Class - III B.com
Subject- Financial services

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UNIT- IV

☆ Meaning of venture capital

Venture capital is a type of private equity capital. Typically it is provided by outside investors to new businesses that promise to grow fast. Venture capital investments are usually high risk, but offer the potential for above-average returns.

A venture capitalist (VC) is a person who makes such investments.

☆ Features of venture capital

1. It is basically financing of new companies which are finding it difficult to go to the capital market at their early stage of existence.
2. This finance can also be loan-based, so that they carry a fixed yield for the providers of venture capital
3. Those who provide venture capital aim at capital gain due to the success achieved by the borrowing concern.
4. Venture capital is always a long-term investment and made in companies which have high growth potential. The provision of venture capital will bring rapid growth for the business
5. Not all the capitalists will experience high risk. But venture capital financing contains risks. But the risk is compensated with a higher return.

☆ Methods of venture capital Financing

1) Equity participation;

Venture capital firms participate in equity through direct purchase of shares but their stake does not exceed 49%. These shares are retained by them till the assisted projects making profit, after these are sold to the public in the secondary market at a profit.

2) Conventional Loan;-

Under this form of assistance, a lower fixed rate of interest is charged till the assisted units become commercially operational, after which the loan comes normal or higher of interest.

3) Conditional Loan;-

Conditional loans are the one that does not carry interest and are repayable to the lender in the form of royalty after the venture capital undertaking is able to make revenue.

4) Income Notes;-

It is a combination of conventional and conditional loans. Both interest and royalty are payable.

5) convertible loans :-

The loans which are convertible into equity when interest on the loan is not paid within the stipulated period.

Modes of venture financing.

VCIs in India can be broadly classified into 5 types.

1) VCIs promoted by Development banks.

(a) IDBI - VFC : IDBI promoted venture fund company in the year 1986.

(b) TDICI - TDICI was started in January 1988 with the support of ICICI and UTI. This is the country's First venture Fund scheme.

(c) RCTC - It is a subsidiary of IFCI, started in January 1988. Its resource base has Rs. 30 crores which has contributions from UTI, IFCI and world Bank

2) State level venture capital companies, they are

1. Gujarat venture Finance Ltd.

GVFL, along with Gujarat Lease Finance Ltd, and Gujarat state Fertiliser Ltd, promoted Gujarat venture Finance Ltd, It was started in 1990.

2. Andhra pradesh venture capital Limited (AVCL) :

This was promoted by APIDC, IDBI, Andhra Bank and Indian overseas Bank.

3) Venture capital companies promoted by commercial Banks.

1. Canara Bank venture capital Fund

2. SBI capital venture capital Fund.

4) Private sector venture capital companies.

In private sector, we have Lazard credit capital venture Fund; and Indus venture Management Ltd [IVML].

5) Foreign venture capital Funds

The Hong Kong Bank has promoted venture Fund. Alliance capital of U.S.A has also promoted venture capital Fund.

Factors determining venture investment.

1) character of the business partners. The people behind an idea or company and, more importantly, their character is extremely important..

2) capacity of the business partners..

3) Innovative Idea...

(4) communal benefit..
(5) Long-term sustainability..
(6) Financial outlook

★ Exit machanism :-

1) An important aspect of venture capital investing is the exit strategies.
2) Venture capital funds primarily invest with an exit in mind after a few years.
3) After successfully funding at seed, production and expansion stages, a venture capitalist until start assessing exit strategies.
4) The exit in the form of disinvestment is the last and final stage of the venture capital fund.
The key types of liquidation are,

1. Trade sales :-
In this type of strategy the private company is sold (or) merged with an acquirer for stocks, cash or a combination of both.

2. write off :-
These are voluntary liquidation that may or may not result in any proceeds.
Apart from the above types of disinvestment there are a other option.

3. Buy back.
In this method the entrepreneur buy-back the investment share from the venture capitalists and takes it back to being a privately held company
Investors who invest in a venture capital fund get distributions of stock or cash from realised venture capital investments.
Sometimes the funds may require further investments from limited partners.
At other times, they may make cash or share distribution to the investors. In that time the investors may sell their shares to another buyer if they want.

★ Advantages of venture capital.

1) Promoting Entrepreneurs :-
Just as a scientist brings out his laboratory findings to reality and makes it commercially successful, similarly, an entrepreneur converts his technical knowledge to a commercially viable project with the assistance of VCFs

2. The VCI helps the entrepreneur to promote their projects.

3. Promoting products:-

New Products with modern technology become commercially feasible mainly due to the financial assistance of venture capital institutions.

4. Promotion of exports:-

The venture capital institution encourages export oriented units

5. Technological growth:-

Modern technology will be put to turn around after getting proper nursing from the VCIs.

6. Growth of economy:-

By promoting new entrepreneurs and by reviving sick units, a fillip is given to the economic growth. There will be increase in the production of consumer goods which improves the standard of living of the people.

* Issues of Indian venture capital Industry.

I. Introduction

The volume of venture capital investments in India has been increasing steadily. According to the Economic Times, the 121 investment deals in early stage companies and start-ups in the first half of 2014 constituted a 40% increase in the no. of such deals compared with the same period in 2013.

II. Entry and the Investment phase

A. Regulatory valuation Requirements.

India does not have full capital account convertibility. Instead, the Indian government imposes extensive foreign exchange control regulations.

B. Finalizing the capital structure.

For obvious reasons, finalizing the capital structure is another critical aspect of pre-investment.

C. Voting Rights.

Another fairly common problem regarding the capital structure is linked to voting rights on shares. The Act prohibits holders of compulsorily convertible preference shares from exercising voting rights on these preference shares unless such matters directly affect the rights of the preference shareholders.

D. Director Liability.

Indian Law has always recognized the Fiduciary

duty owed by the directors to a company. However, the Act has changed the role and responsibility, of directors by encouraging their active Participation in the company's affairs and increasing director liability aimed at curbing instances of corporate malpractice in India, such as Falsification or manipulation of accounts by promoters and diversion of funds.

III Exit Related Issues.

(a) Buy-back related Issues.

Another typical exit mode for VC investments consists of buying back shares of the portfolio company.

(b) capital Market related Issues.

Preparing For an initial public offering in India is a time-consuming and painstaking exercise involving investors, the company, promoters, employees, merchant bankers and lawyers.

(X) 2 Marks.

1) Meaning of venture capital.
2) what is conditional Loan?
3) what is convertible loans?

5 Mark

1) what are the features of venture capital?
2) what are the methods of venture capital Financing?
3) what are the exit machanism of venture capital?

10 Mark

1) Explain the modes of venture Financing.
2) what are the advantages of venture capital?

UNIT- V

Factoring

★ Meaning of Factoring

Factoring implies a financial arrangement between the factor and client, in which the firm (client) gets advances in return for receivables, from a financial institution (Factor).

★ concepts of Factoring.

1) As the dictionary rightly points out factoring is nothing but financing through purchase of accounts

2) Factoring is a continuous arrangement between a financial institution (Factor) and a company which sell goods and services to trade customer (client) on credit

3) As per this arrangement, the factor, purchases the clients trade debts including accounts receivable.

4) The clients is immediately paid 80% of the trade debts taken over and when the trade customer repay their dues, the factor will make remaining 20% payment.

★ Types of Factoring

1) **Full Factoring**:- Here, collection of debts and sales ledger maintenance are done by the factor and the factor undertakes the credit risk.

2) **Recourse and Non-recourse Factoring**:-

In this type of arrangement, the financial institution, can resort to the firm, when the debts are not recoverable.

On the other hand, in non-recourse factoring, the factor cannot recourse to the firm, in case the debt turn out to be irrecoverable.

3) **Maturity Factoring**:-

The Factor makes payment only on the maturity of the bill or at end of the collection period to the supplier.

4) **Advance Factoring**:-

The factor provides advance against uncollected debts at an interest to the supplier or seller. Normally, this may be 60% to 75% of the debt amount

5) Maturity Factoring:-

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.

6) 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.

7) Confidential Factoring:-

Here, the arrangement is not disclosed to outsiders. The arrangement between the seller and the factor is kept highly secret. On the supplier receiving money from the customer, he will repay the advance to the Factor.

* Significance of factoring.

1) Immediate increase in cash flow- The client does not wait for the credit time period as he receives money immediately from the factor and bears a nominal fee for the waiting period.

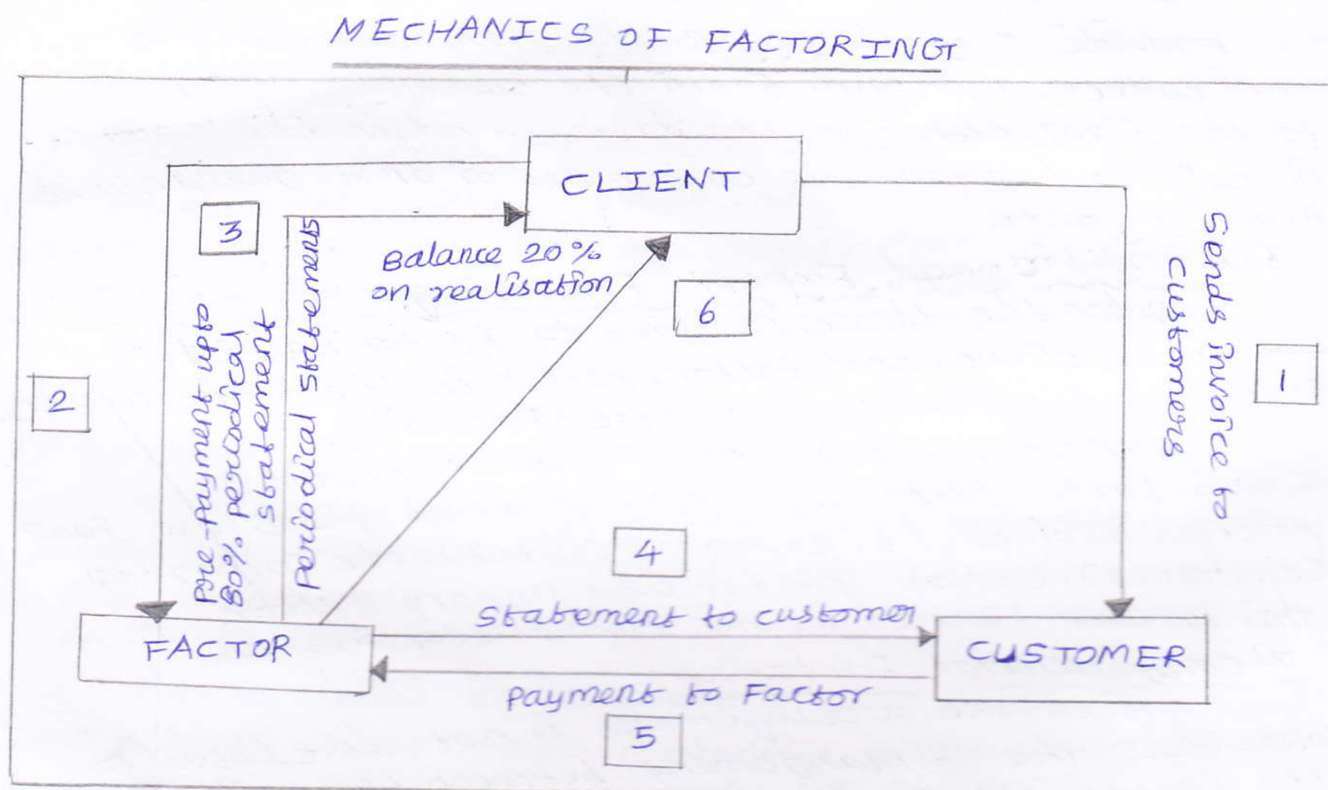
2) Less costly- It reduces the financial burden on the client. It enables the client to invest somewhere else, save cost of manpower, maintenance of accounts, collection of money etc.,

3) Invoice Processing- It relieves the factor from the task of mailing, posting, deposit of cheque, preparing reports etc.,

4) Maintenance of sales Ledger- Ledger a/c of all debtors is maintained by the factor. An open account method is adopted and the factor prepares periodic reports for the client.

5. Financing of trade debt- The Factor provides up to 80% of the cost of goods sold in advance which reduces the financial burden on the client. sometimes the factor provides full credit protection against bad debts

✯ Factoring Machanism.



(1) order received by the seller from the buyer.

(2) seller obtains details of buyer credit worthiness.

(3) seller executes the order.

(4) seller rising the invoice with the Factor.

(5) Factor paying 80% of invoice value to seller

(6) Factor sending statements of accounts to buyer for payment on due date

(7) Buyer settling transaction with the factor

(8) Factor paying balance amount to seller & obtaining commission.

✯ Factoring Vs Bills discounting.

	Factoring	Bills Discounting
1.	This may be with or without recourse seller factoring	All the bills are with recourse to the i.e., if the drawee or buyer fails, the liability falls on the drawer
2.	The Factor collects the bill on his own.	The drawee of the bill makes payment to the

3. Factoring is a service agreement as well as financial arrangement	It is purely a financial arrangement of a short-term nature.
4. Factor undertakes service, based on the quality of the debtor, his past record and his credit worthiness	The credit worthiness of the drawer with the banker is responsible for the bill discounting facility.
5. Factoring get interest and commission for financial services.	But in the case of B/D the financier get the discounting charges for financial services.

☆ Factoring in India

There are two factoring companies in public sector banks.

1) SBI Factors and commercial service limited
2) Can bank Factors limited.

1) SBI Factors and commercial service Ltd:-

It was floated jointly by SBI, SIDBI and Union Bank of India in march 1991.

2) Canbank Factors limited:-

It was jointly promoted by Canara Bank, Andhra bank and SIDBI in August 1992 to operate in south India. Its paid up capital Rs.10 crores is contributed in the ratio of 60:20:20 by its three promoters.

Factoring in India is still in the infant stage. If we have to improve factoring organisation in the country, there should be more credit investigating agencies. so that they can recommend genuine business transactions. However, factoring service as a very bright future in India, it will be a boon for small scale sector.

☆ Meaning of Forfaiting:-

Forfaiting is a financial transaction involving the purchase of receivables from exporters by a forfaiter. The forfaiter taken on all risks associated with the receivable but earns a margin.

★ Forfaiting VS Export Factoring.

(1) A Forfaitor discounts the entire value of the bill. The implication is that Forfaiting is 100% Financing arrangement of receivable Finance.

★ But the extent of advance receivables financing with a Factoring arrangement is only partial ranging between 75% - 85% the balance is retained by the factor as a Factor reserve which is paid after maturity.

(2) The availing bank with provides an unconditional and irrevocable guarantee is a critical element in the forfaiting arrangement. The Forfaitors decisions to provide Financing depends upon the financial standing of the availing bank

★ On the other hand in a Factoring deal, particularly non-recourse type, the export Factor bases his credit decission on the credit standards of the exports and participate in the credit extension and credit protection process.

(3) Forfaiting is a pure Financing arrangement.

★ While Factoring also includes ledger administration, collection & so on.

(4) Factoring is essentially a short term financial deal.

★ Forfaiting Finance notes/bills arising out of differed credit transaction spread over 3-5 years.

(5) A Factor does not guard against exchange rate Fluctuation

★ A Forfaitor charge a premium for such risk.

☆ Problems of Factoring and Forfaiting.

I. Problems of Factoring:-

(1) Lack of access to get common source of information.

(2) Lack of experience and database to taken on jobs such as credit evaluation of clients.

(3) Expensive system of multiple data bases maintained by individual Factor.

(4) Lack of uniformity in the working of specialised credit information agency.

(5) High cost of operations.

II. Problems of Forfaiting.

(1) From bank point of view there is no legal Frame work to protect the banker or financial institution doing forfaiter and hence they Face the risk in the Form of political, exchange rate risk and other is associate with Foreign transaction.

(2) There is no secondary market for these types of instruments hence, there is lack of liquidability for these instruments.

(3) It is very expensive From exporter point of view because banks take high Fees For Forfeiture due to high risk involved in it.

※ 2 Marks

1) what are the meaning of Factoring?
2) what is Full Factoring?
3) what is confidential Factoring?
4) what is Forfaiting?

5 Marks

1) Explain the concept of Factoring?
2) what are the difference between Factoring Vs Bills discounting?

3) what the problems of Factoring and Forfaiting.

10 Marks

1) what are the types of Factoring?

2) Explain about Factoring Machanism.