

Alternative Sources of Financing

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A man in a dark suit jacket and a blue patterned tie is pulling open a light blue dress shirt. Underneath, a white t-shirt is visible with the letters 'VC' printed in a large, bold, grey font. The man's hands are gripping the edges of the dress shirt, pulling it away from his chest. The background is a plain, light blue-grey color.

VC

*The new superhero
of the modern world.*

WHAT IS VENTURE CAPITAL



Money provided by investors to startup firms and small businesses with perceived long-term growth potential.

FEATURES OF VENTURE CAPITAL

- Long-time horizon
- Lack of liquidity
- High risk
- High-tech
- Equity participation and capital gains
- Participation in management

ADVANTAGES OF VENTURE CAPITAL

- They can provide large sum of equity finance
- Able to bring wealth and expertise to your company
- Easier to secure future funding from other sources
- The business is not obligated to repay the money

DISADVANTAGES OF VENTURE CAPITAL

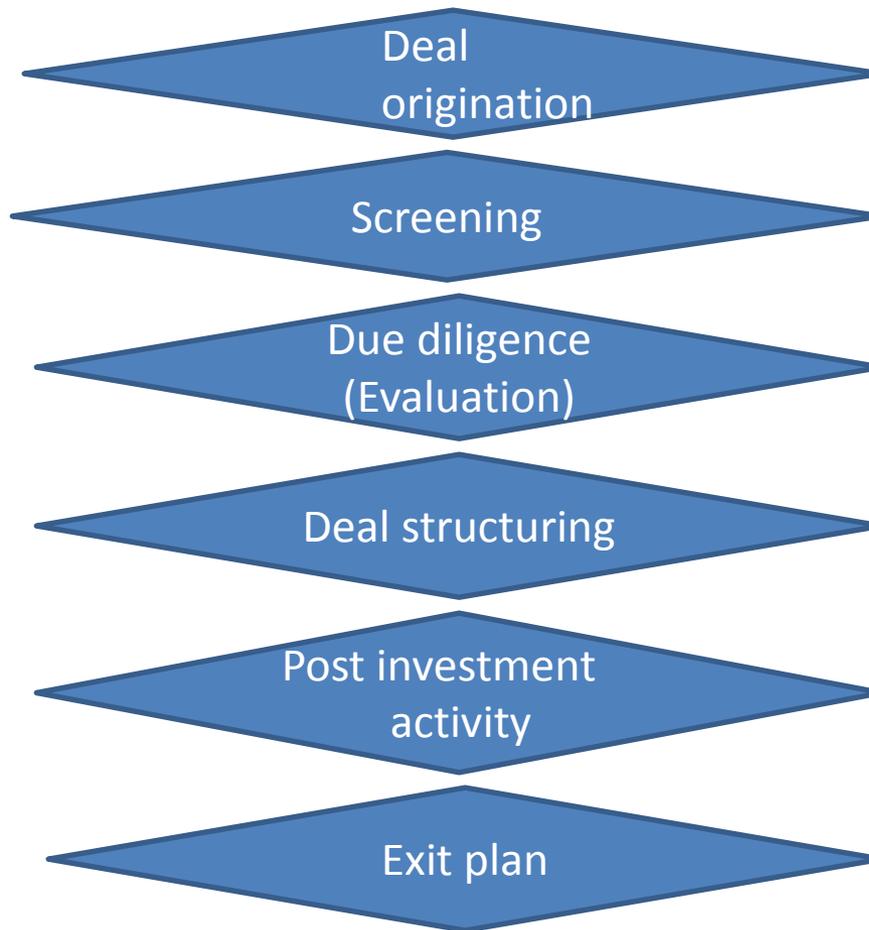
- Lengthy and complex process (needs detailed business plan, financial projections and etc.)
- In the deal negotiation stage, you will have to pay for legal and accounting fees
- Investors become part owners of your business - founder loss of autonomy or control

Stages & Risk of financing

Financial Stage	Period (Funds locked in years)	Risk Perception	Activity to be financed
Seed Money	7-10	Extreme	For supporting a concept or idea or R&D for product development
Start Up	5-9	Very High	Initializing operations or developing prototypes
First Stage	3-7	High	Start commercials production and marketing

Financial Stage	Period (Funds locked in years)	Risk Perception	Activity to be financed
Second Stage	3-5	Sufficiently high	Expand market and growing working capital need
Third Stage	1-3	Medium	Market expansion, acquisition & product development for profit making company
Fourth Stage	1-3	Low	Facilitating public issue

VC INVESTMENT PROCESS



METHODS OF VENTURE FINANCING

The financing pattern of the deal is the most important element.

Following are the various methods of venture financing:

- Equity
- Conditional loan
- Quasi equity

Exit route

- Initial public offer(IPOs)
- Trade sale
- Promoter buy back
- Acquisition by another company

Live Examples





- “In the first meeting, we said we needed Rs. 30 lakh as funding — we were so naïve, we thought this was a huge amount,” says Phanindra Sama.
- But the partner of the VC-fund Mahesh Murthy offered Rs. 3crore.
- Seedfund refused to disclose the profits but it was expected to be over 900%.



For Flipkart, India's largest [internet company](#) by estimated market value, billions seem to be multiplying fast. Soon after announcing a \$1-billion fundraising, the biggest so far by an [e-commerce](#) company in the country, [Flipkart](#) founder & Chief Executive [Sachin Bansal](#) on Tuesday said the next target for his company was entering the \$100-billion valuation club.

That might appear a grand ambition for a company whose estimated valuation after its latest round of [funding](#) is \$7 billion, but Bansal is sure about it. He, however, does not give a timeframe: "The \$100-billion valuation goal could be achieved in five, 10 or 15 years," he says, in a matter-of-fact way.

- Flipkart losses widened to Rs 281 crore in 2012-13 from Rs 110 crore in 2011-12
- Enforcement Directorate has issued a notice to Flipkart seeking Rs 1000 cr penalty for violating rules in its mega sale.
- Basically a pricing scam.



Public Private Partnership

- A business relationship between a private-sector company and a government agency for the purpose of completing a project that will serve the public.
- Used to finance, build and operate projects such as public transportation networks, parks and convention centers.
- Financing a project through a public-private partnership can allow a project to be completed sooner or make it a possibility in the first place.

Why do they come together

Public Sector Strengths	Private Sector Strengths
Legal Authority	Management Efficiency
Balance the competing goal to meet the public needs	Newer Technologies
Capital Resources	Workplace Efficiencies
	Better Cash Flow Management

Advantages of PPPs

- Maximizes the use of each sector's strength
- Reduced development risk
- Reduced public capital investment
- Mobilizes excess or underutilized assets
- Improved efficiencies/quicker completion
- Better environmental compliance
- Improved service to the community
- Improved cost effectiveness
- Shared resources
- Shared/allocated risks
- Mutual rewards

Risk Factors for PPP

- Lack of political leadership, vision and strategy
- Not implemented in a context of wider change/ administrative reform
- Poor costing or lack of resources – creeping commitments
- Inappropriate definition of project goals and scope
- Hurried implementation
- Management of change-resistance from vested interest
- Use of untested fancy technology
- Inadequate attention to monitoring and evaluation

Use of PPP as a source of Finance



HYDERABAD METRO RAIL LIMITED

(A Government of Telangana Enterprise)

- Developed on BOT basis for a period of 35 years.
- Under the concession agreement, the operator has to design, finance, construct, operate, and maintain the corridors and transfer the assets at the end of the concession period.

Total Cost of the Project-11814 crore

Concession Year	Payment
Upfront	₹ 11 crore
Appointment Date	₹ 50 crore
4 th Year	₹ 200 crore
7 th to 9 th Year	₹ 100 crore
18 th to 34 th Year	₹ 1,750 crore
20 th to 35 th Year	1% of the net realisable fare in the 20 th year, 2% of the net realisable fare in 21 st year and so on.

The cost of the project was to be financed with a debt to equity ratio of 2:1. Therefore the consortium had to raise debt of ₹ 7,876 crore and contribute equity of ₹ 3,938 crore without any VGF support.

BOT and similar sources of funding

BOT

- Build–operate–transfer (BOT) or build–own–operate–transfer (BOOT) is a form of project financing, wherein a private entity receives a concession from the private or public sector to finance, design, construct, and operate a facility stated in the concession contract. This enables the project proponent to recover its investment, operating and maintenance expenses in the project.
- Due to the long-term nature of the arrangement, the fees are usually raised during the concession period. The rate of increase is often tied to a combination of internal and external variables, allowing the proponent to reach a satisfactory internal rate of return for its investment.

BOO (build–own–operate)

- In a BOO project ownership of the project remains usually with the project company for example a mobile phone network.

BLT (Build-Lease-Transfer)

- Under BLT a private entity builds a complete project and leases it to the government. On this way the control over the project is transferred from the project owner to a lessee.

DBFO(Design–build–finance–operate)

- Design–build–finance–operate is a project delivery method very similar to BOOT except that there is no actual ownership transfer.

DCMF (design–construct–manage–finance)

- Some examples for the DCMF model are the prisons or the public hospitals. A private entity is built to design, construct, manage, and finance a facility, based on the specifications of the government. Project cash flows result from the government's payment for the rent of the facility.

WHEN IS BOT APPROPRIATE?

In recent years, BOT projects are considered applicable to both developing countries and developed economies. The greatest advantage of BOT for the government is the subcontracting of the majority of the risks to the private sector, with the latter willing to finance and assume risks in the development of a public facility.

Franchising is a method of expanding business on less capital than would otherwise be needed.

For suitable businesses, it is an alternative to raising extra capital for growth.

Under a franchising arrangement, a franchisee pays a franchisor for the right to operate a local business, under the franchisor's trade name. The franchisor must bear certain costs (possibly for architect's work, establishment costs, legal costs, MARKETING costs and the cost of other support services) and will charge the franchisee an initial franchise fee to cover set-up costs, relying on the subsequent regular payments by the franchisee for an operating profit. These regular payments will usually be a percentage of the franchisee's turnover.

Advantages

- The capital outlay needed to expand the business is reduced substantially.
- The image of the business is improved because the franchisees will be motivated to achieve good results and will have the authority to take whatever action they think fit to improve the results.
- The advantage of a franchise to a franchisee is that he obtains ownership of a business for an agreed number of years (including STOCK and premises, although premises might be leased from the franchisor) together with the backing of a large organisation's marketing effort and experience. The franchisee is able to avoid some of the mistakes of many small businesses, because the franchisor has already learned from its own past mistakes and developed a scheme that works.

- **Historical Trading Performance**
- **A Proven System**
- **Branding**
- **Corporate Image**
- **Professionalism**
- **Products and Services with Good Staying Power**
- **Sufficient Profit Margin**

**there are no more
sources of fin...**

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“Other”

Alternative sources
of Financing

Accounts receivable financing

To get around the lag between service and payment, business owners can consider accounts receivable financing, commonly referred to as factoring. With this strategy, small business owners sell their invoices to a third-party factoring firm at a discount, which could be anywhere from 1% to 6% of the invoice's total.

Vendor financing

- An alternative to borrowing funds from a bank is seeing whether a vendor financing agreement can be set up. With vendor financing, a vendor will lend small business owners money to buy their own products. Such a move ensures that the small business owner has the supplies to keep the business going, while the vendor gets the sale

Peer-to-peer lending

www.prosper.com, www.lendingclub.com and www.peer-lend.com let business owners announce what they need and what interest rate they're willing to pay and those who are willing to front the money get to respond. The good thing about peer-to-peer lending sites is that they often provide an easier avenue to cash than a traditional bank, but it's important to note that such sites offer personal loans, even if that loan will be used for business purposes.

Characteristics

- it is conducted for profit;
- no necessary common bond or prior relationship between lenders and borrowers;
- intermediation by a peer-to-peer lending company;
- transactions take place on-line;
- lenders may choose which borrowers to invest in;
- the loans are unsecured and are not protected by government insurance;
- loans are securities that can be sold to other lenders.