



## MEZZANINE FINANCING INSTRUMENTS IN COMPARISON TO THE CLASSIC FINANCING SOURCES

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**Abstract.** The paper deals with innovated financing in the form of mezzanine financing instruments (sources). The authors aimed to identify, characterize, and assess mezzanine financing instruments in comparison to the classic corporate financing sources. Mezzanine financing represents an innovated form of financing interconnecting the features of equity and debt. The paper specifies the sources and characterizes and assesses pros and cons of each of them. Subsequently, it presents an overall evaluation of mezzanine financing instruments in comparison to the selected equity and debt financing sources. This evaluation was performed on the basis of 14 set criteria using a binary scale.

**Keywords:** corporate financing sources, mezzanine, equity, debt, Czech Republic.

**JEL Classification:** G10, G32, M21.

### Introduction

In the today's demanding economic world conditions, where businesses are threatened by strengthening competitors, especially from Asian countries, where the growing public budget deficits result in the growing tax burden of all economic entities, utilization of unconventional economic tools, procedures and practices is a prerequisite for the prosperity and future existence of businesses. We can meet them in all areas of corporate activities, where they represent, on the one hand, an opportunity for businesses and, on the other hand, they might also become a significant threat.

From the point of view of corporate financing, the innovated tools include mezzanine financing instruments (sources). Mezzanine financing instruments represent a hybrid form of financing, interconnecting the features of classic long-term financing sources in the forms of equity and debt. Although some mezzanine financing sources were first used in the USA as early as in the 80's of the 20th century and then in Europe in the 90's, they still have not seen broad utilization in a number of countries, see more e.g. in (Amon & Dorfleitner, 2013; Dec & Masiukiewicz, 2017; Knežević, Ljumović, & Pavlović, 2015; Sazanov et al., 2016; Svedik & Tetrevoval, 2014b).

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The question is what mezzanine financing instruments are offered by the financial market, or what specific features, advantages and disadvantages these instruments have. The authors of this paper aimed to identify, characterize, and assess mezzanine financing instruments in comparison to the classic corporate financing sources.

The fact is that the economic situation and competitiveness of economic entities is strongly affected by their financial structure. The structure of financial sources, particularly the capital structure, i.e. the structure of financing sources intended to cover long-term investment activities, determines the ability to respond quickly and accurately to the permanently changing market conditions, which subsequently leads to the extended creation of financial sources. It is also necessary to assess whether mezzanine financing sources represent a feasible opportunity for businesses and offer them something extra compared to classic financial sources.

## **1. Literature review and hypotheses**

Mezzanine financing (or mezzanine capital or just mezzanine) represents an omnibus term for hybrid forms of financing that have both the features of equity and the features of debts (Amon & Dorfleitner, 2013; Bondarenko, Maksimova, & Zhdanova, 2016; Shen, Xu, & Yang, 2016; Svedik & Tetrevova, 2012). These sources are inserted into the company's capital structure between the "floor" of equity and the "ceiling" of senior debt (Anson, Fabozzi, & Jones, 2010). They can be of various forms. According to Silbernagel and Vaitkunas (2008), mezzanine capital includes senior subordinated debt, convertible subordinated debt and redeemable preferred stocks. According to the European Commission (EC, 2007), Vasilescu (2007, 2009, 2010), or Tetrevova (2009) they are subordinated loans, participating loans, silent participation, profit participation rights, convertible bonds and bonds with warrants. On the basis of the above, we can state that mezzanine financing instruments include silent participations, preferred stocks, participating loans, participating bonds, subordinated loans, subordinated bonds, convertible bonds and bonds with warrants.

The above mezzanine financing instruments can be classified from the point of view of the corporate balance or from the point of view of public tradability. From the point of view of the corporate balance, we can differentiate equity mezzanine, including mezzanine financing instruments with a higher rate of equity, and debt mezzanine, including mezzanine financing instruments with a higher debt tendency (Dec & Masiukiewicz, 2017; Golej, 2016; Meluzin & Zinecker, 2009). From the point of view of public tradability, it is possible to distinguish private mezzanine, including mezzanine financing instruments that do not enter the open capital market, i.e. which are not publicly tradable, and public mezzanine, including mezzanine financing instruments that are publicly tradable on the capital market (Haldia & Mittal, 2015; Oncioiu, 2012; Tetrevova, 2009; Vasilescu, 2010).

Equity mezzanine includes silent participations and preferred stocks. The reason why they have been included in this mezzanine category is the fact that these instruments are, in the corporate financial structure, a part of the equity capital, but they do not fulfil one or more basic characteristics of equity, e.g. the right to take part in the management of the company or nonpayability of the given source (Meluzin & Zinecker, 2009; Svedik & Tetrevova, 2014b).

Silent participation represents capital investment in the company, where the silent partner shares profits or losses, but not the company management itself (Comino, Nicolò, & Tedeschi,

2010; Ernst & Häcker, 2012). This partnership is conditional on a special type of agreement on the basis of which the company is obliged, within a specified period, to return the investment to the silent partner (Svedik & Tetreva, 2014a). Therefore, it is a property contribution (a feature of equity), but it is necessary to redeem this contribution within a certain period and it does not include any voting rights (typical features of debt) (Svedik & Tetreva, 2012).

Preferred stocks represent securities confirming the investors share in the corporate assets. They are connected with the priority right to a share in profits in the form of dividends, which are usually fixed, and also with the priority right to a share in the liquidation balance; however, the holder of this security has no right to take part in the company management (Kallberg, Liu, & Villupuram, 2013; Ravid et al., 2007). By issuing preferred stocks, businesses increase their equity capital, but the existing proportions of the company owners' voting rights do not change (Rejnus, 2011). Therefore, this is also a case of a property contribution (a feature of equity). However, preferred stocks are not connected with any voting rights, their yields are fixed in advance, and they often become mature as at a certain date (typical features of debt).

Debt mezzanine includes participating loans, participating bonds, subordinated loans, subordinated bonds, convertible bonds, and bonds with warrants. The reason why they have been included in this mezzanine category is the fact that these instruments are, in the corporate financial structure, a part of the debt, but they also have some features that are typical for equity (Svedik & Tetreva, 2014b).

Participating loan represents an analogue of a classic bank loan, but in this case, the loan provider's yield depends on the economic result of the company (van Gelder & Niels, 2013; Mütze, Senff, & Möller, 2012). This instrument is thus connected with the feature typical for equity in the form of investment of an owner that is connected with yields depending on the company's economic results (Franke & Hein, 2008). However, participating loan comes into existence on the basis of a loan agreement that does not establish any ownership rights relating to the company, and so its provider is in the position of a creditor. Another difference compared to equity is that the amount of payment for the loan is defined in the loan agreement, while the amount of the dividend is determined on the basis of a decision made by the general meeting (Sanders, 2013). Another difference is in the way of sharing the liquidation balance of the company, where the providers of participating loans share the liquidation balance in the same manner as the other creditors, and so they have priority, in this respect, over the company owners (Helminen, 2010).

Participating bond is an analogue of participating loan and represents corporate bond whose yield depends on the economic result of the issuer and is determined as a share in profits specified in advance (Johnson, 2010). This debt financing source has, in this respect, features that are similar to those of the equity financing sources (Hutchison et al., 2016; Svedik & Tetreva, 2015). Unlike the stockholders, the holders of these securities are in the position of a creditor. Moreover, the coupon payments from participating bonds are not determined on the basis of a decision made by the general meeting, but on the basis of pre-defined rules specified in the issue conditions. In the case of winding-up, the holders of participating bonds share the liquidation balance in the same manner as the other providers of debt capital, i.e. they are satisfied prior to the company owners (Svedik & Tetreva, 2014a).

Subordinated loans represent loans whose providers are entitled, in the case of bankruptcy of the company, to settlements only after settlement of any liabilities towards the providers of senior debts and other creditors (Conlon & Cotter, 2014; Mäntysaari, 2010). The providers of the equity capital are then paid off after the creditors providing subordinated debt (Lasher, 2011). At the same time, subordination is a reason for classification of these loans among mezzanine financing instruments; the thing is that it is a feature typical for the equity capital (Ernst & Häcker, 2012).

Subordinated bonds represent corporate bonds connected with the right to settlement of liabilities (redemption of the nominal value and disbursement of the adequate yield) in the case of winding-up only after settlement of liabilities towards any other creditors, except liabilities with the same condition of subordination (Conlon & Cotter, 2014; Svedik & Tetrevova, 2015). At the same time, the holders of subordinated bonds are satisfied before the providers of the equity capital (Iannotta, 2010). Also, in this case, the subordination, which is typical for the equity capital, is a reason for classification of subordinated bonds among mezzanine financing instruments (Svedik & Tetrevova, 2014b).

Convertible bond combines both the rights connected with holding of a classic bond and the rights to exchange this bond for another security of the given issuer (Batten, Khaw, & Young, 2013; Zhang, 2016). In view of the characteristics of mezzanine financial sources, convertible bonds are understood as bonds exchangeable for certain property securities, i.e. for common or preferred stocks. Such convertible bonds combine the features of equity and debt financing sources. An exchange of convertible bonds for stocks is made possible for the investor through purchase option, attached to the bond (Koller, Goedhard, & Wessels, 2010; Madura, 2011; Strobel, 2012). This option entitles the holder of the convertible bond to make a decision to exercise the conversion right as at the specified date and thus get stocks of the given company, or not to exercise the conversion right and receive the nominal value of the bond (Stickney et al., 2010).

Bonds with warrants represent bonds connected with the possibility of buying newly issued stocks of the given issuer (Rahim, Goodacre, & Veld, 2012). So, they combine both the features of debt financing sources representing the rights connected with holding of a classic bond and the features of the equity financing sources in the form of stocks. The bondholder is provided with the purchase option through the warrant, which can be traded as an integral part of the bond with warrants, or it can be separated from the bond with warrants and traded separately (Choudhry, 2010). Unlike convertible bonds, in the case of application of the warrant the company's debt does not cease to exist. The company is obliged to continue to pay out the bond yields, and as at the maturity also redeem their nominal value. Nevertheless, the company obtains additional financial sources from the sale of stocks (Svedik & Tetrevova, 2012).

As for the classification from the point of view of public tradability, private mezzanine instruments include silent participations, participating loans, and subordinated loans. On the other hand, public mezzanine instruments include preferred stocks, participating bonds, subordinated bonds, convertible bonds, and bonds with warrants.

As stated above, mezzanine financing instruments represent a hybrid form of financing, which interconnects the features of equity and debt financing sources. Therefore, it is possible to presume that they are instruments combining the positive features, i.e. advantages, of the

classic financing instruments in the forms of equity and debt capital, and so mezzanine sources should be, in comparison to the classic financial sources, more advantageous. Thus the first survey question was whether mezzanine financing instruments interconnect, from the qualitative point of view, the advantages of equity and debt financing sources, and within complex assessment, they are advantageous compared to the classic financial sources. Therefore, it is necessary to verify Hypothesis *H1: Mezzanine financing sources represent, from the qualitative point of view, more advantageous sources compared to equity and debt financing sources.*

Professional discussions are still being conducted over the problems of choosing the optimal capital structure, where one of the significant questions is whether to give preference to private or public financial sources. Corporate managers consider, when choosing the capital structure, a number of aspects (Elsas, Flannery, & Garfinkel, 2013; Öztekin, 2015; Robb & Robinson, 2012), and an important criterion in the present knowledge economy is represented by information, to be more specific the scope of information, which has to be published by the company in relation to the acceptance of a certain financial source. The key role in this respect is played mainly by the protection of the corporate know-how and the related still low level of sharing information (Vlckova, 2011), but it is also the cost of provision of such information what plays another important role. The second significant question is whether finance managers consider, within individual groups of mezzanine instruments, private mezzanine or public mezzanine instruments as more advantageous. The fact is that a larger scope of information has to be provided in relation to the public sources, unlike the private sources (Tetrevova, 2006). It is possible to define Hypothesis *H2: Private mezzanine instruments appear, within alternative instruments, more advantageous compared to public mezzanine instruments.*

## 2. Data and methodology

The presented study develops results of the research realized in 2013, which only briefly dealt with mezzanine instruments from the perspective of industrial, especially metallurgical, firms (see Svedik & Tetrevova, 2014a) and adds new aspects – deep analysis of advantages and disadvantages of mezzanine instruments and their comparison with classic financial sources. The study draws on the integration of two key knowledge areas, the theory and practice of corporate financial management. It is based on a secondary analysis focussed on the processing of the current status of knowledge of the solved problems. Its essence was research into scientific literature, both books and papers, and conference contributions. The research team took a multidisciplinary approach, where the analyzed secondary sources included sources from the areas of the financial theory, banking, corporate finance, or business economy.

The secondary analysis was followed by a qualitative survey focussed on assessment of individual mezzanine financing instruments in comparison to selected classic corporate financial sources, namely bank loans, corporate bonds, and common stocks. The research team identified the pros and cons of individual mezzanine financing instruments and also conducted an overall assessment of mezzanine and classic financial sources through 14 identified criteria using the binary scale of numbers, which has two digits 0 and 1 (Amos, 2013; Ramaswamy, 2016). For the purpose of application of assessment using the binary scale, the assessed criteria, i.e. advantages and disadvantages of the assessed financial sources, were

expressed as positive (desirable) features. In this respect, it is necessary to point out that when this method is used all the assessed criteria are of the same weight. In practice, however, corporate managers may attach different weights to the specified criteria with respect to the current situation.

To determine the advantages and disadvantages of individual mezzanine financing instruments, to identify the 14 criteria that were applied within the overall assessment and their evaluation, the research team used, on the one hand, the outcomes of the scientific literature research and, on the other hand, directed interviews with representatives of the selected commercial banks as bank loan providers and security issuance intermediaries and with managers of the selected companies as persons making decisions about utilization of these financial sources, but also discussions with experts from the academic environment. The survey among banking subjects involved representatives of the banks that rank among big banks according to the methodology of the Czech National Bank, i.e. banks with the balance sheet sum exceeding CZK250bn, i.e. Ceskoslovenska obchodni banka, a.s., Ceska sporitelna, a.s., Komerčni banka, a.s., and Unicredit bank, a.s. The survey among entrepreneurial subjects involved top managers (in the positions of a director or a finance director) of the selected industrial companies operating in the Czech Republic from the engineering (3), food (5), chemical (5), metallurgical (3), and electro-technical (2) industries. The above-directed interviews were conducted in two periods – from June to December 2013 (the first study) and from September to December 2016 (the second study) and lasted for 60 minutes on average.

### **3. Results**

#### **3.1. Advantages and disadvantages of mezzanine financing instruments**

When deciding about the inclusion of individual mezzanine financing instruments in the capital structure of the company, the finance managers have to take account of all of their pros and cons.

As for silent participation, it is a source suitable for financing businesses of all sizes, and so they can also be used by smaller entrepreneurial entities for which it is not very convenient to issue securities. Silent participation makes it possible to achieve increased flexibility in financing their business intents; the number of silent partners is not limited, and so the company can get a larger volume of financial sources on the basis of entering into more silent partnership agreements. This financial source is mainly suitable for businesses having a higher ratio of debts in the capital structure, which can optimize their capital structure through silent participation, and decrease thus the average cost of capital. Moreover, the terms and conditions of the provision and repayment are stipulated on an individual basis. This financial source is not connected with any initial costs (as e.g. issuance costs in securities, or bank fees in loans), or with the obligation to provide the silent partner with regular payments. Also, the silent partner has no right to take part in the company management but shares, in the case of a loss, its settlement. On the other hand, what is a disadvantage from the point of view of the company is the fact that in silent participation the silent partner usually requires a higher yield on the provided capital compared to bank loans, corporate bonds, or stocks. Moreover, the share in profits is not a tax-deductible cost, and the company

thus cannot, in the case of profitability, use the tax shield. It is also necessary to mention another disadvantage in the form of terminability of the silent partnership agreement by the silent partner.

Through issues of preferred stocks, the company can obtain a big volume of financial sources, which makes it possible for the issuer to be more flexible in financing their entrepreneurial intents. Businesses having a higher ratio of debts in their capital structure can, through the issuance of preferred stocks, optimize their capital structure and thus decrease the average cost of capital. Another advantage is that the amount of dividends on preferred stocks does not grow together with growing profits of the company. Moreover, non-payment of dividends on preferred stocks is connected with relatively less significant consequences compared to non-payment of interests on loans. Preferred stocks are thus usually not connected with voting rights, i.e. with participation in the company management. Another advantage that cannot be omitted is the fact that acquisition of financial sources in the form of an issue of stocks increases the creditors' confidence in the given company and its creditworthiness. On the other hand, an issue of preferred stocks is connected with certain disadvantages for the company as the issuer. It is mainly the fact that the volume of issued preferred stocks is usually legislatively limited in relation to the total volume of the company's equity capital. An issue of these securities also involves high issuance costs. Another disadvantage is the fact that in preferred stocks the investors require higher profitability compared e.g. to bonds; the amount of the paid dividends then, in the case the profits made are going down, do not decrease, and the paid dividends do not represent a tax-deductible cost, and so it is not possible to use, in the case of profitability, the tax shield.

An advantage of a participating loan is that it can also be obtained by businesses that cannot acquire finance through an issue of securities (i.e. stocks or bonds), and the terms and conditions of provision and repayment are stipulated on an individual basis. Another advantage is that when this source is obtained, the control over the company activities is not extended. Moreover, in the period when the company's profits are going down, the payments for the provision of this financing source are decreasing, too. On the other hand, a disadvantage of a participating loan from the point of view of the company is the fact that it is a limited source of capital compared to an issue of corporate bonds or stocks. To obtain it, the company has to have a certain share of its own financial sources at its disposal. It is also required to secure loans with collaterals. The creditors may also place certain limiting conditions on the company. Moreover, the payments for provision of the loan and repayments of the nominal value have to be performed in time and properly, and in the case the company achieves high profits, its cost of holding the given source is also rising, and the payments for provision of the loan do not represent a tax-deductible cost, and so the company cannot use the tax shield. And although in this case there are no issuance costs as it is in the case of securities, it is not possible to omit the costs in the form of bank fees connected with this financing source.

As for participating bonds, their issue makes it possible to obtain a big volume of financial sources from a large number of creditors, which brings company managers increased flexibility in the creation of the capital structure. Moreover, the interest on these bonds usually represent lower amounts than dividends on the common or preferred stocks, and in the period when the issuing company shows a lower economic result, the payments for this

financing source are decreasing. Another advantage can be seen in the fact that in relation to this financing source the control over the company's activity is not extended and that securing in the form of property collaterals is not required. Successful placement of these bonds on the capital market then increases the soundness of the issuer. On the other hand, an issue of participating bonds places significant demands on the company's creditworthiness, where the financial risk rises due to an increase in the ratio of debt to the total capital. Another disadvantage is that the interest and the principal value have to be settled in time and properly. In the case the company's profitability is growing, the interest payments are growing and increasing the cost of holding this financial source. Moreover, the paid interest is not a tax-deductible cost and the company thus cannot use the tax shield. This source is also connected with high issuance costs and it might also be connected with certain limiting conditions for the owners and the company management.

As for the subordinated loan, it can also be obtained by companies that cannot obtain finances through an issue of securities, and the terms and conditions of provision and repayment are stipulated on an individual basis. In this case, the company is not burdened with high issuance costs and the control over the company's activity is not extended, either. An advantage is that the paid interest represents a tax-deductible cost, and the company can thus use the tax interest shield. Moreover, the inclusion of subordinated loan in the company's capital structure makes it possible to obtain the classic loan under better conditions. However, a disadvantage is that it is a limited source of capital compared to an issue of corporate bonds or stocks. Also, the company has to have a certain share of its own financial sources at its disposal to be able to get this loan. Moreover, securing in the form of collaterals is required, and the creditors may also place certain limiting conditions on the company. Another disadvantage can be seen in the fact that the payments of the interest and of the nominal value have to be performed in time and properly, and subordinated loans are connected with a higher interest rate, i.e. with a higher cost of capital, compared to the classic loans. They are also connected with certain bank fees.

An issue of subordinated bonds gives the company the chance to obtain a big volume of financial sources from a large number of creditors and thus achieve an increased flexibility in the creation of the corporate capital structure, but it also makes it possible to obtain another debt capital under better conditions. Another advantage is in the fact that the interest on subordinated bonds represent, in most cases, lower amounts compared to dividends on common or preferred stocks. Moreover, it is a tax-deductible cost, and the company can thus use the interest tax shield. Subordinated bonds are not connected with the extension of the control over the company's activity, and their issue does not require any securing in the form of property collaterals. Another advantage that must not be omitted is the fact that successful placement of subordinated bonds on the capital market increases the company's soundness. On the other hand, their issue results in an increase in the financial risk due to an increased ratio of debt to the total capital. It is also connected with high issuance costs and the obligation to pay the interest and the principal value in time and properly, where the interest rates are higher compared to the classic bonds. Moreover, these bonds may also be connected with certain limiting conditions for the company owners and management.

Convertible bonds, as well as the other types of bonds, make it possible to obtain a big volume of financial sources from a large number of creditors and lead to an increased flexibility in the creation of the corporate capital structure, and their issue does not require any securing in the form of property collaterals. Another advantage is that the interest on convertible bonds represents, in most cases, lower amounts compared to the interest on the classic corporate bonds or dividends on the common and preferred stocks. Moreover, it is tax deductible and the company can thus use the interest tax shield. In the case of an exchange of convertible bonds for stocks, the company obtains a non-payable financial source, where the right to an exchange can be the reason for an increased interest of investors in these securities. Successful placement of these bonds on the capital market increases the soundness of the issuer and, moreover, the issuer can implement, through convertible bonds, a new issue of stocks even in the period when there are limited conditions for their placement. On the other hand, an issue of convertible bonds places significant demands on the creditworthiness of the issuer and leads to an increased financial risk due to an increased ratio of debt to the total capital. The interest (and in the case, there is no conversion, also the principal value) has to be settled in time and properly and, at the same time, it is also necessary to pay high issuance costs. In the case of implementation of an exchange of the bonds for stocks, the control over the company's activity is extended, and after such an exchange the increase in the number of stocks also results in a decrease in earnings per stock.

Also, an issue of bonds with warrants makes it possible to obtain a big volume of financial sources from a large number of creditors and to ensure increased flexibility in the creation of the company's capital structure, and it is not necessary to secure them with property collaterals. Moreover, in the case of exercise of the warrants, the company acquires additional financial sources from the sale of stocks. Another advantage is that the interest on bonds with warrants usually represents lower amounts than dividends on preferred or common stocks and, at the same time, it is a tax-deductible cost and so it is possible to use the interest tax shield. Another fact that must not be omitted is that the option right might be a reason for an increased interest of investors in these securities and that successful placement of these bonds on the capital market increases the soundness of the issuer. On the other hand, an issue of bonds with warrants places significant demands on the issuer's creditworthiness and increases the financial risk due to an increase in the ratio of debt to the total capital. An issue of these securities is then connected with high issuance costs and the obligation to pay the interest and the principal value in time and properly as the company's debt relating to the bond does not cease to exist if the warrants are exercised. Another disadvantage is that if the warrants are exercised, the control over the company management is extended and the earnings per stock are decreased due to an increased number of stocks. Moreover, warrants usually have a long-term to maturity and so the investor is entitled to purchase the company's stocks for a longer time period.

### **3.2. Assessment of mezzanine financing instruments in comparison to equity and debt financial sources**

The outcomes of the overall evaluation of pros and cons of mezzanine financing instruments in the forms of silent participations, preferred stocks, participating loans, participating bonds,

subordinated loans, subordinated bonds, convertible bonds, and bonds with warrants and their comparison to the pros and cons of the classic financing sources in the forms of common stocks as equity financing sources and the classic bank loans and corporate bonds as debt financing sources are shown in Table 1.

Table 1 implies that the first place in the assessment was taken by silent participations, the second by preferred stocks and common stocks, i.e. from the point of view of the corporate balance equity capital, and from the financial point of view equity capital and equity mezzanine. The third place was taken by subordinated loans, the fourth by subordinated bonds

Table 1. Evaluation of mezzanine, equity and debt financial sources (source: authors)

Evaluated criterion	Mezzanine								Equity	Debt	
	SP	PS	PL	PB	SL	SB	CB	BW	Common stocks	Bank loans	Corporate bonds
1. Big volume of the capital	0	1	0	1	0	1	1	1	1	0	1
2. Availability for businesses of all sizes	1	0	1	0	1	0	0	0	0	1	0
3. Special conditions	1	0	1	0	1	0	0	0	0	1	0
4. Creditors set no limitations	1	1	0	0	0	0	0	0	1	0	0
5. No possibilities of extended control over the corporate activities arise	1	0	1	1	1	1	0	0	0	1	1
6. Demands on the corporate credit capacity do not increase	1	1	0	0	0	0	0	0	1	0	0
7. Improvement of corporate creditworthiness	1	1	0	0	1	1	0	0	1	0	0
8. Financial risk does not increase	1	1	0	0	0	0	0	0	1	0	0
9. No threat of sanctions if a payment is not performed in time and at proper amount	1	1	0	0	0	0	0	0	1	0	0
10. Financial source provider does not share growing profits	0	1	0	0	1	1	1	1	0	1	1
11. Financial source provider bears consequences of decreased profitability	1	0	1	1	0	0	0	0	1	0	0
12. Tax deductibility of payments	0	0	0	0	1	1	1	1	0	1	1
13. Absence of security in the form of a pledge	1	1	0	1	0	1	1	1	1	0	1
14. Absence of issue costs	1	0	1	0	1	0	0	0	0	1	0
$\Sigma$	11	8	5	4	7	6	4	4	8	6	5
Order	1	2	5	6	3	4	6	6	2	4	5

Legend: SP – silent participations, PS – preferred stocks, PL – participating loans, PB – participating bonds, SL – subordinated loans, SB – subordinated bonds, CB – convertible bonds, BW – bonds with warrants.

and classic bank loans. The fifth place was taken by participating loans and classic corporate bonds. The last, sixth place was taken by participating bonds, convertible bonds and bonds with warrants. It is, from the point of view of the corporate balance, debt capital, and from the financial point of view debt capital and debt mezzanine.

#### **4. Discussion**

The study shows that equity capital together with equity mezzanine is connected with a larger number of advantages compared to debt capital and debt mezzanine. However, there is no substantial difference between the advantages of mezzanine and classic equity or debt financing sources.

As for the comparison between private and public mezzanine, there are no evident fundamental differences between the mentioned groups. However, within individual instrument categories (loans versus bonds, silent participations versus preferred stocks), private mezzanine instruments appear, compared to public mezzanine instruments (i.e. securities), more advantageous.

As the paper implies, there is no significant difference between the advantages of mezzanine and classic equity or debt financing sources. Therefore, Hypothesis H1: "Mezzanine financing sources represent, from the qualitative point of view, more advantageous sources compared to equity and debt financing sources." has been disproved.

As for the conducted comparison between private and public mezzanine instruments, there are no significant differences between the mentioned groups, but within individual instrument categories, private mezzanine instruments appear more advantageous than public mezzanine instruments. This confirms Hypothesis H2: "Private mezzanine instruments appear, within alternative instruments, more advantageous compared to public mezzanine instruments."

#### **Conclusions**

Mezzanine financing represents a hybrid form of financing interconnecting the features of equity and debt. Mezzanine financing instruments came into existence on the basis of the classic financial sources in the forms of bank loans, corporate bonds, and common stocks. They include silent participations, preferred stocks, participating loans, participating bonds, subordinated loans, subordinated bonds, convertible bonds, and bonds with warrants. Each of these instruments is distinguished by specific features and is connected with certain advantages and disadvantages.

As the study implies, there is no substantial difference between the advantages of mezzanine and equity or debt; however, equity together with equity mezzanine is connected with a larger number of advantages compared to debt and debt mezzanine. The study also shows that there are no significant differences between private and public mezzanine, but within individual instrument categories, private mezzanine instruments appear more advantageous than public mezzanine instruments.

In conclusion, we can state that the innovated method of financing in the form of mezzanine financing instrument does not bring, from the qualitative point of view, significant

advantages compared to the classic financial sources. Their inclusion in the corporate capital structure will be considered by the corporate finance managers in specific situations in view of individual characteristics of these instruments. At the same time, they will also have to take account of the quantitative point of view, i.e. the costs of the above forms of capital with respect to the current conditions on the financial market.

This paper was compiled on the basis of a survey performed in the conditions of the Czech Republic. Therefore, its limiting factor can be seen in the projection of certain specifics of the given financial market. However, with respect to harmonization of the rules, procedures and practices within the area of the European Union, any potential differences can be considered as marginal.

## Disclosure Statement

We do not have any competing financial, professional, or personal interests from other parties.

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