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NATIONAL MONTHLY REFEREED JOURNAL OF REASEARCH IN COMMERCE & MANAGEMENT
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A STUDY OF INNOVATIVE FUNDING STRATEGIES FOR INDIAN COMPANIES

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ABSTRACT

Raising finance is now not an issue because of the steady growth and expansion of equity and debt market in India. However, raising funds intelligently is a matter of interest to all. The sources of funds have to be according to the requirements. Modern day business organizations do not rely only on the conventional sources of finance like equity, preference, debentures etc. Many of them are opting for innovative sources of finance like project finance, versatile bonds ,Flexi rate bonds, Special Purpose Vehicles to name a few. Another concept which has emerged with force is Networking Funding. If funds are required for one department then why should the whole company bear that burden, that department should be given the autonomy to raise its own funds and made accountable for it. This paper examines various facets of innovative funding strategies for Indian companies across different sectors such as Automobiles, Pharmaceuticals, Infrastructure, Information Technology, Banking and FMCG.

Keywords: Financial Re-Engineering, Project Finance, Versatile Bonds, Special Purpose Vehicles

INTRODUCTION

Businesses are witnessing an increasing alignment of business operations with financial strategies in recent times. One of the key questions that business enterprises seek to explore is where to raise finance. Running a business is not only restricted to raising finance, its success also depends on how effectively that money is utilized, in other words efficient financial Management

Financial management is about making financial decisions namely; financing decisions (Raising Finance), investing Decisions (Allocating Finance) and Dividend decisions (Distribution of Profit). Apart from determining the sources of finance, it also includes how to acquire funds at lowest possible cost and judicious mix of various sources in the capital structure. The second Dimension to this aspect is financial engineering.

Financial engineering is aligning products, systems, people, brands and technology with financial structuring, financial control system, financial benchmarking, and financial quantification of every qualitative business variable. Applying innovation to this concept is called financial Reengineering. The changing and challenging business environment has forced companies to bring innovation to existing concepts and updating their tools and techniques. This has led to the era of financial re-engineering. Opening up of economy and availability of global resources has enabled companies to choose from various options of financing; traditional sources like equity, preference shares, debentures, bank finance et all and innovative sources like junk bonds, versatile bonds, project finance, special purpose vehicles, Foreign currency convertible bonds, venture finance, off-balance sheet financing etc.

In-depth research has been carried out on traditional sources of finance but alternative sources of finance are still untouched. Through this research paper an effort is made to see the type and penetration of innovative sources of finance used by the Indian companies. The paper also throws some light on the gap between theoretical concepts and practical applicability of innovative sources of finance. The study also focuses on the concept of networking funding (segments within the company given the autonomy to raise their own funds) which puts the financing decisions to the upper level of strategic paradigm

OBJECTIVES OF STUDY

- To study the funding strategies;
- To study the re-engineering techniques adopted by the business firms;
- To study the penetration level of networking funding.

MOTIVATION OF STUDY

The research study focuses on studying the financial strategies of growth sector companies as They are set to grow in terms of markets, sales, and volume. To sustain the increased scale of Operations huge funds are required. This entails that the management needs to concentrate its Efforts on existing sources of finance as also to tap the innovative sources of finance.

SCOPE OF STUDY

The sectors which have registered high growth rate in last year have been chosen for research Purpose comprising of the following:

- Automobiles
- Pharmaceuticals
- Infrastructure
- Information Technology
- Banking
- FMCG

Key companies representative of these sectors have been chosen for research purpose. Companies from pharmaceutical sector include Ranbaxy Laboratories Ltd, Sun Pharmaceutical Industries Ltd., Unichem Laboratories Ltd., Panacea Biotech Ltd., Piramal Healthcare, Cipla, Matrix Laboratories, Wockhardt, Biocon, Dr Reddy's Laboratories, Aventis Pharma and Abbott India. Automobile companies included in the study are Ashok Leyland, Maruti Suzuki India, Bajaj Auto, Eicher Motors, Hero Honda, Hindustan Motors, HMT Machine Tools, Mahindra and Mahindra, Swaraj Mazda, Tata Motors and TVS Motors. IT companies chosen for the study are Hexaware Technologies, Mindtree, Patni Computer, Persistent Systems, Tata Consultancy Services, Techmahindra, Zensar Technologies, Infosys Technologies and Wipro.

Britannia, Colgate Palmolive, Dabur India, Emami, Godrej Consumer Products, HindustanUnilever, Gillette India, Jyothy Laboratories, Nestle India, Nirma and Vadilal Enterprises are theFMCG companies chosen for the study. Axis Bank, Bank of Baroda, Bank of India, HDFCBank, State Bank of India, ICICI Bank, IDBI Bank, Bank of Maharashtra, Union Bank of Indiaand Andhra Bank are taken for study from banking sector. Infrastructure companies that are partof this study include Ansal Properties & Infrastructure, BSEL Infrastructure Realty, Era InfraEngineering, Gammon Infrastructure Projects, GTL Infrastructure, Reliance Power and GMRInfrastructure.

RESEARCH METHODOLOGY

Collection of Data

The data is collected from:

1. Annual reports of companies
2. Books and magazines
3. Internet

Tools of Analysis

The analysis is done through Ratios namely debt equity ratio and Percentage analysis

LIMITATION OF STUDY

The scope of the analysis is restricted to key companies which have pan India presence. The Unorganized sector and small scale companies are not considered for the research purpose

DATA ANALYSIS

Funding Strategies

The analysis has been done for various sectors on percentage basis. For the Better perspectives of funding strategies, the sources have been divided into the traditional sources and other sources of finance. The traditional sources which include shareholder funds, Debentures and bank finance have been analyzed in Part (A). Other sources which include FCCBs, ECBs and Deferred Sale Tax Loan have been discussed in Part (B).

Sector-Wise Analysis Is Provided As Under

Pharmaceutical Sector In pharmaceutical sector eleven leading companies were selected to analyze the funding structure. The major source of finance for pharmaceutical industry is through the owners' equity i.e. 74.22% of the funds requirement. 14.31% of the funds were raised through banks, 1.64% through debentures and the balance 9.83% was contributed by others. It can be concluded that though the debentures are considered as one of the prominent sources of finance, it is not the most commonly used method by the companies. The reason can be attributed to 'Still in Infancy Stage' debt market in India

Information Technology For the analysis of capital structure strategies in IT sector, nine prominent Indian companies were selected. As per the average figures of selected companies, 89.89% of the funds have been contributed by the shareholders, 6.50% through Banks and the rest 3.61% through other sources. Out of the nine companies selected for the study it was found that four companies have 100% owners' equity. This shows the preference of the investing public to shares offered by these companies. As a result of this none of the companies have raised funds through debentures.

Automobiles Sector Analysis was carried out on 11 growth companies for automobile sector. In The automobile sector net worth is 62.68% of the total funds raised. Other sources of funds are at a higher rate of 23.39% of the overall funds requirement as compared to other sectors. Bank finance is at 11.62% and debentures stands at a miniscule 2.41%. Swaraj Mazda Ltd has raised a Phenomenal 69.53% through banks for its fund requirement.

Infrastructure Sector Data was available for only seven companies for infrastructure sector and all the companies were taken for analysis. 56.94% of the funds have been raised through proprietors' equity. Of the seven companies, two companies, Gammon Infrastructure Projects Ltd and Reliance Power Ltd, have 100% owners equity and BSEL Infrastructure Realty Ltd has97.63%. Remaining companies have raised a good amount of funds through bank loans and other sources. It can be deduced from the analysis that for this sector also, equity is the favored mode of raising finance.

Banking In total ten banks (both public and private) were selected for the study of funding strategies in banking sector. Demand, savings bank and term deposits account for 47.47% of the funds mobilized by the banks. Deposits of branches stand at 43.32% and borrowings at 4.38%.Shareholders have contributed 4.82% of the total funds raised by the banks. *FMCG* eleven companies from FMCG (including food processing companies) were analyzed for studying traditional sources of finance. Nearly 80% of the funds are provided by the shareholders, bank finance accounted for 11.21% and balance 8.82% was contributed by others. None of the companies had issued debentures and shows higher reliance on the owners for fund requirement purpose.

Debt -Equity Ratio IT industry has the lowest debt-equity ratio among all the sectors. Infrastructure industry's DER stands at 0.7563 which shows that debt is 75% of the owners' equity. The leverage effect will be considerable and help in raising the shareholders equity. It can be concluded that the firms are still not tapping the debt markets for raising money. Using debt in the capital structure help companies increase the value of firm (gearing on equity) without diluting the ownership. It is recommended that companies should resort to debt finance for further expansion or operational purposes. There is a tremendous scope for the debt market to be tapped.

Innovative Sources of Finance In first part of data analysis an effort was made to study the composition and proportion of traditional sources of finance in the capital structure of the selected companies. This section is devoted to analyze the innovative sources of finances. For the purpose of analysis the innovative Sources have been divided into two categories; alternative sources of finances and new sources of finances.

Alternative Sources of Finance are the sources which are not of recent origin but do-not fall into category of traditional sources of finance as well. Foreign Currency Convertible Bonds/Notes, External Commercial Borrowings, Deferred Sale tax loan are taken as the constituents of Alternative sources of finance. Out of other sources only FCCBs, ECBs and deferred sale tax loan have significant proportion across the sectors. So, only these three sources have been discussed in detail.

Foreign Currency Convertible Bonds It is a type of convertible bond issued in a currency different than the issuer's domestic currency. In other words, the money being raised by the issuing company is in the form of a foreign currency. A convertible bond is a mix between a debt and equity instrument. It acts like a bond by making regular coupon and principal payments, but these bonds also give the bondholder the option to convert the bond into stock. These types of bonds are attractive to both investors and issuers. The investors receive the safety of guaranteed payments on the bond and are also able to take advantage of any large price appreciation in the company's stock. (Bondholders take advantage of this appreciation by means warrants attached to the bonds, which are activated when the price of the stock reaches a certain point.) Due to the equity side of the bond, which adds value, the coupon payments on the bondare lower for the company, thereby reducing its debt-financing costs. FCCB accounts for 79.60%of the other sources of finance in Pharmaceutical sector, 40.53% in Automobiles and 0.78% in IT sector. Infrastructure and FMCG do not tap this source

External Commercial Borrowings External Commercial borrowing (ECB) is a term used to refer to commercial loans availed from non-resident lenders with a minimum average maturity of 3years in the form of bank loans, buyers credit, suppliers credit, securitized instruments (e.g. floating rate notes and fixed rate bonds).A company is free to raise ECB from any internationally recognized source such as banks, export credit agencies, suppliers of equipment, foreign collaborators, foreign equity-holders, international capital markets etc., but offers from unrecognized sources are not entertained.

Deferred Sales Tax Loan If the company is not able to make sales tax payment as per the schedule, then the company can apply for the sales tax deferment with Department of Sales Tax. Sales tax officer evaluates the proposal and grants the payment to be made in installments. The unpaid amount at the end of the financial year is considered as deferred sales tax loan. Sales tax deferral loan is 10.31% in automobile sector, 2.45% in pharmaceuticals and 0.07% in FMCG sector. It is very less in the case of FMCGs as it has a high liquidity on account of low operating cycle and can easily pay off its sales tax obligations on time. In case of infrastructure companies, sale of products are not there as such, so, question of sales tax does not arise. Same logic can be applied to IT companies. There are some product based IT companies which might be paying their sales tax liabilities as per the schedule.

New Sources of Finance New Sources of Finance are sources which have originated and gained prominence in last decade. Theoretically new sources of finance include Brand Finance, Vendor Finance, Venture Finance, Employee Finance, Versatile Bonds, vendor Finance, Dealer Finance, and Structured Finance. Employee finance indicates their investment in the company's business through shares, convertible debentures etc, this has already been included in ESOPS under the shareholder funds. Brand Finance means raising finance keeping brand value of employees as collateral. This concept is similar to structured finance. Venture finance means raising funds for the business based on innovative idea/themes, this does not represent the new source. Against this background, the study concentrates on the following new sources of finance.

Vendor Finance Bank offers Bill Discounting services to vendors of large Indian corporate, including priority sector companies. Once the client accepts the bills drawn by the company, they may be discounted by bank. Discounting rate is linked to the tenor based IBR. Limit is outside the banking arrangement of the Corporate, and recourse is to the company. In case the client is not willing to accept a bill of exchange, company can also opt for Invoice Discounting facility. Bank also offers a range of solutions for funding dealers and end customers. Facilities are offered on a standalone basis against collateral as well as through structured transactions. Dealer financing is an effective tool that meets the funding requirements of dealers at a competitive rate. It results in a satisfied and loyal dealer network, helps in increasing sales and streamlines working capital management.

Dealer Finance Dealer Finance services include short-term unsecured finance to procure goods from corporate. These may be on a non-recourse basis; or, in some cases, corporate recourse byway of First Loss Deficiency Guarantee. The corporate provides non-financial comforts like Stop Supply Letter, Assistance in Recovery & Resale. All payments due to you must be routed through our accounts. Dealer financing may be in the form of Bill Discounting or an Overdraft facility. Term facility is also available for assets, like vending machines, which are required by the company to deliver the corporate products. These are available to selected dealers of large corporates. None of the companies under the study have mentioned availing vendor/dealer finance facilities. Moreover both of these sources are shown under the heading of bank finance and usually bifurcation is not given in either financial statements or the annual reports of the companies. It is observed that this type of finance has limited penetration because of requirement of high credibility and thus can be availed only by big business houses

Structured Finance Structured finance encompasses all advanced private and public financial arrangements that serve to efficiently refinance and hedge any profitable economic activity beyond the scope of conventional forms of on-balance sheet securities (debt, bonds, equity) in the effort to lower cost of capital and to mitigate agency costs of market impediments on liquidity. Structured finance is invoked by financial and non-financial institutions in both banking and capital markets if established forms of external finance are either (i) unavailable (or depleted) for a particular financing need, or (ii) traditional sources of funds are too expensive for issuers to mobilize sufficient fund for what would otherwise be an unattractive investment based on the issuer's desired cost of capital. Securitization seeks to substitute capital market-based finance for credit finance by sponsoring financial relationships without the lending and deposit-taking capabilities of banks (disintermediation). The issuer raises funds by issuing certificates of ownership as pledge against existing or future cash flows from an investment pool of financial assets in the bid to increase the issuer's liquidity position without increasing the capital base or by selling these reference assets to a SPV, which subsequently issues debt to investors to fund the purchase.

Types of Structured Finance Asset Backed Securitization (ABS) – Fixed income debt instrument whose principal and interest Payments are governed by cash flow generated by underlying asset. Process of distributing risk by aggregating debt instruments or assets in a pool, then issuing new securities back by the pool. Asset pool being securitized has a lower default risk than the company itself and therefore if financed discretely, commands a better rating and tighter pricing. Ratings improvement can also occur relative to the issuer or the sovereign ceiling rating if the issuer is resident in a noninvestment grade country. By convention ABS is backed by non-mortgage assets. Mortgage Backed Securitization (MBS) – Specific type of ABS where the debt instruments are backed by a pool of mortgage loans. MBS in Asia emulates the United States' success in securitizing housing loans mortgages (where fees and interest received are not liquid and loans not negotiable), making them liquid and marketable

Networking Funding Traditionally concept of capital structure, sources of finance and cost of finance is related to organization as a whole. But the concept of networking funding suggests that Segments of the companies should be given autonomy and accountability to raise their own finances which match the quantum and duration of requirement.

Networking funding Independent funding for each segment of value chain but with combined advantage to organization. Investor should be allowed to invest in financial instrument pertaining to one segmented: Flexi-rate bond issued by purchase dept. or segment –I. Investor enjoys fractional expose & can treat investment in co. as a portfolio.

Advantages of networking funding

- Vertical expansion can be facilitated with independent expansion of segments' financial structure.
- Co-partnership of vendors & distributors with single segment can offer long term advantages to whole enterprise.
- Facilitates valuation of segment.
- Single segment is scrutinized for further fund raising.
- Segmental ROI can be monitored.

- Whole co. as portfolio mix by promoters by varied financial exposures to different Segments

Penetration of Networking Funding None of the companies selected for research study have used the concept of networking funding.

The reason of non existence of this concept can be explained through two reasons:

1. The analysis has been carried out by the detailed analysis of financial statements of thecompany given in the annual reports. The companies might not reveal such kind of details infinancial statements as these are prepared as per the set format of companies' act 1956 which donot warrant companies to reveal such kind of information.
2. The other reason can be that concept of networking funding requires strong management Control system in place. Management control system in terms of:
    - Establishing the performance measures like ROI/RI and EVA.
    - Judging performance of responsibility mangers on the basis of how well the funds have been utilized in the business.

The concept of management control system is still in nascent stage in India and even the big and successful organizations have failed to design the foolproof management control system. This explains the incapability of companies to use this concept.

CONCLUSION

Funding structure of the companies under the study is quite different from what is preached intext books/theory. Though most of the companies are inclined to use equity financing, debentures are not seen to have that kind of penetration. Surprisingly out of 50 companies onlyGammon Infrastructure Pvt. Ltd. and TCS Ltd. is found to have raised preference shares for itsfund requirements. It can be inferred that out of traditional sources of finance, equity capital isthe only dominant constituent. Bank finance was also found to have decent share in totalfunding. As for alternative sources of finance, FCCBs, ECBs are components which have a fairexposure among all the sectors chosen for the study. Most interesting observations came from analysis of innovative sources of finance. Depth ofexposure of dealer/vendor finance can-not be judged from studying annual reports of thecompanies. They are clubbed under the heading of bank finance and the details are not given inannual reports. Securitization is also an off-balance sheet activity. Therefore, it is not discussedin financial statements. Another notable point here is that only large corporate houses can resortto these new sources of finance due to the credibility issues. This coupled with lack of awarenessfor such sources describe the reasons for low penetration of new sources of finance.

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Table 4: Funding pattern of the selected companies in the Infrastructure Industry for the year 2008-09

S. No	Name of Company	Shareholder Fund	Debentures	Bank Finance	Others	Total
1	Ansal Properties & Infrastructure Ltd	48.93	7.14	19.60	43.93	100
2	BSEL Infrastructure Realty Ltd	97.63		2.34	2.37	100
3	Era Infra Engineering Ltd	32.85	7.96	36.09	23.10	100
4	Gammon Infrastructure Projects Ltd	100.00	-	-	-	100
5	GTL Infrastructure Ltd	26.92		42.27	73.08	100
6	Reliance Power Ltd	100.00			-	100
7	GMR Infrastructure Ltd	34.99	2.65	43.05	62.36	100
	INDUSTRY AVERAGE	56.94	2.01	26.58	14.49	100

S. No	Name of Company	Shareholder Fund	Debentures	Bank Finance	Others	Total
1	Hexaware Technologies	98.12			1.88	100
2	Mindtree Ltd	79.19		20.54	0.27	100
3	Patni Computer Systems Ltd	99.97			0.03	100
4	Persistent Systems Ltd	100.00	-	-	-	100
5	Tata Consultancy Services Ltd	99.70		0.01	0.29	100
6	Techmahindra IT Services and Telecom Solutions	100.00			-	100
7	Zensar Technologies Ltd	100.00			-	100
8	Infosys Technologies Ltd	100.00			-	100
9	Wipro Ltd.	70.55		18.88	10.57	100
INDUSTRY AVERAGE		89.89		6.50	3.61	100

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Table 3: Funding pattern of the selected companies in Automobile Industry for the year 2008-09

S. No	Name of Company	Shareholder Fund	Debentures	Bank Finance	Others	Total
1	Ashok Leyland Limited	63.95	3.38	1.75	30.92	100
2	Maruti Suzuki India Limited	92.65		0.64	6.71	100
3	Bajaj Auto Ltd	54.36		7.22	38.42	100
4	Eicher Motors Ltd	98.35		0.69	-	100
5	Hero Honda Motors Ltd	97.98			2.02	100
6	Hindustan Motors Ltd	59.39		9.94	30.67	100
7	HMT Machine Tools Ltd	89.11		3.01	7.88	100
8	Mahindra and Mahindra Ltd	56.49	13.96	3.61	25.94	100
9	Swaraj Mazda Ltd	30.47		69.53	-	100
10	Tata Motors	48.16		22.81	29.03	100
11	TVS Motors Company Ltd	47.21		18.87	33.93	100
INDUSTRY AVERAGE		62.68	2.41	11.62	23.29	100