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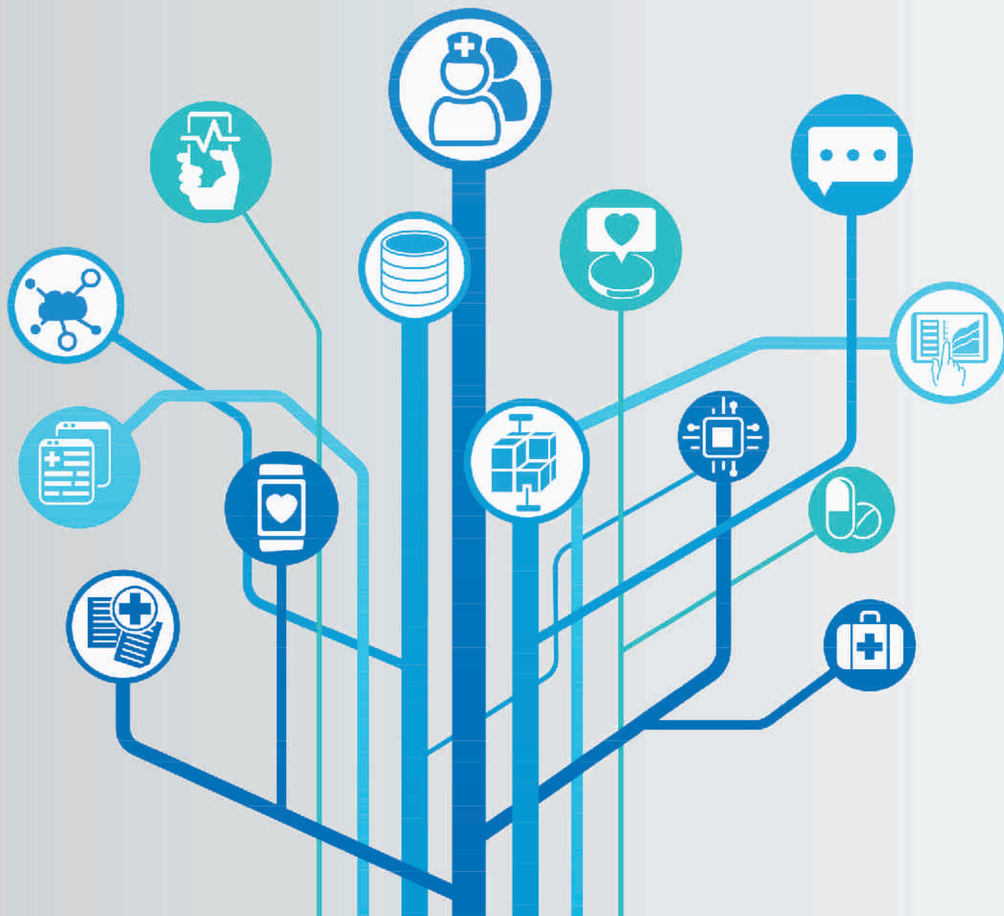

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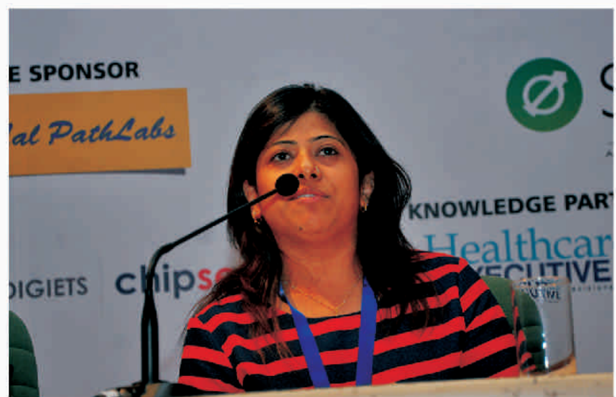

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Before raising Fund for Business in Healthcare

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Author explains the finer details of raising capital for your healthcare startup!

Fund is lifeblood of any business activity. It is required irrespective of the level of business activities, a startup stage to a grown up stage. In case of healthcare sector, funding plays a very important role as a right decision in funding may result in lower cost of operation which can be passed on to the ultimate user, making the healthcare products or services affordable to a large number of people in the society. It also helps in sustainability of the business in long run.

Types of funding and its implications on business

For a business in healthcare, funds can be raised either as capital or as debt. The capital is the permanent source of funding in the business. Even though the contributor of the capital does expect the return, it is not compulsory to pay him / her on annual basis. If the business makes profit, then only they get the return, else not. The contributor of the capital gets the ownership right of the business and hence it is utmost important to use the capital judiciously, as the capital from an investor reduces the stake of the entrepreneur.

The funds raised through debt can either be short-term or long-term. Periodically or at the end of the tenure, the debt has to be repaid and every year an interest has to be paid to the lender, irrespective of the profit earned. Normally, for raising debt, some primary security is needed. When debt is raised, the cost of interest becomes inevitable for the business. The lender, the provider of debt, does not get ownership right in the business. Hence it is advisable to raise the debt only when the business has very definite revenue stream.

Assessing requirements of funding

For the business activities, assessing the requirement of funding is not only important but also very essential, as mistakes on either side will prove detrimental to the business. The under-estimation of requirement of funds will create liquidity crunch bringing the business to a grinding halt. On other hand, over-estimation of requirement of funds will affect the cost of operation adversely. The assessment should be bifurcated into two main categories namely requirement for fixed asset and requirement for working capital.

1. The requirement of fixed assets is a long term requirement and hence it should be met with from the long term sources like equity and long term debt,
2. The requirement of working capital is a short-term requirement, which can be ideally met with short term but renewable sources like cash credit (C/C) facilities from the bank.

Sourcing the right type of funding

Fund is one of the ingredients for business activity and not the only factor for the success of business. The entrepreneur's capability to execute the business idea is very important for a successful business. If he / she is ready to bear the cost of fund, and is able to explain the value-creation by the business to the investor or lender, availability of the fund will not be a problem.

In business the proper combination of capital, debt and hybrid capital is very important since it has a lasting impact on liquidity position of the business and promoters' stake in the business. The right mix of

capital and debt will help the business not only at initial stage but at the growth stage as well. The source of fund, which has the characteristics of capital and debt both, is known as hybrid capital e.g. Redeemable Preference Shares (RPS). The medium to long term RPS serves the purpose of capital without diluting the stake, proving very beneficial to the entrepreneur. When the business starts earning profit, the RPS can be redeemed from the accumulated profit or raising another round of capital can redeem it. The return on RPS is by way of dividend meaning there-by if there is profit in the business, the dividend will be paid and not otherwise. This helps in preventing fund drainage if the business does not generate profit.

Investors' and Lenders' Expectation

Investors provide capital and lenders provide debt to the business entity. By providing capital, the investors participate in the risk of business against which they expect business ownership right and profit share. The lenders provide the debt normally against some security and hence the risk on the part of lender reduces to a great extent and as a result, usually they are happy with a fixed return per annum. While approaching investor or lender, the entrepreneur has to share the business plan which should be fairly achievable. The transparency in providing business information periodically is highly appreciated by investors and lenders.

Cost of Fund

It is very imperative on the part of entrepreneur to understand the cost implications of raising the fund on profit. When the capital is raised, return is paid to the investor by way of dividend, whereas, when debt is raised return is paid to the lender by way of interest. Dividend is considered as distribution of profit but interest is considered as expense of the business, so before paying dividend, income tax has to be paid.

The following illustrations below will explain this concept explicitly.

Table 1: Example calculation to explain the difference between Capital and Debt.

Particulars	Capital (Scenario 1)	Debt (Scenario 2)
Fund raised	100	100
Rate of return		
By way of dividend	16%	
By way of Interest		16%
Profit before return to investor / lender	50	50
Interest	-	16
Profit before Tax (3-4)	50	34
Income Tax (@ prevailing rate 33%) (5*33%)	16.5	11.55
Profit after Tax (5-6)	33.5	22.45
Dividend	16.0	-
Dividend Distribution Tax (@ prevailing rate 20%) (8*20%)	3.2	-
Profit left in the business (7-8-9)	14.3	22.45

Note: Calculations as per the Indian Tax Law.

When equal amount is raised at equal rate of return by way of capital and debt, everything remaining the same, in case of debt profit left in the business is more than in case of capital because of tax implication. It is necessary to mention that a right mix of capital and debt is required in the business even though, from the above illustration, the debt looks lucrative. Without capital base in the business, raising debt will not be possible.