

Sources of Long Term Finance

- The various sources of long term finance available to a company are:

Debt	Equity
Debentures	Equity Shares
Term Loans	Preference Shares
	Retained Earnings

- Shares provide ownership rights to investors.
- Debentures or bonds provide loan capital to the company, and investors get the status of lenders.
- Loan capital is also directly available from the financial institutions to the companies.

Equity Shares–Features

- Claim on Income
- Claim on Assets
- Right to Control
- Voting Rights
- Pre-Emptive Rights
- Limited Liability

Equity Shares—Pros and Cons

- **Advantages**

- ✓ Permanent Capital
- ✓ Increases Borrowing Base
- ✓ Dividend Payment Discretion

- **Disadvantages**

- Cost
- Risk
- Earnings Dilution
- Ownership Dilution

Preference Shares

- **Similarity to Equity Shares:**
 1. Non payment of dividends does not force company to insolvency.
 2. Dividends are not deductible for tax purposes.
 3. In some cases, it has no fixed maturity dates.
- **Similarity to Debentures:**
 1. Dividend rate is fixed.
 2. Do not share in residual earnings.
 3. Preference shareholders have claims on income and assets prior to ordinary shareholders.
 4. Usually do not have voting rights.

Preference Shares–Features

1. Claims on Income and Assets
2. Fixed Dividend
3. Cumulative Dividend
4. Redemption
5. No Voting Rights
6. Convertibility

Preference Shares—Pros and Cons

- **Advantages:**
 - ✓ Risk less leverage advantage
 - ✓ Dividend postponability
 - ✓ Fixed dividend
 - ✓ Limited Voting Rights
- **Disadvantages:**
 - ☒ Non-deductibility of Dividends
 - ☒ Commitment to pay dividends

DEBENTURES

- A debenture is a long-term promissory note for raising loan capital.
- The firm promises to pay interest and principal as stipulated.
- The purchasers of debentures are called debenture holders.
- An alternative form of debenture in India is a bond.
- Mostly public sector companies in India issue bonds.

Debentures–Features

- Interest Rate
- Maturity
- Redemption
- Security
- Claims on Assets and Income
- Tax Advantage on Interest

Types of Debentures

1. Non – Convertible Debentures
2. Fully – Convertible Debentures
3. Partly – Convertible Debentures
4. Registered / Non Registered Debentures
5. Secured / Unsecured Debentures

Debentures—Pros and Cons

- **Advantages:**
 - ✓ Less Costly
 - ✓ No ownership Dilution
 - ✓ Fixed payment of interest
 - ✓ Reduced real obligation
- **Disadvantages:**
 - ☒ Obligatory Payment
 - ☒ Financial Risk
 - ☒ Cash outflows
 - ☒ Restricted Covenants

Term Loans–Features

- Maturity
- Direct Negotiations
- Security
- Restrictive Covenants
 1. Asset related covenants
 2. Liability related covenants
 3. Cash flow related covenants
 4. Control related covenants
- Repayment Schedule

RETAINED EARNINGS

- These are the part of profits that are kept aside by the company over a period of time to meet the future capital requirements of the company.
- These are free reserves of the company which do not carry any cost and are available without any interest or dividend burden on it