Mail: banishagupta2099@gmail.com
Website: https://iibf.info

SOURCES OF FINANCE I

It is essential to understand and be familiar with the different components of the balance sheet of a company. The balance sheet of a company comprises sources and uses of funds (finance).
Share capital of different types and debentures are the different sources of funds for a company.

SHARE CAPITAL

- Share capital of a company represents the amount invested in the company to carry out its operations.
- A share is the interest of a member in the company.

Section 2(84) of the Companies Act, 2013, defines a share as a share in the capital of a company and includes stock.

- It represents the interest of a shareholder in the company, **measured for the purposes of liability and dividend**. It attaches various rights and liabilities.

Types :

1) **Equity Share Capital:** As per Section 43 of Companies Act, equity share capital with reference to any company limited by shares, means **all share capital which is not preference share capital.**

Equity Shareholders enjoy the following rights as members as per the Companies Act, 2013:

- Right of pre-emption in the matter of fresh capital.

- Right to vote in general meetings
- Right to apply to Tribunal to call for the Annual General Meeting, if the company fails to call such a meeting (Section 97)
- Right to apply to Tribunal for calling for a meeting of the company (section 98)
- Right to receive audited financial statement along with the auditor's report, directors report and other information (section 136)
- Right to share the profit of the company in the form of dividend and bonus shares.

2) **Preference Share Capital:** According to Section 43 of the Companies Act, Preference Share Capital means that **part of the issued share capital of a company which carries or would carry a preferential right with respect to, payment of dividend, either a fixed amount or at a fixed rate, either free or subject to income tax.**

- Preference shares represent **ownership in a company**. They are **secondary owner** of business.
- Preference shareholders enjoy the preference over common shareholders in the **payment of dividend and capital**
- Fixed rate of dividend is paid to the preference share holder.

Different Types

a) Cumulative Preference Shares: All arrears of preference dividend have to be paid out, before paying dividend on equity shares.

Mail: banishagupta2099@gmail.com
Website: https://iibf.info

b) Non-Cumulative Preference Shares: In this type of shares, the dividend does not accumulate. Fixed rate of dividend is guaranteed, though at the time of inadequate profit they will not get anything.

c) Redeemable Preference Shares: The shares are redeemed on a given date which the company may **repay after a fixed period of time subject to the condition**. The company can issue redeemable preference shares which are redeemable not later than 20 years.

d) Irredeemable preference shares: Shares cannot be redeemed and payable only at winding up. According to the Section 55 of the Companies Act, 2013, **a company cannot issue preference shares which are irredeemable.**

e) Participating Preference Shares: Participating in Preference shares takes part in the **company's profit after a specified fixed dividend, is paid.**

f) Non-Participating Preference Shares: Unless the terms of issue indicate specifically or otherwise, all preference shares are to be regarded as non-participating preference shares.

g) Convertible Preference Shares: It can be converted into equity shares within a certain period. It includes a right for converting them into equity shares at the end of a specified period.

h) Fully convertible cumulative preference shares: This instrument is in two parts A&B. **Part A** is convertible into equity shares automatically and compulsorily on the date of allotment without application by the allottee. **Part B** is redeemed at par/converted into equity after a lock in period at the option of the investor at a price lower than the average market price. **Dividend is given only for part B shares.** Dividend is fixed and shall be given only for the portion it represents i.e. the second part shares.

i) Non-Convertible Preference Shares: It cannot be converted into equity shares.

3) Sweat Equity

Sweat Equity Shares: Section 2(88) of the Companies Act, 2013, states sweat equity shares as **equity shares issued by a company to its Directors or employees at a discount or for consideration, other than cash, for providing know-how or making available rights in the nature of intellectual property rights or value additions.**
SEBI (Issue of Sweat Equity) Regulations, 2002 shall be applicable to all the listed companies.

COMPONENTS OF DIFFERENT TYPES OF CAPITAL

- Basel III changes are the Basel Committee on Banking Supervision's (BCBS) reaction to **improving the banking industry's ability to absorb shocks coming from financial and economic stress**, regardless of cause, hence minimising the risk of financial sector spillover into the real economy.

- It was deemed important to enhance the regulatory structure in order for banks and other financial businesses to collaborate and boost capital levels in order to **eliminate practises that contribute to excessive risk-taking.**
- As a result, in December 2010, the Basel Committee on financial Supervision (BCBS) issued a comprehensive reform package titled **BASEL III:** A worldwide regulatory framework for more resilient banks and financial systems, often known as Basel III capital standards.
- These are being implemented in India **with effect from April 1,2013, and would be fully implemented as on March 31, 2019.**

For capital adequacy purposes, **the following entities may be considered financial institutions other than banks and insurance companies:**

- Asset Management Companies of Mutual Funds/Venture Capital Funds/ Private Equity Funds etc.
- Non-Banking Finance Companies
- Housing Finance Companies
- Primary dealers
- Merchant Banking Companies
- Entities engaged in activities which are ancillary to the business of banking under the Banking Regulation Act, 1949
- Central Counter Parties (CCPs)

Total regulatory capital will be comprised of the following categories:

1) Tier 1 Capital (going concern capital)

a) Common Equity Tier 1

b) Additional Tier 1

2) Tier 2 Capital (gone concern capital)

From regulatory and capital perspective, going concern capital is the capital which can absorb losses without triggering bankruptcy of the bank. Gone-concern capital is the capital which will absorb losses only in a situation of liquidation of the bank.

Limits and Minima

a) As a matter of prudence, it has been decided that scheduled commercial banks (excluding LABs and RRBs) operating in India shall maintain a minimum total capital (MTC) **of 9% of total risk weighted assets (RWAs) i.e. capital to risk weighted assets (CRAR).**

b) Common Equity Tier 1 (CET1) capital must be at **least 5.5% of risk-weighted assets (RWAs) i.e. for credit risk + market risk +operational** risk on an ongoing basis.

c) Tier 1 capital must be at least 7% of RWAs on an ongoing basis. Thus within the minimum **Tier 1 capital, additional tier 1 capital can be admitted to a maximum of 1.5% of risk weighted assets (**RWAs).

d) Total Capital (Tier 1 Capital plus Tier 2 Capital) **must be at least 9% of RWAs on an ongoing basis**. Thus within the minimum **CRAR of 9%, Tier 2 capital can be admitted maximum up to 2%.**

e) If a bank has complied with the minimum Common Equity Tier1 and **Tier 2 capital ratios, then the excess additional tier 1 capital can be admitted for compliance within the minimum CRAR of 9% of RWAs.**

f) In Addition to the minimum Common Equity Tier 1 capital of 5.5% of RWAs, banks are also required to maintain a capital conservation buffer (CCB) of 2.5% of RWAs in the form of Common Equity Tier 1 capital.

Transitional Arrangements: In order to ensure smooth migration to Basel III without aggravating any near term stress, appropriate transitional arrangements have been made. The arrangements began in 2013. **Capital ratios and deductions from Common Equity will be phased-in and implemented as on March 31, 2019.**

Minimum Capital Ratios	April1, 2013	March 31, 2014	March 31, 2015	March31, 2016	March 31, 2017	March31, 2018	March 31,2019
Minimum Common Equity Tier 1 CET1	4.5	5	5.5	5.5	5.5	5.5	5.5
Capital conservation BUFFER (CCB)	-	-	-	0.625	1.25	1.875	2.5
Minimum CET1 + CCB	4.5	5	5.5	6.125	6.75	7.375	8
Minimum Tier 1 Capital	6	6.5	7	7	7	7	7
Minimum Total Capital	9	9	9	9	9	9	9
Minimum Total Capital + CCB	9	9	9	9.625	10.25	10.875	11.5

Mail: banishagupta2099@gmail.com
Website: https://iibf.info

	Regulatory Capital	As % to risk weights
(*i*)	Minimum Common Equity Tier 1 Ratio	5.5
(*ii*)	Capital Conversion Buffer (comprised of common equity)	2.5
(*iii*)	Minimum Common Equity Tier 1 Ratio plus Capital Conservation Buffer [(i) + (ii)]	8.0
(*iv*)	Additional Tier 1 Capital	1.5
(*v*)	Minimum Tier 1 Capital Ratio [(i) + (iv)]	7.0
(*vi*)	Tier 2 Capital	2.0
(*vii*)	Minimum Total Capital Ratio (MTC) [(V) + (VI)]	9.0
(*viii*)	Minimum Total Capital Ratio plus Capital Conversion Buffer [(vii) + (ii)]	11.5

CAPITAL REQUIREMENTS FOR NBFCs

a) Every applicable NBFC shall maintain a minimum capital ratio consisting of Tier I and Tier I capital which shall **not be less than 15% of its aggregate risk weighted assets on-balance sheet and of risk adjusted value of off-balance sheet items.**

b) The Tier I capital in respect of applicable NBFCs (other than NBFC-MFI and IDF NBFC), at any point of time, **shall not be less than 8.5% by March 31, 2016 and 10% by March 31, 2017.**

c) Applicable NBFCs primarily **engaged in lending against gold jewellery** (such loans comprising 50% or more of their financial assets) shall **maintain a minimum Tier I capital of 12%**

DEBENTURES

- A company **raise long-term finance through public borrowings** by the issue of debentures.
- A debenture holder is a creditor of the company. A fixed **rate of interest** is paid on debentures.

TYPES OF DEBENTURE

- Unsecured Debentures
- Secured Debentures
- Registered Debentures
- Bearer Debentures
- Redeemable Debentures
- Irredeemable Debentures
- Convertible Debentures

Government Securities (G-Secs)

These are sovereign coupon-bearing instruments, which are issued by the **Reserve Bank of India**, on behalf of the **Government of India**.

Security Receipts

Security receipts mean receipts or other securities, issued by a **securitisation company or a reconstruction company.**