



**FirstRanker.com**

FirstRanker's choice

[www.FirstRanker.com](http://www.FirstRanker.com)

[www.FirstRanker.com](http://www.FirstRanker.com)

# **F.S Unit - 5**

## **Venture Capital, Micro Finance & Credit Rating**

## Venture Capital

- Venture capital is the capital that is available to finance a new venture
- The venture capitalist earns his returns primarily in the form of capital gain
- Generally V.C finance new firms/new ideas and entrepreneurs
- V.C does not involve financing the enterprise which is engaged in trading, broking, investment or financial services and agency
- It is generally considered as high risk capital
- It is not only capital but generally injection of a lot of management, marketing, strategies, management etc
- Origin of venture capital
- Bank of England defines Venture capital as:  
“Venture capital investment is defined as an activity by which investors support entrepreneurial talent with financial resources and business skills to exploit market opportunities and the potential for long term capital gains”

## Features of Venture capital

- New ventures - use new technology, produce new products, high expectation of high gains
- Continuous involvement - by providing loans or managerial assistance
- Mode of investment - equity financing method or loan financing
- Wealth maximisation - capital gain or regular return on debt
- Hands-on approach - value added services – skills, management, investment
- High risk- return ventures - huge capital gain at the time of exit
- Nature of firms - Small and medium – new, high technology oriented firms
- Liquidity – depends on success of new venture product.

## **Objectives venture Capital**

- Encourage technology and its commercial application
- Adopt the imported technology to suit the Indian environment
- Setting up of pilot projects
- Technological innovations and modernisation
- Developing appropriate technology
- Meeting the cost of market surveys and market promotion programmes

## Private Equity

- Investments in equity of private companies and public limited company
- They may invest in private placement offers of limited companies
- Highly illiquid investments and gestation period is high.
- Usually tend to engage in management of the firms
- Differs from venture capital with respect to stage of development of the firm in which they invest. VC comes in early at seed/start-up stage while PE comes in at later stage investments.

## **Investment Banking perspective in Private Equity**

- Deal Origination
- Due diligence
- Deal negotiation
- Deal closing
- Post-acquisition monitoring
- Exit
- Repeat

## **Private Equity VS Venture capital**

- Meaning
  - Type of investment
  - Company type
  - Percentage acquired
  - Size
  - Structure
  - Stage
- 
- Risk and Return



## **Micro Finance**

- Provision of financial services to poor income groups including consumers and employed
- Services include loans, insurance, deposits for poor entrepreneurs who would not qualify for bank finance
- According to NABARD, microfinance is “provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi urban or urban areas enabling them to raise their income level and improve living standards”



## Characteristics of Micro Finance

- Is a part of rural finance and a developmental tool
- Deals with small loans meant for working capital
- Informal appraisal of borrowers and investments is done
- MFIs go to clients
- Procedure for loan is very simple
- Rate of interest is reasonable
- No restrictions on purpose of loan
- Repayment through income from business and other sources
- Number of accounts are manageable
- Collateral substitutes – Group or relationships
- Access to repeat loan depends on repayment performance
- Provides an opportunity for self employment
- It is more service oriented and less profit oriented





## **Future and growth of Micro Finance**

- Micro finance has been a major success and is growing across country
- Helped in providing social and economic empowerment
- But eradication of poverty is difficult by itself
- Good governance, security, health, education and social inclusion work hand-in-hand in eradication of poverty
- Availability of credit may be a trigger for growth
- MFIs operate in 588 districts in India spread across states
- 166 MFIs with a branch network of 12,221 employees reached out to an all time high of 39 million clients with outstanding loan portfolio of Rs 63,853 crore.
- The average loan outstanding per borrower stood at Rs 11,425 and 94% of loans were used for income generating purposes.



## **Advantages of Micro Finance**

- Financial services are made available to poor people.
- Microfinance helps in the development of an economy by giving the chance to establish a sustainable means of income.
- Promotes community building and mutual accountability.
- A culture of responsibility and encouragement can be fostered.
- Microfinance programmes can be self-funding.
- Taking out loans, buying insurance, and saving money teaches people how to be future oriented.
- Microfinance helps women. Almost all micro-borrowers are women, who develop home businesses. Women are generally more responsible than men. They use their profits to feed their families, educate their children, instead of spend more on booze and gambling.

## Dis-advantages of Micro finance

- Some borrowers have become dependent on loans for expenditures rather than capital investments.
- There are some microfinance institutions charging excessive rates.
- Studies of micro-credit programs have found that women often act as collection agents for their husbands and sons, such that they spend the money on themselves while women are burdened with credit risk.
- Microfinance helps women. That's good, but not good enough to transform communities. Communities are formed of equal men and women, who have a strong affinity for forming bonds with each other. Development that helps women but doesn't include men has a natural self-limitation.
- Microfinance is small scale. Small businesses become micro-businesses sometimes. But more often they don't.
- Some argue that there's too much focus on microfinance and that it be motivating less spending in other helping assistances such as health, welfare and education.



## Credit Rating

- Credit rating refers to assessment of the credit worthiness of individuals and corporations. It is based on history of borrowings, payments as well as availability of assets and liabilities.
- Credit rating started in USA in 1909 by John Moody and spread across the globe
- In India it started in 1993 by the establishment of CRI (Credit Rating Information Services of India Ltd.)
- Followed by establishment of IICRA (Investment Information Credit Rating Agency) promoted by IFCI
- Credit Analysis and Research (CARE) as a subsidiary of IICRA in 1995
- Duffs and Phelps Credit Rating (DCRI) was established as an NBFC for fixed deposits in 1995
- According to Moody "Credit rating is an opinion on the creditworthiness and legal obligation of the issuer to make timely payments of principal and interest on a specific fixed income security."
- Rating is represented by an alphabetical symbol like AAA, AA, A, etc



## Features of credit Rating

- **Based on information:** It is based on published information with certain limitations. Privileged and confidential information is handled internally which decides success of rating system
- **Many factors affect rating:** There is no formula. Rating is based upon many factors like management quality, corporate performance, economic outlook, international environment. Committee of experts in finance and rating.
- **Rating by more than one agency:** Debt issues are usually rated by two or more agencies and the ratings may differ e.g AA, AA+ or AA-
- **Monitoring the already rated issues:** Agencies have to monitor the debt servicing capabilities on a periodic basis and upgrade/downgrade as required.
- **Publication of ratings:** Ratings done at the behest of issuer are accepted and then published. Changes have to be made as required irrespective of acceptance
- **Right to appeal:** Issuer can furnish additional relevant information and appeal for a revision which the rating agency will consider.
- **Rating of rating agencies:** Rating agencies are assessed on the basis of public opinion based on quality of services offered, cost and integrity.

- **Rating is for the instruments and not the company:** Instruments issued by the same company may have different ratings depending upon term, guarantees, etc.
- **Rating is not applicable to equity shares:** There is no obligation of servicing of debt in equity context and hence no rating is done.
- **Credit v/s financial analysis:** Rating is much broader than financial analysis. Rating is done by experts based on a number of factors.

## Objectives of Credit Rating

- To restore the Confidence in capital market
- Provides assessment of credit worthiness
- Information to investors
- Provide a basis for risk-return decision
- Helps in framing public policy guidelines for institutional investments



## **Types of Credit Rating**

- Financial instruments rating including bank deposits and Commercial papers
- Customer rating refers to assessment of creditworthiness of customers to whom goods are sold on credit
- Borrower rating is to assess the ability of a borrower to repay the debt. If the borrower is a country the evaluation of creditworthiness of such country is made referred as sovereign rating.

## **Benefits of Credit Rating**

### **For investors**

- Information service
- Systematic risk assessment
- Professional competency
- Easy to understand
- Low cost
- Efficient portfolio management
- Information and research

### **For the Company**

- Easy to raise resources
- Reduced cost of borrowing
- Reduced cost of public issues
- Builds up image
- Facilitates growth
- Recognition to unknown companies

## **Credit Rating Information Services of India Limited (CRISIL)**

- The Credit Rating Information Services of India Limited was promoted in 1987 by ICICI and UTI. It has its head office in Mumbai.
- The principal objective is to rate debt obligation of Indian companies.
- The rating provides guide to the investors as to the degree of certainty of timely payment of interest and principal on a particular debt instrument.
- CRISIL's business operates from 8 countries including Argentina, Poland, UK, India, China, Hong Kong and Singapore.

### **Services offered by CRISIL**

- Credit Rating Services
- Advisory Services
- Training Services

### **Link for you tube video**

<https://www.youtube.com/watch?v=J2THOI-IF6U>

## **Credit Rating Agencies**

### **Investment Information and Credit Rating Agencies of India**

- CARE was incorporated on April 21, 1993, and commenced its operations in October, 1993.
- It undertakes rating of all types of debt instruments like commercial paper, fixed deposits, bonds, debentures, and structural debt, involving an independent and professional assessment of debt capabilities of companies.

### **Onida Individual Credit Rating Agency (ONICRA)**

- A private company, Onida Individual Credit Rating Agency has been set up by Onida Finance.
- It undertakes rating for credit cards, leasing, hire/purchase transactions, housing finance, and bank finance.
- The main objective of these agencies is primarily to restore the confidence in the capital market and to provide unbiased assessment of creditworthiness of the companies issuing debt instrument

## **Duff Phelps Credit Rating (DPCR)**

- Duff Phelps Credit Rating India Pvt. Ltd. Is another sector credit rating agency set up in 1996.

## **Fitch Ratings**

- Fitch Ratings India Ltd. Is the latest agency to do rating from the foreign sector.
- In addition to debt instruments, it also rates companies in various countries on request.

## **Brickwork Rating**

- Brickwork Rating Private Ltd was initiated in the year 2000 by Sangeeta Kulkarni, the company was formed with the main task to rate credits.
- The top rated areas of operation for the company are for NSD, Commercial Papers, MSME rating based on interest payment of debtors.

## **Rating Symbols for different Companies**

- The rating symbols are symbolic expressions of the opinion of the credit rating agency regarding the investment credit quality, grade of the debt, obligation, instrument, etc.
- Separate symbols have been assigned for long-term and short-term instruments.



Rating for FDs	CRISIL	ICRA	CARE
Highest Safety	FAAA	MAAA	CARE AAA
High Safety	FAA	MAA	CARE AA
Adequate Safety	FA	MA	CARE A
Moderate Safety	-	-	CARE BBB
Moderate Default Risk	-	-	CARE BB
High Default Risk	FB	MB	CARE B
Very High Default Risk	FC	MC	CARE C
Default	FD	MD	CARE D





## Credit Rating Symbols(For Long Term Instruments)

CRISIL	ICRA	CARE	FITCH	Meaning
CRISIL AAA	LAAA	CARE AAA	AAA	Highest Safety
CRISIL AA	LAA	CARE AA	AA	High Safety
CRISIL A	LA	CARE A	A	Adequate Safety
CRISIL BBB	LB	CARE BBB	BBB	Moderate Safety
CRISIL BB	LBB	CARE BB	BB	Moderate Risk
CRISIL B	LB	CARE B	B	High Risk
CRISIL C	LC	CARE C	CCC, CC & C	Very High Risk
CRISIL D	LD	CARE D	D & RD	Default