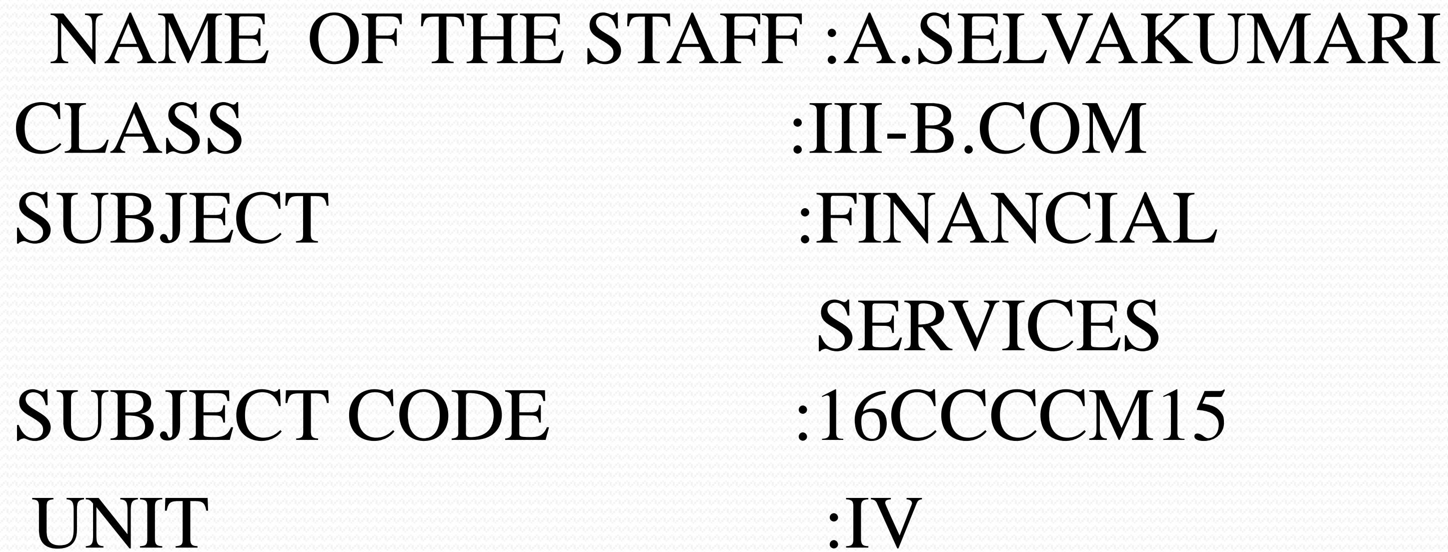
SENGAMALA THAYAAR EDUCATIONAL TRUST WOMEN’S COLLEGE-MANNARGUDI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UNIT :IV

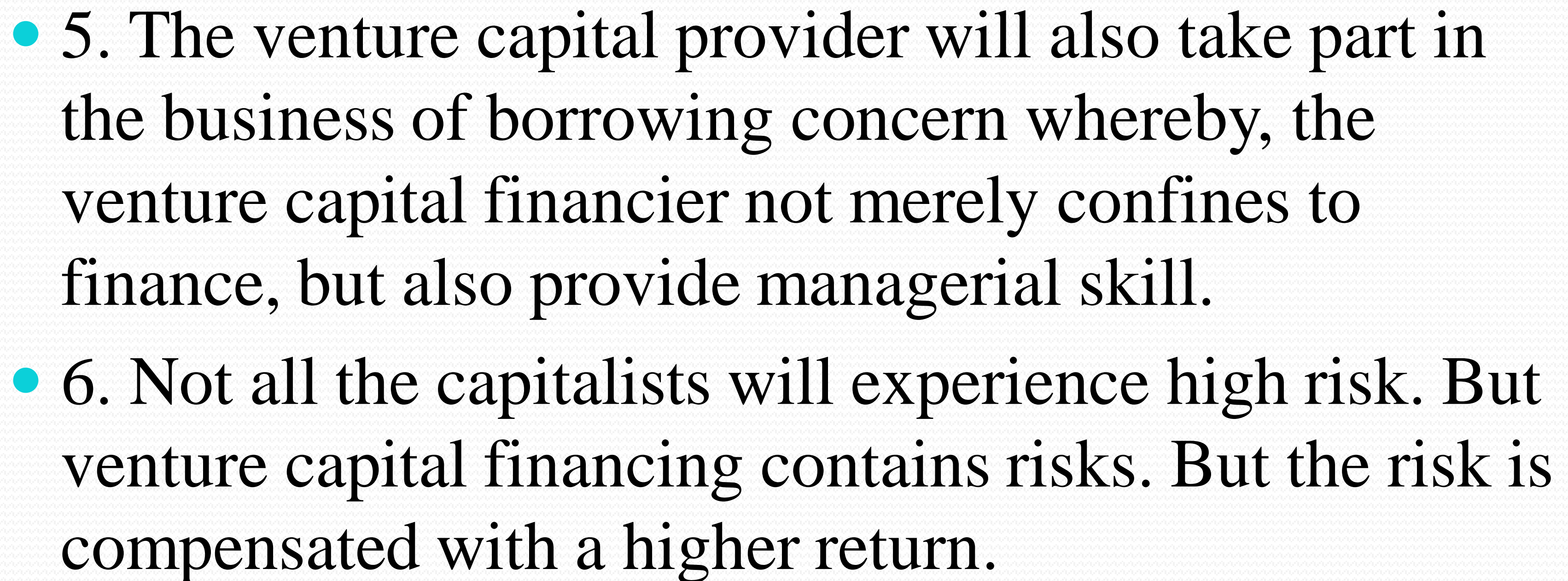
Venture Capital

- Venture capital is a subset of private equity (PE). While the roots of PE can be traced back to the 19th century, venture capital only developed as an industry after the Second World War. Harvard Business School professor Georges Dariot is generally considered the "Father of Venture Capital". He started the American Research and Development Corporation (ARDC) in 1946 and raised a $3.5 million fund to invest in companies that commercialized technologies developed during WWII. ARDC's first investment was in a company that had ambitions to use x-ray technology for cancer treatment. The $200,000 that Dariot invested turned into $1.8 million when the company went public in 1955.

Features of Venture Capital

Features of Venture Capital:

- Venture capital has the following features:
- 1. Venture capital investments are made in innovative projects.
- 2. Benefits from such investments may be realized in the long run.
- 3. Suppliers of venture capital invest money in the form of equity capital.
- 4. As investment is made through equity capital, the suppliers of venture capital participate in the management of the company.


5. The venture capital provider will also take part in the business of borrowing concern whereby, the venture capital financier not merely confines to finance, but also provide managerial skill.
6. 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 :

Equity Financing

- When a company requires money to finance the start-up which has huge capital requirements with a robust business plan and has the potential to grow into a highly profitable venture, the company makes use of equity financing. Companies offer a percentage of the business or the company to the investors, in exchange for capital when the company or firm is not able to give timely returns to its investors. The investors who buy the share of any company have a voting right.

Conditional Loan

- Unlike bank loans, conditional loans have neither pre-determined repayment schedule nor any fixed interest rate on the borrowed capital. In the case of conditional loans, an entrepreneur needs to pay the lender in the form of royalty when the company is able to generate revenue or profit. No interest is payable to the lender for the loan amount.

Conventional Loans

- Unlike conditional loans, where the entrepreneurs need not pay any interest to the lender, in the case of the conventional loans an entrepreneur has to pay interest initially but with a low-interest rate on the borrowed capital. The interest rate will increase as per the increase in profit. Along with the interest on the borrowed capital, an entrepreneur needs to pay a royalty in accordance with the sales/profit.

Income Note

- This is the combination of both the traditional loans from banks or NBFCs and conditional loans. Here are the key features of income note,
- Entrepreneurs need to repay the principal amount along with the interest within the predetermined stipulated period.
- Entrepreneurs need to pay a royalty on sales or profit.

Debentures

- The start-up companies raise funds by issuing debenture with a guarantee to repay the amount of the invested money when the security is matured. In other words, whenever capital is required the companies issue a debt paper for a specific period of time. Then the company pays out the interest on the money invested at the fixed maturity date. Usually, the interest on debentures is payable at three various rates in accordance with the phase of operation or business,
- Before the commencement of operation – NIL.
- Commencement of operation – Low rate of interest.
- After reaching a particular level of sales or profit – A high rate of interest.

Types Of Venture Capital Financing

- **Seed financing-** in this small amount is required for the purpose of starting up the loan. The amount which is been used in this is received by the entrepreneur.

- **Start up financing-** in this finished developed products and services are given to the companies as this can also be used under the initial marketing where the development of products and services takes place.

- **First stage financing-** in this companies which has spent all their starting capital and which are requiring further finance to begin their business activities at full scale are used.

Process Of Venture Capital Financing

Deal Origination:

- Venture capital financing begins with origination of a deal. For venture capital business, stream of deals is necessary. There may be various sources of origination of deals. One such source is referral system in which deals are referred to venture capitalists by their parent organizations, trade partners, industry association, friends, etc.

Screening

- Venture capitalists in India ask the applicant to provide a brief profile of the proposed venture to establish prime facie eligibility. Entrepreneurs are also invited for face-to-face discussion for seeking certain clarifications.

Evaluation

- Theyalso consider the entrepreneur's entre-preneurital skills, technical competence, manufacturing and marketing abilities and experience. Further, the project's viability in terms of product, market and technology is examined

Deal Negotiation

- It also contains protective covenants such as venture capitalists right to control the venture company and to change its management, if necessary, buy back arrangements, acquisition, making IPOs. Terms of the deal should be mutually beneficial to both venture capitalist and the entrepreneur. It should be flexible and its structure should safeguard interests of both the parties.

Exit Plan.

- The last stage of venture capital financing is the exit to realise the investment so as to make a profit/minimize losses. The venture capitalist should make exit plan, determining precise timing of exit that would depend on an a myriad of factors, such as nature of the venture, the extent and type of financial stake, the state of actual and potential competition, market conditions, etc.

- The deal is financed and the venture begins working, the venture capitalist associated.

Factors Determining Venture Capital

- **Hands on or Hands off Approach:**
- The hands on style of management will normally involve a representation on the board. It would involve very active interaction between the entrepreneur and the venture capitalist. An attempt is made to value add the services in an advisory role or active involvement in marketing, recruitment and finding technical collaborators.

Deal Structuring Flexibility:

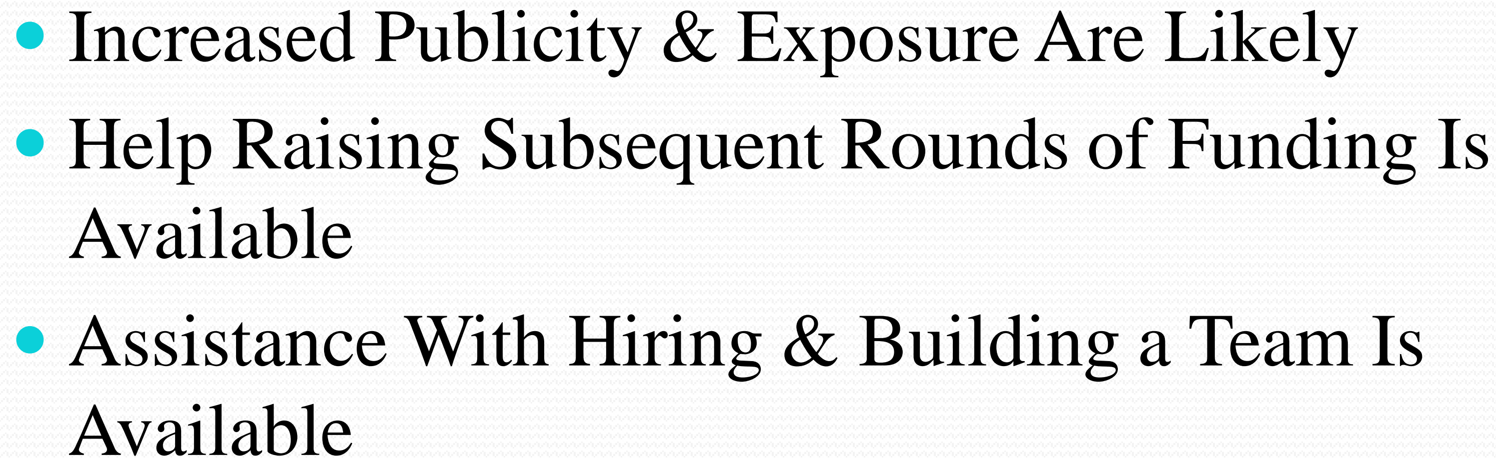
- The entrepreneur should seek out the fund which gives a package that best meets his needs. Some funds are very flexible in this matter and any surprise the entrepreneur with their generosity. Others have some rigid rules and there are various approaches between these two extremes.

Fund viability and liquidity:

- The entrepreneur must sure that the fund has committed backers and not someone interested in just a quick realisation of capital gains. This is very important in raising follow up finance

Advantages of Venture capital:

- Large Amounts of Capital Can Be Raised
- Personal Assets Don’t Need to Be Pledged
- Experienced Leadership & Advice Is Available
- Networking Opportunities Are Provided
- Collaboration Opportunities With Industry Experts & Other Startups Are Available



- Increased Publicity & Exposure Are Likely
- Help Raising Subsequent Rounds of Funding Is Available
- Assistance With Hiring & Building a Team Is Available

UNIT-V

- **Factoring**
- Factoring is a financial alternative, in financing and management of account receivables. It states the terms and conditions of the sale in the factoring agreement.
- In finer terms factoring is a relationship between the factor and the client, in which the factor purchases the client's account receivables and pay up to 80% (sometimes 90%) of the sum immediately, at the time of entering into the agreement.

- **<u>Factoring</u>**
- **Definition**: 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).

Types of Factoring

- **Recourse and Non-recourse Factoring**: In this type of arrangement, the financial institution, can resort to the firm, when the debts are not recoverable. So, the credit risk associated with the trade debts are not assumed by the factor.
- **Disclosed and Undisclosed Factoring**: The factoring in which the factor's name is indicated in the invoice by the supplier of the goods or services asking the purchaser to pay the factor, is called disclosed factoring.

- **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.
- **Advance and Maturity Factoring**: In advance factoring, the factor gives an advance to the client, against the uncollected receivables

Factoring:

- Meaning:

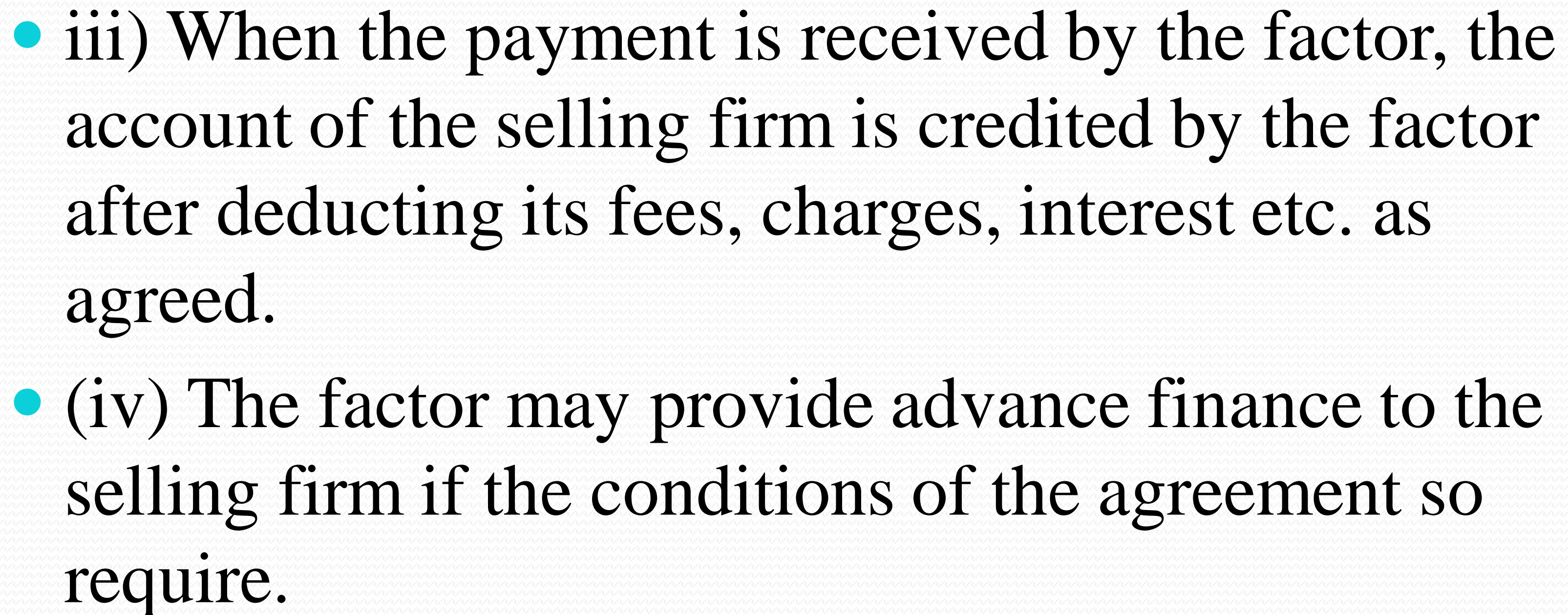
  The factoring company takes on the responsibility for the collection of invoices More expensive than bills discounting Direct payment to the factoring company.

Concepts of factoring:

- Factoring is a method by which a businessman can obtain cash for invoices he sends to his customers in respect of supply of goods and services to them.
- Factoring is also termed as 'Invoice Discounting.' Factoring involves the sale of receivables to a financial institution such as an old line factor commercial banks. The factor purchases accounts acceptable to him generally without recourse;

Types of Factoring

- (i) An agreement is entered into between the selling firm and the factor firm. The agreement provides the basis and the scope of the understanding reached between the two for rendering factor services
- ii) The sales documents should contain the instructions to make payments directly to the factor who is assigned the job of collection of receivables



- iii) When the payment is received by the factor, the account of the selling firm is credited by the factor after deducting its fees, charges, interest etc. as agreed.
- (iv) The factor may provide advance finance to the selling firm if the conditions of the agreement so require.

Differences between Factoring and Bill Discounting

Factoring:

- Includes value-added services such as collection services and full sales ledger
- The factoring company takes on the responsibility for the collection of invoices
- More expensive than bills discounting
- Direct payment to the factoring company

Bills Discounting:

- Do not include services such as collection services and full sales ledger
- The actual business takes on the responsibility of the collection of invoices
- Less expensive than factoring
- Normal payment to the company's name

- **Forfaiting** is a **means** of financing that enables exporters to receive immediate cash by selling their medium and long-term receivables—the amount an importer owes the exporter—at a discount through an intermediary. ... A forfaiter is typically a bank or a financial firm that specializes in export financing.

Differences Between Factoring and Forfeiting

- **Factoring**: A financial arrangement where business owners sell their pending invoices (accounts receivables) to a third party (factoring companies, lenders, or banks) in exchange for fast cash.
- **Forfeiting**: Belongs under export financing in which an exporter sells their rights of trade receivables to a forfeit-er to acquire immediate cash payment.

TIMING

- **Factoring:** Deals with short-term accounts receivables, which typically falls due within 90 days or less.
- **Forfeiting:** Deals with medium- to long-term accounts receivables.

SALE OF RECEIVABLES

- **Factoring:** The sale of receivables are usually on ordinary products or services.
- **Forfeiting:** The sales of receivables are on capital goods

- **Factoring:** Deals with negotiable instruments, such as promissory notes and bills of exchanges.
- **Forfeiting:** Does not deal with negotiable instruments

RECOURSE VS. NON-RECOURSE

- **Factoring:** It can be recourse or non-recourse.
- **Forfeiting:** Always non-recourse.

SECONDARY MARKETS

- **Factoring:** No secondary market.
- **Forfeiting:** There is a secondary market that increases the liquidity in forfeiting.

WHO PAYS FOR THE COST

- **Factoring:** The seller or client pays for the factoring costs.
- **Forfeiting:** The overseas buyer pays for the forfeiting costs.

Problems of Forfaiting

- Factoring could prove to be costlier to in-house management of receivables, specially for large firms which have access to similar sources of funds as the factors themselves and which on account of their size have well organised credit and receivable management.
- Factoring is perceived as an expensive form of financing and also as finance of the last resort. This tends to have a deleterious effect on the creditworthiness of the company in the market.