Means of finance, i.e. how the business is to be financed

LECTURE – 30 AND 31

20MS2007 - BUSINESS PLAN


Need for Business Finance
To purchase fixed assets
To meet day-to-day expenses
To fund business growth
To adopt modern technology
To fill the gap related to the time between production and recovery sales
To hire services of human resources
To meet contingencies

How the business is to be financed

- Many large-cap companies routinely seek capital infusions to meet short-term obligations. **For small businesses, finding a suitable funding model is vitally important**. Take money from the wrong source, and you may lose part of your company or find yourself locked into repayment terms that impair your growth for many years into the future.
- **Debt Financing** - Debt financing involves borrowing money and paying it back with interest. The most common form of debt financing is a loan
- **Equity Financing** - Equity financing is the process of raising capital through the sale of shares. By selling shares, a business effectively sells ownership in its company in return for cash.
- **Mezzanine Capital** - It is a hybrid of debt and equity financing—similar to debt financing in that you need cash flow to repay the loan, but with repayment terms that are more flexible than conventional debt financing.
- **Funding From Family and Friends** - Crowdfunding. You might take small amounts of money from several family members or close friends, to raise a more significant overall sum. Friends and family investors may be willing to put money into your business venture on an interest-free basis.

Debt Financing

- Debt financing comes from a bank or some other lending institution. Although private investors can offer it to you, this is not the norm.
- When you decide you need a loan, you head to the bank and complete an application. If your business is in the earliest stages of development, the bank will check your personal credit.
- For businesses that have a more complicated corporate structure or have been in existence for an extended period, banks will check other sources.
- If the bank approves your loan request, it will set up payment terms, including interest.

Debt Financing - Advantages

- The lending institution has no control over how you run your company, and it has no ownership.
- Once you pay back the loan, your relationship with the lender ends. That is especially important as your business becomes more valuable.
- The interest you pay on debt financing is tax deductible as a business expense.
- The monthly payment, as well as the breakdown of the payments, is a known expense that can be accurately included in your forecasting models

Debt Financing - Disadvantages

- Adding a debt payment to your monthly expenses assumes that you will always have the capital inflow to meet all business expenses, including the debt payment. For small or early-stage companies that is often far from certain.
- Small business lending can be slowed substantially during recessions. In tougher times for the economy, it can be difficult to receive debt financing unless you are overwhelmingly qualified.

Gautam Adani, Chairman, Adani Group

ADANI GROUP TO CoC

- No intention to delay auction process
- Ensure full transparency
- Want lenders to get maximum value for asset
- Ready to improve its offer
- Bidding document says offers can be revised for any asset during process

DHFL INSOLVENCY
TOP 10 CLAIMS BY BANKS

	Amount (₹ cr)
SBI*	10,083
Bank of India	4,126
Canara Bank	2,682
National Housing Bank	2,437
Union Bank of India	2,378
Canara Bank **	2,228
Bank of Baroda	2,075
Indian Bank	1,553
Central Bank of India	1,398
PNB	1,222

Note: As of Aug 2020; * including SBI Singapore; ** Syndicate Bank

Source: Company website

No	Company	Banker(s)
1		HDFC Bank
2		ICICI Bank
3		IDBI Bank
4		Kotak Mahindra Bank
5		State Bank of India
6	Adani Total Gas	Syndicate Bank
7		Union Bank of India
8		Yes Bank
9		Bank of Baroda
10		Axis Bank
11		Indusind Bank

Equity Financing

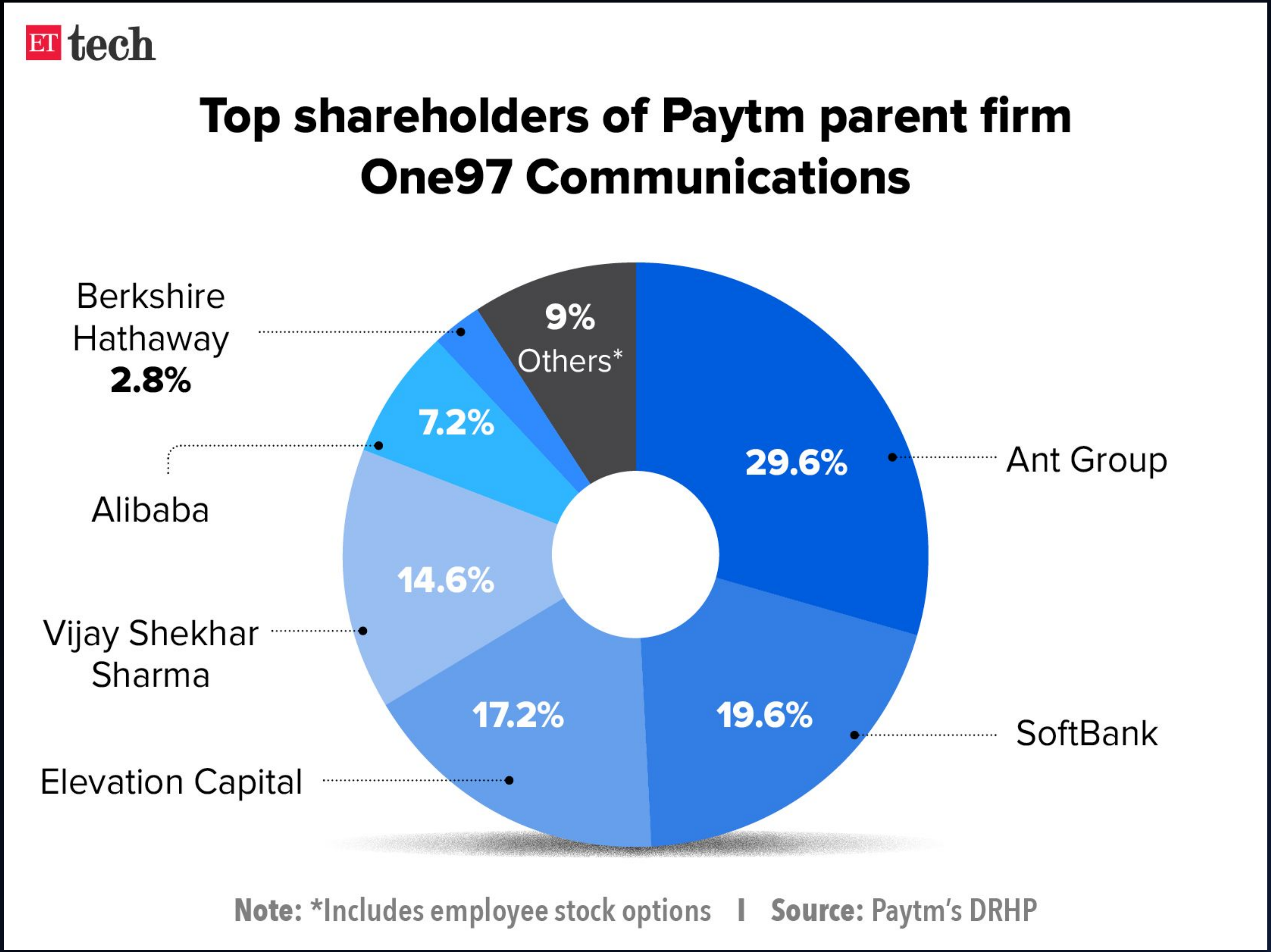
Types

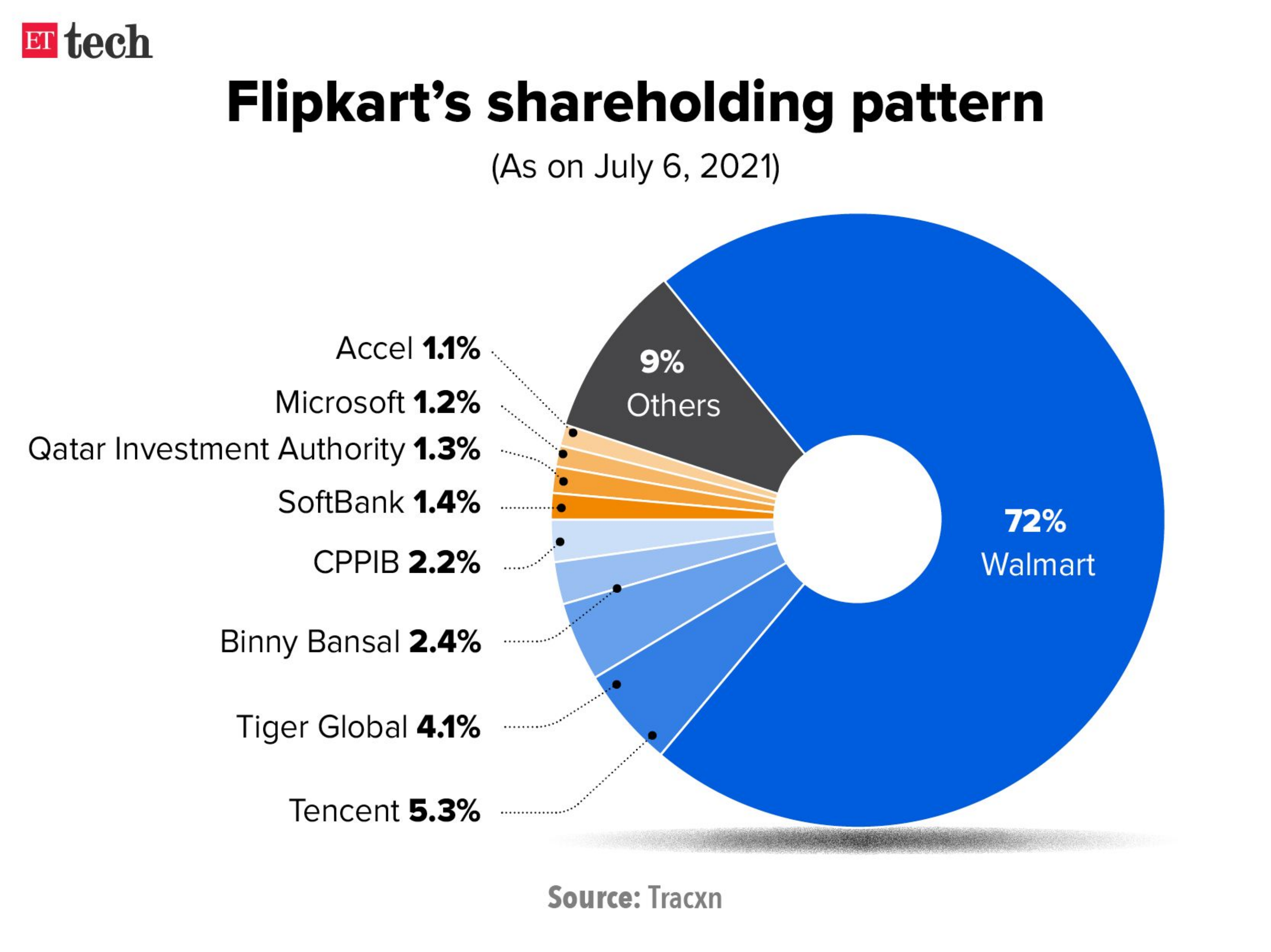
- Angel Investors
- Venture Capitalists
- Crowdfunding
- Initial Public Offering

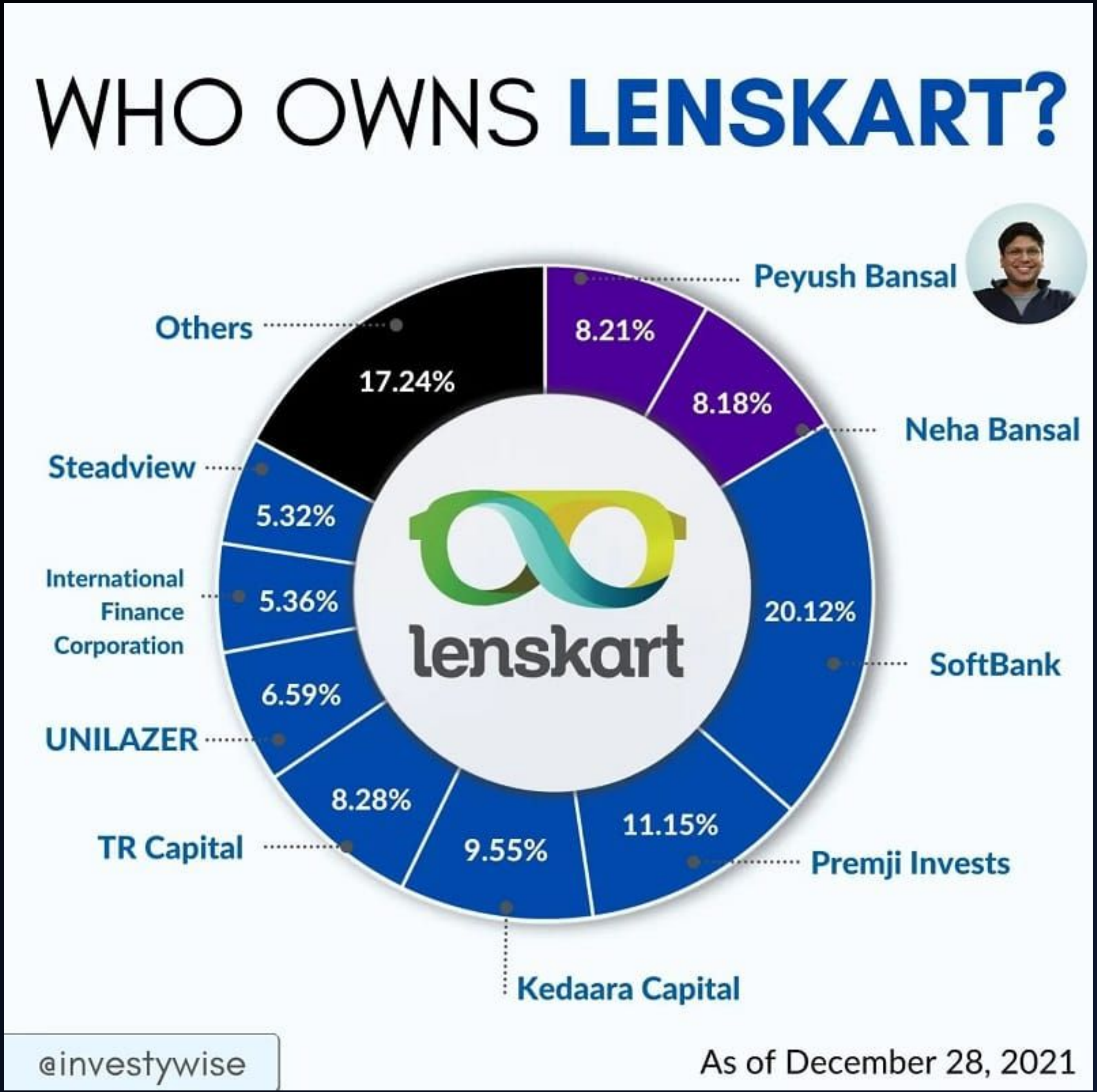
WallStreetMojo

Equity Financing

- A venture capitalist is usually a firm rather than an individual. The firm has partners, teams of lawyers, accountants, and investment advisors who perform due diligence on any potential investment. Venture capital firms often deal in significant investments ($3 million or more), so the process is slow, and the deal is often complex.
- Angel investors, by contrast, are generally wealthy individuals who want to invest a smaller amount of money into a single product instead of building a business. They are perfect for software developer who needs a capital infusion to fund their product development. Angel investors move fast and want simple terms.


ET tech
Top shareholders of Paytm parent firm
One97 Communications
9%
Others*
Berkshire
Hathaway
2.8%
7.2%
Alibaba
29.6%
Ant Group
14.6%
Vijay Shekhar
Sharma
17.2%
19.6%
SoftBank
Elevation Capital
Note: *Includes employee stock options I Source: Paytm's DRHP


ET tech
Flipkart's shareholding pattern
(As on July 6, 2021)
Accel 1.1%
Microsoft 1.2%
Qatar Investment Authority 1.3%
SoftBank 1.4%
CPPIB 2.2%
Binny Bansal 2.4%
Tiger Global 4.1%
Tencent 5.3%
9%
Others
72%
Walmart
Source: Tracxn


WHO OWNS LENSKART?
Peyush Bansal
8.21%
Others
17.24%
8.18%
Neha Bansal
Steadview
5.32%
lenskart
International Finance Corporation
5.36%
20.12%
SoftBank
6.59%
UNILAZER
8.28%
11.15%
TR Capital
9.55%
Premji Invests
Kedaara Capital
@investywise
As of December 28, 2021

Equity Financing - Advantages

- The biggest advantage is that you do not have to pay back the money. If your business enters bankruptcy, your investor or investors are not creditors. They are partial owners of your company and, because of that, their money is lost along with your company.
- You do not have to make monthly payments, so there is often more liquid cash on hand for operating expenses.
- Investors understand that it takes time to build a business. You will get the money you need without the pressure of having to see your product or company thriving within a short amount of time.

Equity Financing - Disadvantages

- When you raise equity financing, it involves giving up ownership of a portion of your company. The more significant and riskier the investment, the more of a stake the investor will want. You might have to give up 50% or more of your company. Unless you later construct a deal to buy the investor's stake, that partner will take 50% of your profits indefinitely.
- You will also have to consult with your investors before making decisions. Your company is no longer solely yours, and if an investor has more than 50% of your company, you have a boss to whom you have to answer.

Mezzanine Capital

- Mezzanine capital often combines the best features of equity and debt financing. Although there is no set structure for this type of business financing, debt capital often gives the lending institution the right to convert the loan to an equity interest in the company if you do not repay the loan on time or in full.

Mezzanine Capital - Advantages

- This type of loan is appropriate for a new company that is already showing growth.
- Banks may be reluctant to lend to a company that does not have at least three years of financial data.
- However, a newer business may not have that much data to supply.
- By adding an option to take an ownership stake in the company, the bank has more of a safety net, making it easier to get the loan.

Mezzanine Capital - Disadvantages

- The coupon or interest is often higher, as the lender views the company as high risk. Mezzanine capital provided to a business that already has debt or equity obligations is often subordinate to those obligations, increasing the risk that the lender will not be repaid. Because of the high risk, the lender may want to see a 20% to 30% return.
- Much like equity capital, the risk of losing a significant portion of the company is genuine.

Funding From Family and Friends

- If your funding needs are relatively small, you may want to first pursue less formal means of financing.
- Family and friends who believe in your business can offer advantageous and straightforward repayment terms in exchange for setting up a lending model similar to some of the more formal models.
- For example, you could offer them stock in your company or pay them back just as you would a debt financing deal, in which you make regular payments with interest