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Sources of Long Term & Short Term Finance

- CA Vikram Menda

Agenda

- ✓ *Need for finance*
- ✓ *Different Funding options*
- ✓ *Pros & cons of each of these options*
- ✓ *Factors affecting choice of funds*

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Need for Finance

- ✓ *Finance is rightly called “the **lifeblood**” of any business. Why?*
- ✓ *Almost half of the ventures fail because of poor financial management – Dun & Bradstreet*
- ✓ *Practical Illustration: BOT Concessionaire*
- ✓ *Profit margins V/s. Finance costs*

Different requirements

Businesses require finance for:

A. Capital Expenditures

- ✓ *To start a new business*
- ✓ *To construct another Factory (or purchase a machinery) that will double / triple the existing manufacturing capacity*
- ✓ *To purchase / renovate a Sales Office (or Branch) abroad.*

B. Revenue Expenditures

- ✓ *To pay off its wages / salaries, rents, electricity, advertisement & marketing,*
- ✓ *To pay for its raw materials & Inventory*
- ✓ *To service its loans periodically*

SOURCES OF FINANCE

Internal Sources

1. Personal savings
2. 3 F's
3. Trade Credit
4. Retained Earnings
5. Depr./Sinking / Contingency Fund
6. Sale of Assets

External Sources

Equity

1. Angel Investors
2. Incubators
3. Venture Capital
4. Private Equity
5. IPO

Debt

1. Banks
2. NBFC's
3. Micro Finance Institutions
4. Private Lenders

Internal Sources

- ✓ Self Financing
- ✓ 3 F's
- ✓ Trade Credit
- ✓ Retained Earnings
- ✓ Depr./Sinking / Contingency Fund
- ✓ Sale of Assets

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External Sources

✓ Money is taken from an external party (i.e., someone out of the business)

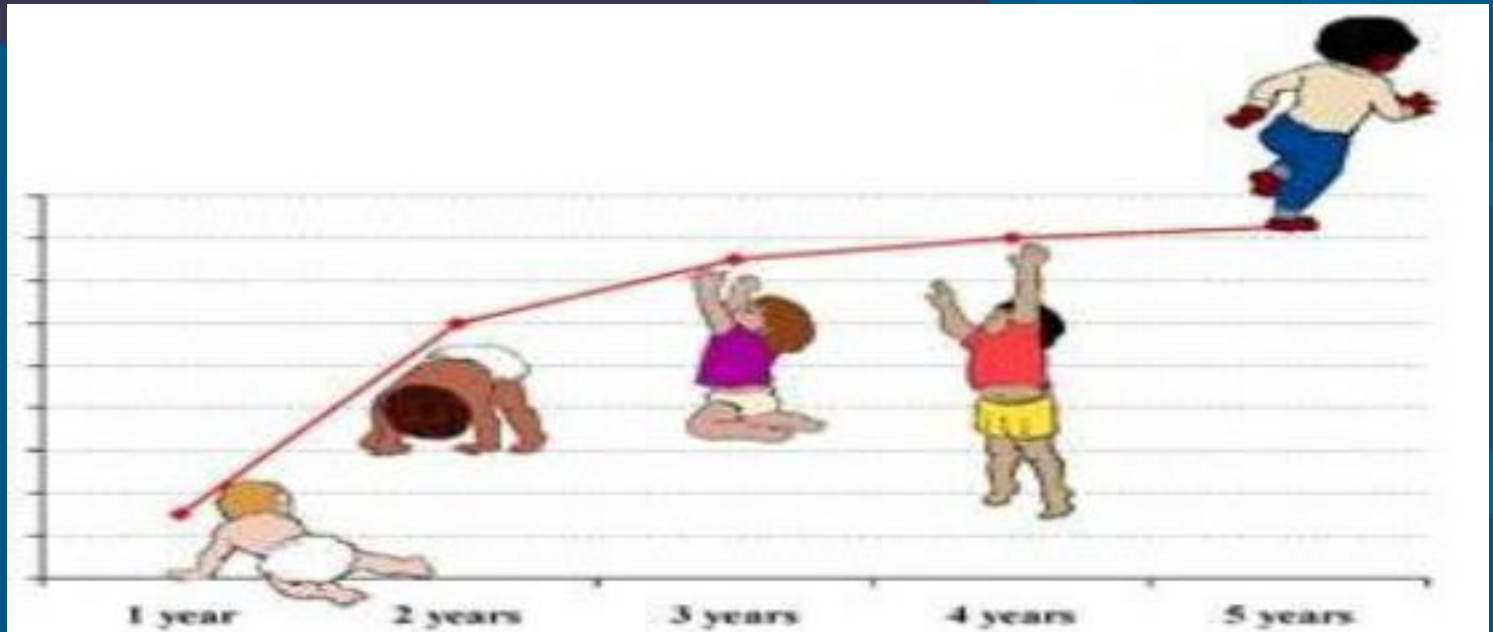
✓ 2 options:

Equity

Debt

Equity:

Stages of Investment



- ✓ **Early Stage**: Pre-revenue (or little revenue) with losses (or little profits)
- ✓ **Development Stage**: Established Revenues with losses (or little profits)
- ✓ **Later Stage**: Established Revenues with large profits

Equity: Stages of Investment

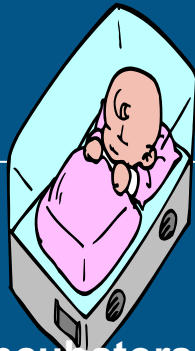
Seed (< \$ 1 mil)

Early Stages (\$1 - 10 mil)

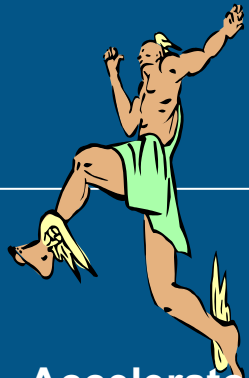
Expansion/ (\$ 10+ mil)
development



Angels



Incubators



Accelerators



Venture Capital



Private Equity &
Merchant Banks

Equity: Stages of Investment

Business Angels:

- ✓ HNI Individuals looking for attractive investment opportunities
- ✓ Have great industry knowledge & contacts
- ✓ Looking for young & aggressive people with a profitable business idea.
- ✓ Bring in small sums of money.
- ✓ Aspire for 10X returns

Equity:

Stages of Investment

Venture Capital:

- ✓ Pooling of capital in the form of limited companies – Venture Capital Companies
- ✓ Looking for investment opportunities in fast growing businesses or businesses with highly rated prospects
- ✓ Great advice, contacts and experience

What do VC's look for:

- ✓ Competent management
- ✓ Competitive edge
- ✓ Growth industry
- ✓ Viable exit strategy

Functioning of VC's



Investor

Investor

Investor

Investor

VC
fund

Startup

Startup

Startup

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P/E's bring in...

- ✓ Financial Advice
- ✓ Corporate Strategy & Direction
- ✓ Sounding board for ideas
- ✓ Challenging status quo
- ✓ Contacts or market information
- ✓ Management recruitment
- ✓ Money !!!!

Shortlisting the right PE

Compatibility:

- Trustworthy
- Collaborative

✓ Can add value (along with bringing money)

- May not be experts in the sector, but have to understand the business.
- Good network of industry contacts.

✓ Investment Horizon

Public Issue

Advantages of an IPO:

- ✓ Ability to raise large amounts of capital
- ✓ Improved corporate image
- ✓ Improved access to future financing
- ✓ Use of stock for acquisitions

Public Issue

Disadvantages of an IPO:

- ✓ Dilution of ownership
- ✓ Loss of control
- ✓ Loss of privacy
- ✓ Reporting to SEBI
- ✓ Filing expenses
- ✓ Accountability to shareholders
- ✓ Pressure for short-term performance

ESC v/s. PSC

Equity Share Capital:

- ✓ Right to Earnings: (PAT – Pref. Dividends)
- ✓ Right to Control: Voting rights

Preference Share Capital

- ✓ Is a hybrid form of financing...payment is after all Debts, but before ESC
- ✓ Equity Feature: Dividends paid out of distributable profits; are not obligatory. They are not tax deductible
- ✓ Debt Feature: Dividend rate is fixed; No voting rights

Debt

Just like shares, DEBTS are also instruments for raising finance.

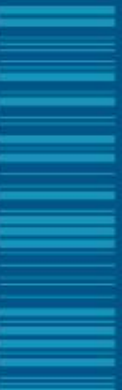
Attributes:-

- ✓ Interest rates
- ✓ Convertibility
- ✓ Security
- ✓ Redemption
- ✓ Credit rating & Trustee
- ✓ Debenture redemption reserve

Sources of Debt

- ✓ Banks
- ✓ NBFC's
- ✓ Micro Finance Institutions (MFI's)
- ✓ Private Lenders

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Debts

Long Term

Home Loan
Car Loan
Machinery Loan
LAS
Mortgage Loans
Structured Financing

Short Term

Fund-Based

CC / OD
Working Capital
Loans
Buyers Credit

Non Fund-Based

LC
BG

Credit Appraisal Process

Teams involved in a Loan Proposal:

- ✓ Business / Relationship Team
- ✓ Credit Team
- ✓ Risk Team
- ✓ Operations Team
- ✓ Policy Team

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Documentation

- ✓ Income Tax Returns along with Financials & Audit Report (3 yrs)
- ✓ Projected Financials
- ✓ Bank Statements (6 mnths)
- ✓ List of Major Debtors & Creditors
- ✓ Monthly Purchases & Sales
- ✓ Net Worth Certificates of Promoter
- ✓ Security Papers
- ✓ KYC Docs:
 - Identity Proof (PAN/Passport)
 - Address Proof (MTNL/MSEB Bill)
 - Certificate of Incorporation with Memorandum & Articles of Association

Security Requirements

- ✓ Primary Security
- ✓ Collateral
- ✓ First charge V/s. Second Charge
- ✓ Personal Guarantee
- ✓ 3rd Party Guarantee

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Post-disbursement

■ Post-disbursement Documentation:

- ✓ End Use Of Funds Certificate
- ✓ Audited Financials

In case of Working Capital Loans:

- ✓ DP Statements (monthly)
- ✓ Quarterly & Half Yearly Reports
- ✓ Annual Stock Audit

Drawing Power (DP)

PARTICULARS	AMOUNT (Rs.in Lakhs)
Working Capital sanctioned by Bank	80.00
Against: Security of Inventory value	100.00
Drawing power	Max.80% of Inventory
Suppose, Actual Inventory on 31 st March	90.00
Drawing Power (DP)	72.00
Suppose, Actual Inventory on 31 st March	120.00
Drawing Power (DP)	???

Non Banking Finance Companies (NBFC)

NBFC's are engaged in the business of :

- ✓ Loans and advances,
- ✓ Leasing, hire-purchase,
- ✓ Insurance business,
- ✓ Chit fund business

NBFCs lend and make investments and hence their activities are akin to that of banks.

However there are a few differences.

Banks v/s. NBFC's

- ✓ NBFCs cannot accept demand deposits (may accept Time Deposits after taking RBI approval).
- ✓ NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself;
- ✓ Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

Loans from NBFC's

Attributes:

- ✓ Higher Interest rates
- ✓ Higher Processing Fees

Products:

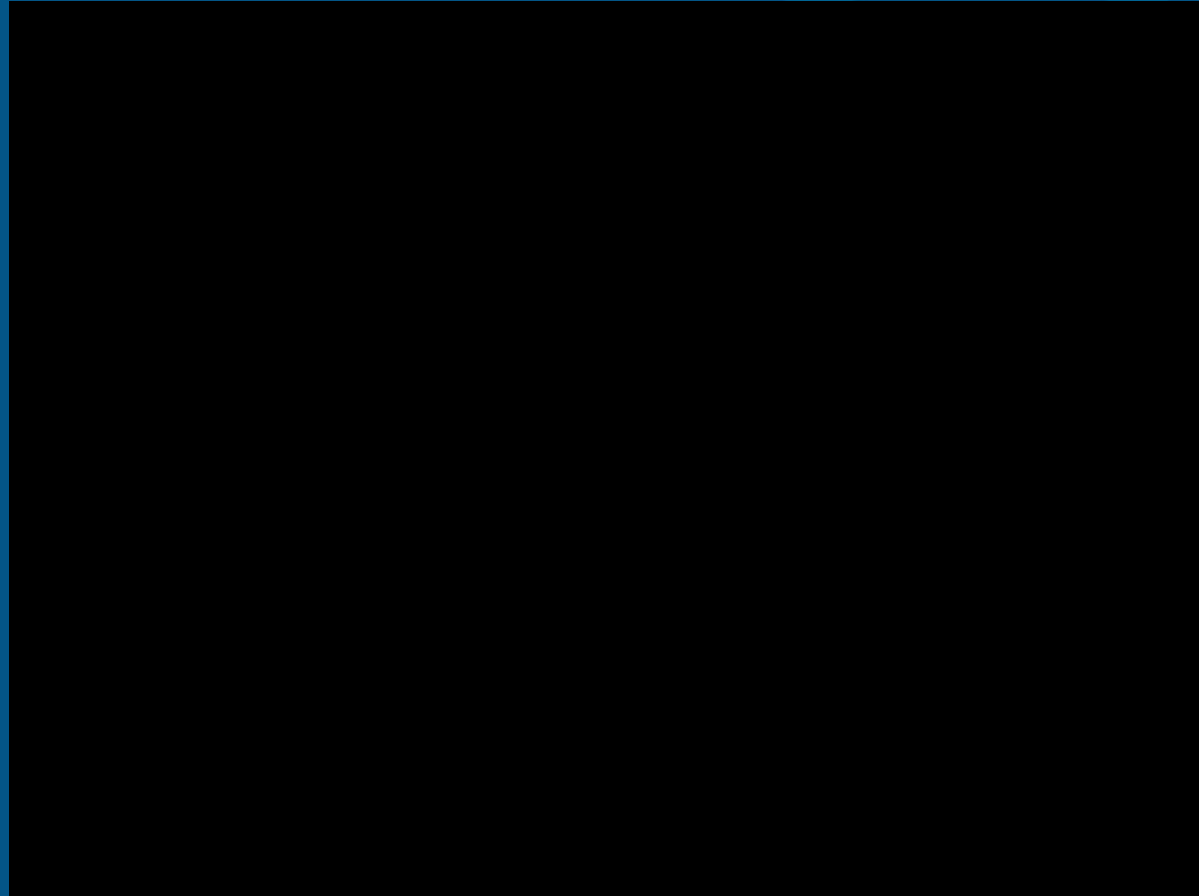
- ✓ Home Loan
- ✓ Car Loan
- ✓ Gold Loan
- ✓ Consumer Loan
- ✓ LAP
- ✓ LAS

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Micro Finance Institutions (MFI's)

MUDRA Yojana 2015

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Thank You

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