock market and realize the difference between face value (Rs.2,700) and market price as capital gain.

Secured Premium Notes: Secured Premium Notes is issued along with a detachable warrant and is redeemable after a notified period of say 4 to 7 years. The conversion of detachable warrant into equity shares will have to be done within time period notified by the company.

Zero interest fully convertible debentures: These are fully convertible debentures which do not carry any interest. The debentures are compulsory and automatically converted a after specified period of time and holders thereof are entitled to new equity shares of the company at predetermined price. From the point of view of company this kind of instrument is beneficial in the sense that no interest is to be paid on it, if the share price of the company in the market is very high then the investors tines to get equity shares of the company at he lower rate.

Zero Coupon Bonds: A Zero Coupon Bonds does not carry any interest buy it is sole by the issuing company at a discount. The difference between the discounted value and maturing or face value represents the interest to be earned by the investor on such bonds.

Double Option Bonds: These have also been recently issued by the IDBI. The face value of each bond is Rs. 5000. The bond carries interest at 15% per annum compounded half yearly from the date of allotment. The bond has maturity period of 10 years. Each bond has two parts in the form of two separate certificates, one for principal of Rs. 5000 and other for interest (including redemption premium) of Rs 16,500. Both these certificates are listed on all major stock exchanges. The investor has the facility of selling either one or both parts anytime he likes.

Option Bonds: These are cumulative and non-cumulative bonds where interest is payable on maturity or periodically. Redemption premium is also offered to attract investors. These were recently issued by IDBI, ICCI etc.

Inflation Bonds: Inflation bonds are the bonds in which interest rate is adjusted for inflation. Thus, the investor gets interest which is free from the effect of inflation. For example, if the interest rate is 11 per cent and the inflation is 5 per cent, the investor will earn 16 per cent meaning thereby that the investor is protected against inflation.

Floating Rate Bonds: This as the name suggests is bond where the interest rate is not fixed and is allowed to float depending upon the market conditions. This is an ideal instrument which can be resorted to by the issuer to hedge themselves against the volatility in the interest rates. This has become more popular as money market instrument and has been successfully issued by financial institutions like IDBI, ICICI etc.

Q-13. What are different international source of financing?

1. Commercial bank

2. Development bank

3. Discounting of trade bills.

4. International agency.

5. International capital markets.

Ans: The essence of financial management is to raise and utilize the funds raised effectively. There are various avenues for organizations to raise funds either through internal or external sources. The sources of external sources include:

Commercial Banks: Like domestic loans, commercial banks all over the world extend Foreign Currency (FC) loans also for international operations. These banks also provide to overdraw over and above the loan amount.

Development Banks : Development banks offer long & medium term loans including FC loans. Many agencies at the national level offer a number of concessions to foreign companies to invest within their country and to finance exports from their countries. E.g. EXIM Bank of USA.

Discounting of Trade Bills: This is used as a short term financing method. It is used widely in Europe and Asian countries to finance both domestic and international business.

International Agencies: A number of international agencies have emerged over the years to finance international trade and business. The more notable among them include the international Finance Corporation (IFC), The International Bank for Reconstruction and Development (IBRD), The Asian Development Bank (ADB), The International Monetary Fund (IMF) etc.

International Capital Markets: Today, modern organizations including MNC’s depend upon sizeable borrowings in Rupees as well as Foreign Currency. In order to cater to the needs of such organizations, international capital markets have sprung all over the globe such as in London.

In international capital market, the availability of FC is assured under the four main systems viz:

? Euro-currency market

? Export credit facilities

? Bond issues

? Financial Institutions

The origin of the Euro-currency market was with the dollar denominated bank deposits and loans in Europe particularly in London. Euro-dollar deposits are dollar denominated time deposits available at foreign branches of US banks & at some foreign banks. Banks based in Europe accept dollar denominated deposits and make dollar denominated deposits to the clients. The forms the backbone of the Euro-currency market all over the globe. In this market, funds are made available as loans through syndicated Euro-credit of instruments such as FRN's, FR certificate of deposits.

Q-14. Explain different financial instrument dealt with in the international market .

1. External commercial borrowing

2. Euro bonds

3. Foreign bonds

4. Fully hedged bonds

5. Medium term notes

6. Floating rates notes

7. Euro commercial papers

8. Foreign currency option.

9. Foreign currency future

Ans: External Commercial Borrowings(ECB): ECBs refer to commercial loans (in the form of bank loans, buyers credit, suppliers credit, securitized instruments (e.g. floating rate notes and fixed rate bonds) availed from non resident lenders with minimum average maturity of 3 years. Borrowers can raise ECBs through internationally recognized sources like (i) international banks, (ii) international capital markets (iii) multilateral financial institutions such as the IFC, ADB etc. (iv) export credit agencies, (v) suppliers of equipment, (vi) foreign collaborators and (vii) foreign equity holders.

External Commercial Borrowings can be accessed under two routes viz (i) Automatic route and (ii) Approval route. Under the Automatic route there is no need to take the RBI/Government approval whereas such approval is necessary under the Approval route. Company's registered under the Companies Act and NGOs engaged in micro finance activities are eligible for the Automatic Route whereas Financial Institutions and Banks dealing exclusively in infrastructure or export finance and the ones which had participated in the textile and steel sector restructuring packages as approved by the government are required to take the Approval Route.

Euro Bonds: Euro bonds are debt instruments which are not denominated in the currency of the country in which they are issued. E.g. a Yen note floated in Germany. Such bonds are generally issued in a bearer form rather than as registered bonds and in such cases they do not contain the investor's names or the country of their origin. These bonds are an attractive proposition to investors seeking privacy.

Foreign Bonds : These are debt instruments issued by foreign corporations or foreign governments. Such bonds are exposed to default risk, especially the corporate bonds. These bonds are denominated in the currency of the country where they are issued, however, in case these bonds are issued in a currency other than the investors home currency, they are exposed to exchange rate risks. An example of a foreign bon 'A British firm placing Dollar denominated bonds in USA'.

Fully Hedged Bonds: As mentioned above, in foreign bonds, the risk of currency fluctuations exists. Fully hedged bonds eliminate the risk by selling in forward markets the entire stream of principal and interest payments.

Medium Term Notes: Certain issuers need frequent financing through the Bond route including that of the Euro bond. However it may be costly and ineffective to go in for frequent issues. Instead, investors can follow the MTN programme. Under this programme, several lots of bonds can be issued, all having different features e.g. different coupon rates, different currencies etc. The timing of each lot can be decided keeping in mind the future market opportunities. The entire documentation and various regulatory approvals can be taken at one point of time.

Floating Rate Notes: These are issued up to seven years maturity. Interest rates are adjusted to reflect the prevailing exchange rates. They provide cheaper money than foreign loans.

Euro Commercial Papers (ECP): ECPs are short term money market instruments. They are for maturities less than one year. They are usually designated in US Dollars.

Foreign Currency Option: A FC Option is the right to buy or sell, spot, future or forward a specified foreign currency. It provides a hedge against financial and economic risks.

Foreign Currency Futures: FC Futures are obligations to buy or sell a specified currency in the present for settlement at a future date.

Q 15. Write short notes on euro issues by indian companies.

ADR

GDR

IDR

American Depository Deposits (ADR): These are securities offered by non-US companies who want to list on any of the US exchange. Each ADR represents a certain number of a company's regular shares. ADRs allow US investors to buy shares of these companies without the costs of investing directly in a foreign stock exchange. ADRs are issued by an approved New York Bank or trust company against the deposit of the original shares. These are deposited in a custodial account in the US. Such receipts have to be issued in accordance with the provisions stipulated by the SEC. USA which are very stringent.

ADRs can be traded either by trading existing ADRs or purchasing the shares in the issuer's home market and having new ADRs created, based upon availability and market conditions. When trading in existing ADRs, the trade is executed on the secondary market on the New York Stock Exchange (NYSE) through Depository Trust Company (DTC) without involvement from foreign brokers or custodians. The process of buying new, issued ADRs does through US brokers, Helsinki Exchanges and DTC as well as Deutsche Bank. When transactions are made, the ADRs change hands, not the certificates. This eliminates the actual transfer of stock certificate between the US and foreign countries.

I n a bid to by pass the stringent disclosure norms mandated by the SEC for equity shares, the Indian companies have however, chosen the indirect route to tap the vast American financial market through private debt placement of GDRs listed in London and Luxemberg Stock Exchanges.

The Indian companies have preferred the GDRs to ADRs because the US market exposes them to a higher level or responsibility than a European listing in the areas of disclosure, costs, liabilities and timing. The SECs regulations set up to protect the retail investor base are some what more stringent and onerous, even for companies already listed and held by retail investors in their home country. The most onerous aspect of a US listing for the companies is to provide full, half yearly and quarterly accounts in accordance with, or at least reconciled with US GAAPS

Global Depository Receipt (GDRs): These are negotiable certificate held in the bank of one country representing a specific number of shares of a stock traded on the exchange of another country. These financial instruments are used by companies to raise capital in either dollars or Euros. These are mainly traded in European countries and particularly in London

ADRs/GDRs and the Indian Scenario: Indian companies are shedding their reluctance to tap the US markets. Infosys Technologies was the first Indian company to be listed on Nasdaq in 1999. However, the first Indian firm to issue sponsored FDR or AFR was Reliance industries Limited. Beside, these two companies there are several other Indian firms are also listed in the overseas bourses. These are Satyam Computer, Wipro, MTNL, VSNL, State Bank of India, Tata Motors, Dr Reddy's lab, Ranbaxy, Larsen & Toubro, ITC, ICICI Bank, Hindalco, HDFC Bank and Bajaj Auto.

Indian Depository Receipts (IDRs): The concept of the depository receipt mechanism which is used to raise funds in foreign currency has been applied in the Indian Capital market through the issue of Indian Depository Receipts (IDRs). IDRs are similar to ADFRs/GDRs in the sense that foreign companies can issue IDRs to raise funds from the Indian Capital Market in the same lines as an Indian company uses ADRs/GDRs to raise foreign capital. The IDRs are listed and traded in India in the same way as other Indian securities are traded.