15 STARTUP FINANCE

Question 1

Explain various stages of Venture Capital Funding.

(MTP 4 Marks Aug'18, PYP 4 Marks Jan '21)

Answer:

Stages of Venture Capital Funding

1. Seed Money: Low level financing needed to prove a new idea.
2. Start-up: Early stage firms that need funding for expenses associated with marketing and product development.
3. First-Round: Early sales and manufacturing funds.
4. Second-Round: Working capital for early stage companies that are selling product, but not yet turning in a profit.
5. Third Round: Also called Mezzanine financing, this is expansion money for a newly profitable company.
6. Fourth-Round: Also called bridge financing, it is intended to finance the "going public" process

Question 2

Explain some of the innovative ways to finance a startup.

(MTP 6 Marks March '19, Oct 20, MTP 4 Marks Oct 22, RTP May '20, Old & New SM, PYP 4 Marks May '19)

OR

Personal Financing is one of the innovative ways to finance a startup. Discuss any four other methods. **(PYP 4 Marks May '23)**

OR

Mr. R has completed his studies and wants to start his new online business. For a successful online business there are various expenditure costs with regards to advertisement & application development. To make the business successful he wants to raise funds. Explain some of the innovative sources for funding a start-up.

(RTP Nov '21)

OR

Non-bank Financial Sources are becoming popular to finance Start-ups. Discuss.

(PYP 4 Marks Jan '21)

Answer:

Every startup needs access to capital, whether for funding product development, acquiring machinery and inventory, or paying salaries to its employee. Most entrepreneurs think first of bank loans as the primary source of money, only to find out that banks are really the least likely benefactors for startups. So, innovative measures include maximizing non-bank financing.

Here are some of the sources for funding a startup:

(i) **Personal financing:** It may not seem to be innovative but you may be surprised to note that most budding entrepreneurs never thought of saving any money to start a business. This is important because most of the investors will not put money into a deal if they see that you have not contributed any money from your personal sources.

(ii) **Personal credit lines:** One qualifies for personal credit line based on one's personal credit efforts. Credit cards are a good example of this. However, banks are very cautious while granting personal credit lines. They provide this facility only when the business has enough cash flow to repay the line of credit.

(iii) **Family and friends:** These are the people who generally believe in you, without even thinking that your idea works or not. However, the loan obligations to friends and relatives should always be in writing as a promissory note or otherwise.

(iv) **Peer-to-peer lending:** In this process group of people come together and lend money to each other. Peer to peer to lending has been there for many years. Many small and ethnic business groups having similar faith or interest generally support each other in their start up endeavors.

(v) **Crowdfunding:** Crowdfunding is the use of small amounts of capital from a large number of individuals to finance a new business initiative. Crowdfunding makes use of the easy accessibility of vast networks of people through social media and crowdfunding websites to bring investors and entrepreneurs together.

(vi) **Microloans:** Microloans are small loans that are given by individuals at a lower interest to a new business ventures. These loans can be issued by a single individual or aggregated across a number of individuals who each contribute a portion of the total amount.

(vii) **Vendor financing:** Vendor financing is the form of financing in which a company lends money to one of its customers so that he can buy products from the company itself. Vendor financing also takes place when many manufacturers and distributors are convinced to defer payment until the goods are sold. This means extending the payment terms to a longer period for e.g. 30 days payment period can be extended to 45 days or 60 days. However, this depends on one's credit worthiness and payment of more money.

(viii) **Purchase order financing:** The most common scaling problem faced by startups is the inability to find a large new order. The reason is that they don't have the necessary cash to produce and deliver the product. Purchase order financing companies often advance the required funds directly to the supplier. This allows the transaction to complete and profit to flow up to the new business.

(ix) **Factoring accounts receivables:** In this method, a facility is given to the seller who has sold the good on credit to fund his receivables till the amount is fully received. 50, when the goods are sold on credit, and the credit period (i.e. the date upto which payment shall be made) is for example 6 months, factor will pay most of the sold amount upfront and rest of the amount later. Therefore, in this way, a startup can meet his day to day expenses.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES
Sources of Funding a Startup were answered well by the examinees and performance was above average.

Question 3

Compare and contrast start-ups and entrepreneurship. Describe the priorities and challenges which start-ups in India are facing.

(MTP 6 Marks Oct '19, 8 Marks Apr '18, Mar '18, RTP Nov '19)

Answer:

Differences between a start-up and entrepreneurship:

Startups are different from entrepreneurship. The major differences between them have been discussed in the following paragraphs:

(i) Start up is a part of entrepreneurship. Entrepreneurship is a broader concept and it includes a startup firm.

(ii) The main aim of startup is to build a concern, conceptualize the idea which it has developed into a reality and build a product or service. On the other hand, the major objective of an already established entrepreneurship concern is to attain opportunities with regard to the resources they currently control.

(iii) A startup generally does not have a major financial motive whereas an established entrepreneurship concern mainly operates on financial motive.

Priorities and challenges which start-ups in India are facing

The priority is on bringing more and more smaller firms into existence. So, the focus is on need based, instead of opportunity based entrepreneurship. Moreover, the trend is to encourage self-employment rather than large, scalable concerns. The main challenge with the startup firms is getting the right talent. And, paucity of skilled workforce can hinder the chances of a startup organization's growth and development. Further, startups had to comply with numerous regulations which escalates it's cost. It leads to further delaying the chances of a breakeven or even earning some amount of profit.

Question 4

Explain the basic documents that are required to make up Financial Presentations during Pitch Presentation. **(MTP 6 Marks May '20)**

Answer:

Basic documents required to make Financial Projections during Pitch Presentation

- **Income statement:** This projects how much money the business will generate by projecting income and expenses, such as sales, cost of goods sold, expenses and capital. For your first year in business, you'll want to create a monthly income statement. For the second year, quarterly statements will suffice. For the following years, you'll just need an annual income statement.

- **Cash flow statement:** A projected cash flow statement will depict how much cash will be coming into the business and out of that cash how much cash will be utilized into the business. At the end of each period leg, monthly, quarterly, annually), one can tally it all up to show either a profit or loss.

- **Balance sheet:** The balance sheet shows the business's overall finances including assets, liabilities and equity. Typically one will create an annual balance sheet for one's financial projections.

Question 5

Explain advantages of bringing Venture Capital in the company.

(MTP 4 Marks May '20, Apr '22, PYP 4 Marks May '18)

Answer:

Advantages of bringing VC in the company:

- It injects long-term equity finance which provides a solid capital base for future growth.
- The venture capitalist is a business partner, sharing both the risks and rewards. Venture capitalists are rewarded with business success and capital gain.
- The venture capitalist is able to provide practical advice and assistance to the company based on past experience with other companies which were in similar situations.
- The venture capitalist also has a network of contacts in many areas that can add value to the company.
- The venture capitalist may be capable of providing additional rounds of funding should it be required to finance growth.
- Venture capitalists are experienced in the process of preparing a company for an initial public offering (IPO) of its shares onto the stock exchanges or overseas stock exchange such as NASDAQ
- They can also facilitate a trade sale.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES

Overall performance was above average.

Question 6

Explain the term Angel Investor. (MTP 4 Marks Oct '20, Mar '21)

OR

Briefly explain how Angel Investors finance the Startups. (MTP 4 Marks Oct '19)

Answer:

Despite being a country of many cultures and communities traditionally inclined to business and entrepreneurship, India still ranks low on comparative ratings across entrepreneurship, innovation and ease of doing business. The reasons are obvious. These include our old and outdated draconian rules and regulations which provides a hindrance to our business environment for a long time. Other reasons are red tapism, our time consuming procedures, and lack of general support for entrepreneurship. Off course, things are changing in recent times.

As per Investopedia, Angel investors invest in small startups or entrepreneurs. Often, angel investors are among an entrepreneur's family and friends. The capital angel investors provide may be a one-time investment to help the business propel or an ongoing injection of money to support and carry the company through its difficult early stages.

Angel investors provide more favorable terms compared to other lenders, since they usually invest in the entrepreneur starting the business rather than the viability of the business. Angel investors are focused on helping startups take their first steps, rather than the possible profit they may get from the business. Essentially, angel investors are the opposite of venture capitalists.

Angel investors are also called informal investors, angel funders, private investors, seed investors or business angels. These are affluent individuals who inject capital for startups in exchange for ownership equity or convertible debt. Some angel investors invest through crowdfunding platforms online or build angel investor networks to pool in capital.

Angel investors typically use their own money, unlike venture capitalists who take care of pooled money from many other investors and place them in a strategically managed fund.

Though angel investors usually represent individuals, the entity that actually provides the fund may be a limited liability company, a business, a trust or an investment fund, among many other kinds of vehicles. Angel investors who seed startups that fail during their early stages lose their investments completely. This is why professional angel investors look for opportunities for a defined exit strategy, acquisitions or initial public offerings (IPOs).

Question 7

Explain the term Business Model with help of an example.

(MTP 4 Marks April '21, Oct '21)

Answer:

The term business model is a wide term denoting core aspects of a business including purpose, business process, target customers, offerings, strategies, infrastructure, organizational structures, sourcing, trading practices, and operational processes and policies including culture.

Further, as per Investopedia, a business model is the way in which a company generates revenue and makes a profit from company operations. Analysts use the term gross profit as a way to compare the efficiency and effectiveness of a firm's business model. Gross profit is calculated by subtracting the cost of goods sold from revenues.

A business model can be illustrated with the help of an example. There are two companies company A and company B. Both the companies are engaged in the business of renting movies. Prior to the advent of internet both the companies rent movies physically. Both the companies made ₹ 5 crore as revenues. Cost of goods sold was ₹ 400000. So, the companies made ₹ 100000 as gross profit. After the introduction of internet, company A started to offer movies online instead of renting or selling it physically. This change affected the business model of company A positively. Revenue is still ₹ 500000. But the significant part is that cost of goods sold is now ₹ 200000 only. This is because online sales lead to significant reduction of storage and distribution costs. So, the gross profit increases from 20% to 60%

Therefore, Company A isn't making more in sales, but it figured out a way to revolutionize its business model, which greatly reduces costs. Managers at company A have an additional 40% more in margin to play with than managers at company A. Managers at company A have little room for error and they have to tread carefully.

Hence, every investor wants to get his money back, so it's important to tell them in a pitch presentation as to how they should plan on generating revenue. It is better to show the investors a list of the various revenue streams for a business model and the timeline for each of them. Further, how to price the product and what does the competitor charge for the same or similar product shall also be highlighted. It is also beneficial to discuss the lifetime value of the customer and what should be the strategy to keep him glued to their product.

Question 8

Explain the methods in which a Startup firm can bootstrap.

(MTP 6 Marks April '21, MTP 5 Marks April '19, MTP 4 Marks Sep '22)

Answer:

Here are some of the methods in which a startup firm can bootstrap:

(i) Trade Credit

When a person is starting his business, suppliers are reluctant to give trade credit. They will insist on payment of their goods supplied either by cash or by credit card. However, a way out in this situation is to prepare a well-crafted financial plan. The next step is to pay a visit to the supplier's office. if the business organization is small, the owner can be directly contacted. On the other hand, if it is a big firm, the Chief Financial Officer can be contacted and convinced about the financial plan.

Communication skills are important here. The financial plan has to be shown. The owner or the financial officer has to be explained about the business and the need to get the first order on credit in order to launch the venture. The owner or financial officer may give half the order on credit and balance on delivery. The trick here is to get the goods shipped and sell them before paying to them. One can also borrow to pay for the good sold. But there is interest cost also. So trade credit is one of the most important ways to reduce the amount of working capital one needs. This is especially true in retail operations.

When you visit your supplier to set up your order during your startup period, ask to speak directly to the owner of the business if it's a small company. If it's a larger business, ask to speak to the chief financial officer or any other person who approves credit. Introduce yourself. Show the officer the financial plan that you have prepared. Tell the owner or financial officer about your business, and explain that you need to get your first orders on credit in order to launch your venture.

The owner or financial officer may give half the order on credit, with the balance due upon delivery. Of course, the trick here is to get the goods shipped, and sell them before one has to pay for them. One could borrow money to pay for the inventory, but you have to pay interest on that money. So trade credit is one of the most important ways to reduce the amount of working capital one needs. This is especially true in retail operations.

(ii) **Factoring:** This is a financing method where accounts receivable of a business organization is sold to a commercial finance company to raise capital. The factor then got hold of the accounts receivable of a business organization and assumes the task of collecting the receivables as well as doing what would've been the paperwork. Factoring can be performed on a non-notification basis. It means customers may not be told that their accounts have been sold.

However, there are merits and demerits to factoring. The process of factoring may actually reduce costs for a business organization. It can actually reduce costs associated with maintaining accounts receivable such as bookkeeping, collections and credit verifications. If comparison can be made between these costs and fee payable to the factor, in many cases it has been observed that it even proved fruitful to utilize this financing method.

In addition to reducing internal costs of a business, factoring also frees up money that would otherwise be tied to receivables. This is especially true for businesses that sell to other businesses or to government, there are often long delays in payment that this would offset. This money can be used to generate profit through other avenues of the company. Factoring can be a very useful tool for raising money and keeping cash flowing.

(iii) **Leasing:** Another popular method of bootstrapping is to take the equipment on lease rather than purchasing it. It will reduce the capital cost and also help lessee (person who take the asset on lease) to claim tax exemption. So, it is better to a take a photocopy machine, an automobile or a van on lease to avoid paying out lump sum money which is not at all feasible for a startup organization.

Further, if you are able to shop around and get the best kind of leasing arrangement when you're starting up a new business, it's much better to lease. It's better, for example, to lease a photocopier, rather than pay $3,000 for it; or lease your automobile or van to avoid paying out $8,000 or more.

There are advantages for both the startup businessman using the property or equipment (le. the lessee) and the owner of that property or equipment (i.e. the lessor.) The lessor enjoys tax benefits in the form of depreciation on the fixed asset leased and may gain from capital appreciation on the property, as well as making a profit from the lease. The lessee benefits by making smaller payments retain the ability to walk away from the equipment at the end of the lease term. The lessee may also claim tax benefit in the form of lease rentals paid by him.

Question 9

"For a Venture Capitalist while the risk is different in each stage of financing so the risk perception and activity to be financed". Explain this statement.

(MTP 4 Marks Oct '21, RTP May '23, PYP 4 Marks July '21)

Answer:

Yes, risk in each stage is different stage of Venture Capital financing and so risk perception and activity to be financed as per indicative Risk matrix is given below:

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 and involves low level of financing.
Start Up	5-9	Very High	Initializing prototypes operations or developing products and its marketing.
First Stage	3-7	High	Started commercials production and marketing.
Second Stage	3-5	Sufficiently high	Expanding market and growing working capital need though not earning profit.
Third Stage	1-3	Medium	Market expansion, acquisition & product development for profit making company. Also called Mezzanine Financing.
Fourth Stage	1-3	Low	Facilitating public issue i.e. going public. Also called Bridge Financing.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:

Overall performance in this theoretical question was average as most of the students have not correctly mentioned the elements of Period and Risk Perceptions in the Risk Matrix table.

Question 10

Who are Angel Investors and how they are different from Venture Capitalists.

(MTP 4 Marks Nov '21)

Answer:

As per Investopedia, Angel investors invest in small startups or entrepreneurs. Often, angel investors are among an entrepreneur's family and friends. The capital angel investors provide may be a one-time Investment to help the business propel or an ongoing injection of money to support and carry the company through its difficult early stages.

Angel investors provide more favorable terms compared to other lenders, since they usually invest in the entrepreneur starting the business rather than the viability of the business. Angel investors are focused an helping startups take their first steps, rather than the possible profit they may get from the business. Essentially, angel investors are the opposite of venture capitalists.

Angel investors are also called informal investors, angel funders, private investors, seed investors or business angels. These are affluent individuals who inject capital for startups in exchange for ownership equity or convertible debt. Some angel investors invest through crowdfunding platforms online or build angel investor networks to pool in capital.

Angel investors typically use their own money, unlike venture capitalists who take care of pooled money from many other investors and place them in a strategically managed fund.

Though angel investors usually represent individuals, the entity that actually provides the fund may be a limited liability company, a business, a trust or an investment fund, among many other kinds of vehicles.

Angel investors who seed startups that fail during their early stages lose their investments completely. This is why professional angel investors look for opportunities for a defined exit strategy, acquisitions or initial public offerings (IPOs).

Question 11

Explain alternatives available to offshore investors for making investments in Venture Capital Funds in India.

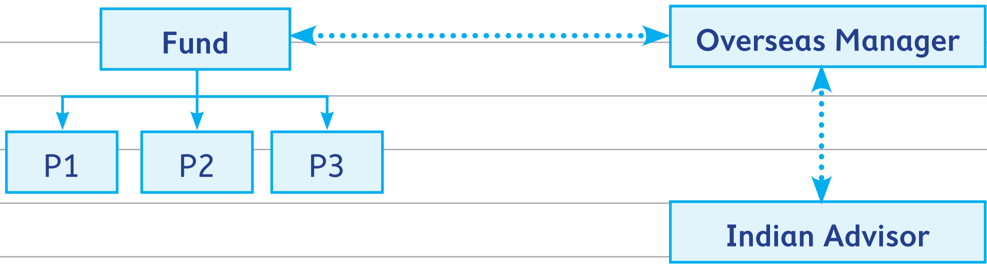
(MTP 4 Marks Nov '21)

Answer:

Two common alternatives available to offshore investors are: the "offshore structure" and the "unified structure".

Offshore structure

Under this structure, an investment vehicle (an LLC or an LP organized in a jurisdiction outside India) makes investments directly into Indian portfolio companies. Typically, the assets are managed by an offshore manager, while the investment advisor in India carries out the due diligence and identifies deals.



Off shore structure

Unified Structure

When domestic investors are expected to participate in the fund, a unified structure is used. Overseas investors pool their assets in an offshore vehicle that invests in a locally managed trust, whereas domestic investors directly contribute to the trust. This is later device used to make the local portfolio Investments.

Unified Structure

Question 12

"Angel Investors provide more favourable terms than other lenders". EXPLAIN.

(MTP 4 Marks, March '22)

Answer:

To some extent the given statement is correct because though being a country of many cultures and communities traditionally inclined to business and entrepreneurship, India still ranks low on comparative ratings across entrepreneurship, innovation and ease of doing business. The reasons are obvious. These include our old and outdated draconian rules and regulations which provides a hindrance to our business environment for a long time. Other reasons are red tapism, our time consuming procedures, and lack of general support for entrepreneurship. Off course, things are changing in recent times.

Often, angel investors are among an entrepreneur's family and friends. The capital angel investors provide may be a one-time investment to help the business propel or an ongoing injection of money to support and carry the company through its difficult early stages.

Further since they usually invest in the entrepreneur starting the business rather than the viability of the business. Angel investors are focused on helping startups take their first steps, rather than the possible profit they may get from the business. Essentially, angel investors are the opposite of venture capitalists Angel investors are also called informal investors, angel funders, private investors, seed investors or business angels. These are affluent individuals who inject capital for startups in exchange for ownership equity or convertible debt. Some angel investors invest through crowdfunding platforms online or build angel investor networks to pool in capital.

Angel Investors typically use their own money, unlike venture capitalists that take care of pooled money from many other investors and place them in a strategically managed fund.

Though angel investors usually represent individuals, the entity that actually provides the fund may be a limited liability company, a business, a trust or an investment fund, among many other kinds of vehicles.

Question 13

EXPLAIN briefly the term Pitch Presentation. **(MTP 4 Marks, April '22)**

Answer:

Pitch presentation is a short and brief presentation (not more than 20 minutes) to investors explaining about the prospects of the company and why they should invest into the startup business. So, pitch deck presentation is a brief presentation basically using PowerPoint to provide a quick overview of business plan and convincing the investors to put some money into the business. Pitch presentation can be made either during face to face meetings or online meetings with potential investors, customers, partners, and co-founders.

Question 14

Peer-to-Peer Lending and Crowd funding are same and traditional methods of funding. Do you agree? Justify your stand.

(MTP 4 Marks March '23, PYP 4 Marks Nov '20)

Answer:

No, I do not agree with the given statement because while peer-to-peer lending is in existence for many years the crowd funding is contemporary source of finance for Startup finance.

Further in peer-to-peer lending a group of people come together and lend money to each other. Many small and ethnic business groups having similar faith or interest generally support each other in their start up endeavors.

On the other hand, Crowdfunding is the use of small amounts of capital from a large number of individuals to finance a new business initiative. Crowdfunding makes use of the easy accessibility of vast networks of people through social media and crowdfunding websites to bring investors and entrepreneurs together.

Question 15

Explain the conditions that are required to be satisfied by an entity to be considered as a Startup vide GSR Notification 127 (E) dated 19th February 2019.

(MTP 4 Marks April '23, MTP 4 Marks Mar '22, RTP Nov '23)

OR

Enlist the criteria for an entity to be classified as a Startup entity under the Startup India Scheme initiated by the Government of India.

(PYP 4 Marks May '22)

OR

What is a startup to avail the benefits of government scheme?

(MTP 4 Marks March '21, RTP Nov '18, PYP 4 Marks Nov '19)

Answer:

As per GSR Notification 127 (E) dated 19th February 2019, an entity shall be considered as a Startup:

(i) Upto a period of ten years from the date of incorporation/ registration, if it is incorporated as a private limited company (as defined in the Companies Act, 2013) or registered as a partnership firm (registered under section 59 of the Partnership Act, 1932) or a limited liability partnership (under the Limited Liability Partnership Act, 2008) in India.

(ii) Turnover of the entity for any of the financial years since incorporation/ registration has not exceeded one hundred crore rupees.

(iii) Entity is working towards innovation, development or improvement of products or processes a services, or if it is a scalable business model with a high potential of employment generation or wealth creation.

Provided that an entity formed by splitting up or reconstruction of an existing business shall not be considered or 'Startup'.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:
Most of the examinees answered well in theoretical question on meaning of start up to avail the benefits of government scheme.

Question 16

During Pitch Presentation to convince the investors to put money into the proposed business how promoters deal with following points:
(i) Problem (ii) Solution (iii) Marketing/Sales (iv) Business Model

(MTP 4 Marks Sep '23)

Answer:

(i) **Problem:** The promoter should be able to explain the problem the startup is going to solve and solutions emerging from it. It is important to convince the investors that the newly introduced product or service will solve the problem.

(ii) **Solution:** It is very important to describe in the pitch presentation as to how the company is planning to solve the problem.

(iii) **Marketing/Sales:** This is a very important part where investors will be deeply interested. The market size of the product must be communicated to the investors. This can include profiles of target customers, but one should be prepared to answer questions about how the promoter is planning to attract the customers. If a business is already selling goods, the promoter can also brief the investors about the growth and forecast future revenue.

(iv) **Business Model:** The term business model is a wide term denoting core aspects of a business including purpose, business process, target customers, offerings, strategies, infrastructure, organizational structures, sourcing, trading practices, and operational processes and policies including culture.

Question 17

How Peer to Peer funding different from Crowd Funding?

(MTP 4 Marks Oct '23)

Answer:

Peer-to-peer lending: In this process group of people come together and lend money to each other. Peer to peer lending has been there for many years. Many small and ethnic business groups having similar faith or interest generally support each other in their start up endeavors.

Crowdfunding: Crowdfunding is the use of small amounts of capital from a large number of individuals to finance a new business initiative. Crowdfunding makes use of the easy accessibility of vast networks of people through social media and crowdfunding websites to bring investors and entrepreneurs together.

Question 18

State the characteristics of Venture Capital financing.

(MTP 4 Marks Oct '23, PYP 4 Marks Nov '19, Dec '21)

OR

Venture Capital Financing is a unique way of financing Startup'. Discuss.

(RTP May '21)

Answer:

Characteristics of Venture Capital Financing

(i) **Long time horizon:** The fund would invest with a long time horizon in mind. Minimum period of investment would be 3 years and maximum period can be 10 years.

(ii) **Lack of liquidity:** When VC invests, it takes into account the liquidity factor. It assumes that there would be less liquidity on the equity it gets and accordingly it would be investing in that format. They adjust this liquidity premium against the price and required return.

(ii) **High Risk:** VC would not hesitate to take risk. It works on principle of high risk and high return. So, high risk would not eliminate the investment choice for a venture capital.

(iv) **Equity Participation:** Most of the time, VC would be investing in the form of equity of a company. This would help the VC participate in the management and help the company grow. Besides, a lot of board decisions can be supervised by the VC if they participate in the equity of a company.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:
This theoretical question on the concept of Venture Capital Financing was attempted well by majority of examinees.

Question 19

EXPLAIN the concept of Bootstrapping and describe the various methods of bootstrapping used by startups.

(RTP May '18, Nov '20)

OR

An individual attempts to found and build a company from personal finances or from the operating revenues of the new company. What this method is called? Discuss any two methods.

(PYP 3 Marks Nov '20, PYP 4 Marks Dec '21)

Answer:

An individual is said to be boot strapping when he or she attempts to found and build a company from personal finances or from the operating revenues of the new company.

A common mistake made by most founders is that they make unnecessary expenses towards marketing, offices and equipment they cannot really afford. So, it is true that more money at the inception of a business leads to complacency and wasteful expenditure. On the other hand, investment by startups from their own savings leads to cautious approach. It curbs wasteful expenditures and enable the promoter to be on their toes all the time.

Methods: Here are some of the methods in which a startup firm can bootstrap:

- **Trade Credit:** When a person is starting his business, suppliers are reluctant to give trade credit. They will insist on payment of their goods supplied either by cash or by credit card. However, a way out in this situation is to prepare a well-crafted financial plan. The next step is to pay a visit to the supplier's office. If the business organization is small, the owner can be directly contacted. On the other hand, if it is a big firm, the Chief Financial Officer can be contacted and convinced about the financial plan.

- **Factoring:** This is a financing method where accounts receivable of a business organization is sold to a commercial finance company to raise capital. The factor then got hold of the accounts receivable of a business organization and assumes the task of collecting the receivables as well as doing what would've been the paperwork. Factoring can be performed on a non-notification basis. It means customers may not be told that their accounts have been sold.

- **Leasing:** Another popular method of bootstrapping is to take the equipment on lease rather than purchasing it. It will reduce the capital cost and also help lessee (person who take the asset on lease) to claim tax exemption. So, it is better to a take a photocopy machine, an automobile or a van on lease to avoid paying out lump sum money which is not at all feasible for a startup organization.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:
Though overall good performance has been noticed in this theoretical question on Startup Finance but in some cases, student mentioned headings with no explanation.

Question 20

Can a company with no commercial operations raise capital via an IPO? Discuss.

(RTP Nov '21)

Answer:

Although the statement "a company with no commercial operation can launch an IPO" appears to be absurd but this is a fact that even if company does not have any business, it can float an IPO. In recent time the concept of Special Purpose Acquisition Companies (SPACs) has come into existence wherein an entity is set up with the objective to raise funds through an IPO to finance a merger or acquisition of an unidentified target within a specific time period. It is commonly known as a blank cheque company.

The main objective of SPAC is to raise money, despite having any operations or revenues. The money raised from the public is kept in an escrow account, which can be accessed while making the acquisition. However, in case the acquisition is not made within stipulated period of time of the IPO, the SPAC is delisted and the money is returned to the investors. Shareholders have the option to redeem their shares if they are not interested in participating in the proposed merger. Finally, if the merger is approved by shareholders, it is executed, and the target private company or companies become public entities. Once a formal merger agreement has been executed the SPAC target is usually publicly announced.

New investment opportunities in Indian companies have resurfaced and have set up new platform for SPAC transactions. The implementation of SPACs might face certain challenges since India does not have a specific regulatory framework guarding these transactions.

The current regulatory framework in India does not support the SPAC transactions. Further as per the Companies Act, 2013, the Registrar of Companies is authorized to strike-off the name of companies that do not commence operation within one year of incorporation. SPACs generally take 2 to 3 years to identify a target and performing due diligence and before it could get operationalized its name can be stricken off and hence enabling provisions relating to SPAC need to be inserted in the Companies Act in order to make it functional in India.

Though, SPACs do not find acceptance under the Securities and Exchange Board of India (SEBI) Act as it does not meet the eligibility criteria for public listing however SEBI is planning to come out with a framework for SPACs.

The International Financial Services Centres Authority (IFSCA), being the regulatory authority for development and regulation of financial services, financial products and financial institutions in the Gujarat International Finance Tec-City, has recently released a consultation paper defining critical parameters such as offer size to public, compulsory sponsor holding, minimum application size, minimum subscription of the offer size, etc.

SPAC approach offers several advantages over traditional IPO, such as providing companies access to capital, even when market volatility and other conditions limit liquidity. SPACs help to lower the transaction fees as well as expedite the timeline in becoming a public company. Raising money through a SPAC is easier as compared to traditional IPO since the SPAC has already raised money through an IPO. This implies the company in question only has to negotiate with a single entity, as opposed to thousands of individual investors. This makes the process of fundraising a lot easier and quicker than through an IPO. The involvement of skilled professionals in identifying the target makes the investment a well thought and a well governed process.

However, the merger of a SPAC with a target company presents several challenges, such as complex accounting and financial reporting/registration requirements, to meet a public company readiness timeline and being ready to operate as a public company within a period of three to five months of signing a letter of intent.

It is typically more expensive for a company to raise money through a SPAC than an IPO. Investors money Invested in a SPAC trust to earn a suitable return for up to two years, could be put to better use elsewhere.

Question 21

Define Angle Investors, are these only individuals? If not, list the entities.

(PYP 4 Marks May '22)

Answer:

Despite being a country of many cultures and communities traditionally inclined to business and entrepreneurship, India still ranks low on comparative ratings across entrepreneurship, innovation and ease of doing business. The reasons are obvious. These in clude our old and outdated draconian rules and regulations which provides a hindrance to our business environment for a long time. Other reasons are red-tapism, our time-consuming procedures, and lack of general support for entrepreneurship. Off course, things are changing in recent times.

Angle Investors invest in small startups or entrepreneurs. Often angle investors are among the entrepreneur's family and friends.

Though angel investors usually represent individuals, the entity that actually provides the fund may be a limited liability company, a business, a trust or an investment fund, among many other kinds of vehicles.

Question 22

What do you mean by Bootstrapping? Explain the method of Trade Credit used by the startup firms in bootstrapping.

(MTP 4 Marks Nov '22)

Answer:

An individual is said to be boot strapping when he or she attempts to found and build a company from personal finances or from the operating revenues of the new company. Trade Credit - When a person is starting his business, suppliers are reluctant to give trade credit. They will insist on payment of their goods supplied either by cash or by credit card. However, a way out in this situation is to prepare a well-crafted financial plan. The next step is to pay a visit to the supplier's office. If the business organization is small, the owner can be directly contacted. On the other hand, if it is a big firm, the Chief Financial Officer can be contacted and convinced about the financial plan. Communication skills are important here. The financial plan has to be shown. The owner or the financial officer has to be explained about the business and the need to get the first order on credit in order to launch the venture. The owner or financial officer may give half the order on credit and balance on delivery. The trick here is to get the goods shipped and sell them before paying to them. One can also borrow to pay for the good sold but there is interest cost also. So trade credit is one of the most important way to reduce the amount of working capital one needs. This is especially true in retail operations.

Question 23

Write a short note on Venture Capital Fund.

(PYP 4 Marks Nov '22)

Answer:

Venture Capital Fund means investment vehicle that manage funds of investors seeking to invest in startup firms and small businesses with exceptional growth potential. Venture capital is money provided by professionals who alongside management invest in young, rapidly growing companies that have the potential to develop into significant economic contributors. Venture Capitalists generally.

- Finance new and rapidly growing companies
- Purchase equity securities
- Assist in the development of new products or services
- Add value to the company through active participation.

Question 24

"A Limited Partnership Entity, in India, is not recognized for the purpose of Venture Capital Fund." Do you agree? Briefly explain the structure of Venture Capital Fund in India.

(PYP 4 Marks May '23)

Answer:

Yes, agree with the statement.

Three main types of fund structure exist: one for domestic funds and two for offshore ones:

(a) **Domestic Funds:** Domestic Funds (i.e. one which raises funds domestically) are usually structured as:

(i) A domestic vehicle for the pooling of funds from the investor, and

(ii) A separate investment adviser that carries those duties of asset manager.

The choice of entity for the pooling vehicle falls between a trust and a company, (India, unlike most developed countries does not recognize a limited partnership), with the trust form prevailing due to its operational flexibility.

(b) **Offshore Funds:** Two common alternatives available to offshore investors are: the "offshore structure" and the "unified structure".

Offshore structure

Under this structure, an investment vehicle (an LLC or an LP organized in a jurisdiction outside India) makes investments directly into Indian portfolio companies. Typically, the assets are managed by an offshore manager, while the investment advisor in India carries out the due diligence and identifies deals.

Unified Structure

When domestic investors are expected to participate in the fund, a unified structure is used. Overseas investors pool their assets in an offshore vehicle that invests in a locally managed trust, whereas domestic investors directly contribute to the trust. This is later device used to make the local portfolio investments.

Question 25

What do you mean by Pitch Presentation in context of Start-up Business?

(Old & new SM, PYP 4 Marks July '21, MTP 6 Marks Oct '18, MTP 4 Marks Oct '22)

Answer:

Pitch presentation is a short and brief presentation (not more than 20 minutes) to investors explaining about the prospects of the company and why they should invest into the startup business. So, pitch deck presentation is a brief presentation basically using PowerPoint to provide a quick overview of business plan and convincing the investors to put some money into the business. Pitch presentation can be made either during face to face meetings or online meetings with potential investors, customers, partners, and co-founders.

Here, some of the methods have been highlighted below as how to approach a pitch presentation:

(i) **Introduction:** To start with, first step is to give a brief account of yourself i.e. who are you? What are you doing? But care should be taken to make it short and sweet. Also, use this opportunity to get your investors interested in your company. One can also talk up the most interesting facts about one's business, as well as any huge milestones one may have achieved.

(ii) **Team:** The next step is to introduce the audience the people behind the scenes. The reason is that the investors will want to know the people who are going to make the product or service successful. Moreover, the investors are not only putting money towards the idea but they are also investing in the team? Also, an attempt should be made to include the background of the promoter, and how it relates to the new company. Moreover, if possible, it can also be highlighted that the team has worked together in the past and achieved significant results.

(iii) **Problem:** Further, the promoter should be able to explain the problem he is going to solve and solutions emerging from it. Further the investors should be convinced that the newly introduced product or service will solve the problem convincingly.

For instance, when Facebook was launched in 2004, it added some new features which give it a more professional and lively look in comparison to Orkut which was there for some time. It enabled Facebook to become an instant hit among the people. Further, customers have no privacy while using Orkut. However, in Facebook, you can view a person's profile only if he adds you to his list. These simple yet effective advantages that Facebook has over Orkut make it an extremely popular social networking site.

(iv) **Solution:** It is very important to describe in the pitch presentation as to how the company is planning to solve the problem. For instance, when Flipkart first started its business in 2007, it brought the concept of e-commerce in India but when they started, payment through credit card was rare. So, they introduced the system of payment on the basis of cash on delivery which was later followed by other e-commerce companies in India. The second problem was the entire supply chain system. Delivering goods on time is one of the most important factors that determine the success of an ecommerce company. Flipkart addressed this issue by launching their own supply chain management system to deliver orders in a timely manner. These innovative techniques used by Flipkart enabled them to raise large amount of capital from the investors.

(v) **Marketing/Sales:** This is a very important part where investors will be deeply interested. The market size of the product must be communicated to the investors. This can include profiles of target customers, but one should be prepared to answer questions about how the promoter is planning to attract the customers. If a business is already selling goods, the promoter can also brief the investors about the growth and forecast future revenue.

(vi) **Projections or Milestones:** It is true that it is difficult to make financial projections for a startup concern. If an organization doesn't have a long financial history, an educated guess can be made. Projected financial statements can be prepared which gives an organization a brief idea about where is the business heading? It tells us that whether the business will be making profit or loss?

Financial projections include three basic documents that make up a business's financial statements.

- **Income statement:** This projects how much money the business will generate by projecting income and expenses, such as sales, cost of goods sold, expenses and capital. For your first year in business, you'll want to create a monthly income statement. For the second year, quarterly statements will suffice. For the following years, you'll just need an annual income statement.

- **Cash flow statement:** A projected cash flow statement will depict how much cash will be coming into the business and out of that cash how much cash will be utilized into the business. At the end of each period (e.g. monthly, quarterly, annually), one can tally it all up to show either a profit or loss.

- **Balance sheet:** The balance sheet shows the business's overall finances including assets, liabilities and equity. Typically, one will create an annual balance sheet for one's financial projections.

(vii) Competition: Every business organization has competition even if the product or service offered is new and unique. It is necessary to highlight in the pitch presentation as to how the products or services are different from their competitors. If any of the competitors have been acquired, their complete details like name of the organization, acquisition prices etc. should also be highlighted.

(viii) Business Model: The term business model is a wide term denoting core aspects of a business including purpose, business process, target customers, offerings, strategies, infrastructure, organizational structures, sourcing, trading practices, and operational processes and policies including culture.

Further, as per Investopedia, a business model is the way in which a company generates revenue and makes a profit from company operations. Analysts use the term gross profit as a way to compare the efficiency and effectiveness of a firm's business model. Gross profit is calculated by subtracting the cost of goods sold from revenues. A business model can be illustrated with the help of an example. There are two companies company A and company B. Both the companies are engaged in the business of renting movies. Prior to the advent of internet both the companies rent movies physically. Both the companies made ₹ 5 crore as revenues. Cost of goods sold was ₹ 4 crores. So, the companies made ₹ 1 crore as gross profit. After the introduction of internet, company A started to offer movies online instead of renting or selling it physically. This change affected the business model of company A positively. Revenue is still ₹ 5 crore but the significant part is that cost of goods sold is now ₹ 2 crore only. This is because online sales lead to significant reduction of storage and distribution costs. So, the gross profit increases from 20% to 60%.

Therefore, Company A isn't making more in sales, but it figured out a way to revolutionize its business model, which greatly reduces costs. Managers at company A have an additional 40% more in margin to play with than managers at company A. Managers at company A have little room for error and they have to tread carefully.

Hence, every investor wants to get his money back, so it's important to tell them in a pitch presentation as to how they should plan on generating revenue. It is better to show the investors a list of the various revenue streams for a business model and the timeline for each of them. Further, how to price the product and what does the competitor charge for the same or similar product shall also be highlighted. It is also beneficial to discuss the lifetime value of the customer and what should be the strategy to keep him glued to their product

(ix) **Financing:** If a startup business firm has raised money, it is preferable to talk about how much money has already been raised, who invested money into the business and what they did about it. If no money has been raised till date, an explanation can be made regarding how much work has been accomplished with the help of minimum funding that the company is managed to raise.

It is true that investors like to see entrepreneurs who have invested their own money. If a promoter is pitching to raise capital, he should list how much he is looking to raise and how he intends to use the funds.

EXAMINERS' COMMENTS ON THE PERFORMANCE OF EXAMINEES:
Good performance has been observed in this theoretical question on Stratup Finance though in some cases students mentioned lesser points and, in some cases, only headings have been mentioned hence losing the marks unnecessarily.

Question 26

Succession planning is a good way for companies to ensure that businesses are fully prepared to promote and advance all employees-not just those who are at the management or executive levels. Explain the above statement. (chapter Startup Finance)

(RTP May '24)

Answer:

Succession planning is the process of identifying the critical positions within an organization and developing action plans for individuals to assume those positions. A succession plan identifies future need of people with the skills and potential to perform leadership roles. Taking a holistic view of current and future goals, this type of preparation ensures that the right people are available for the right jobs today and in the years to come. It can also provide a liquidity event, which enables the transfer of ownership in a going concern to rising employees.

Need for succession planning can be explained below:

- **Risk mitigation -** If existing leader quits, then searches can take six-nine months for suitable candidate to close. Keeping an organization without leader can invite disruption, uncertainty, conflict and endangers future competitiveness.

- **Cause removal -** If the existing leader is culpable of gross negligence, fraud, wilful misconduct, or material breach while discharging duties and has been barred from undertaking further activities by court, arbitral tribunal, management, stakeholders or any other agency.

- **Talent pipeline -** Succession planning keep employees motivated and determined as it can help them obtaining more visibility around career paths expected, which would help in retaining the knowledge bank created by company over a period of time and leverage upon the same.

- **Conflict Resolution Mechanism -** This planning is very helpful in promoting open and transparent communication and settlement of conflicts.

- **Aligning -** In family-owned business succession planning helps to align with the culture, vision, direction and values of the business.

Question 27

What do you mean by the term Unicorn? State the features a Start-up should possess to be referred as a Unicorn?

(MTP 6 marks March '24)

Answer:

A Unicorn is a privately held start-up company which has achieved a valuation US$ 1 billion. This term was coined by venture capitalist Aileen Lee, first time in 2013. Unicorn, a mythical animal represents the statistical rarity of successful ventures.

A start-up is referred as a Unicorn if it has following features:

(i) A privately held start-up.

(ii) Valuation of start-up reaches US$ 1 Billion.

(iii) Emphasis is on the rarity of success of such start-up.

(iv) Other common features are new ideas, disruptive innovation, consumer focus, high on technology etc.

However, it is important to note that in case the valuation of any start-up slips below US$ 1 billion it can lose its status of "Unicorn'. Hence a start-up may be Unicom at one point of time and may not be at another point of time.

Question 28

Why is there a need for succession planning in business? Explain.

(MTP 4 Marks April '24)

Answer:

Need for succession planning in business is explained below:

- **Risk mitigation -** If existing leader quits, then searches can take six-nine months for suitable candidate to close. Keeping an organization without leader can invite disruption, uncertainty, conflict and endangers future competitiveness.

- **Cause removal -** If the existing leader is culpable of gross negligence, fraud, willful misconduct, or material breach while discharging duties and has been barred from undertaking further activities by court, arbitral tribunal, management, stakeholders or any other agency.

- **Talent pipeline-**Succession planning keep employees motivated and determined as it can help them obtaining more visibility around career paths expected, which would help in retaining the knowledge bank created by company over a period of time and leverage upon the same.

- **Conflict Resolution Mechanism-**This planning is very helpful in promoting open and transparent communication and settlement of conflicts.

- **Aligning -** In family-owned business succession planning helps to align with the culture, vision, direction and values of the business.

Question 29

NIYA Healthcare is a proprietary concern engaged in the manufacture and development of Pharmaceutical products since last five years. To scale up the business operations and increase the present turnover which is hovering around 500 Million, the proprietor decides to convert his existing business into a Private Limited Company. He also wants to get access to various tax benefits, easier compliances under the startup India initiative and get recognized as a startup company.

Advise whether NIYA Healthcare can be recognized as a startup company in view of the criteria considered eligible for the startup recognition initiated by the Government of India? **(4 Marks)**

(PYP 4 Marks Nov '23)

Answer:

As per Government of India notification an entity can be considered as a Startup:

(i) If it is incorporated as a private limited company or registered as a partnership firm or a limited liability partnership in India upto a period of 10 years from date of incorporation or registration.

(ii) Turnover of the entity for any of the financial years since incorporation/registration has not exceeded one hundred crore rupees.

(iii) Entity is working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with a high potential of employment generation or wealth creation.

Provided that an entity formed by splitting up or reconstruction of an existing business shall not be considered a 'Startup'.

Advise: In the present scenario, NIYA healthcare is converted into a private limited company. In other words there is a reconstruction of an exiting propriety business into a private limited company. In view of the above the company cannot be recognised as a startup company.

Question 30

"In Deal Structuring, in many structures to facilitate the exit, the Venture Capital may put a tag-along clause". What do you mean by that clause? Explain Deal Structuring and Exit Plan to Venture Capital Investment Process. **(PYP 4 Marks Nov '23)**

Answer:

Tag-alone clause means VC is put by condition that promoter must sell a part of his/her stake along with the VC.

Deal Structuring: Once the case passes through the due diligence it would now go through the deal structuring. The deal is structured in such a way that both parties win. In many cases, the convertible structure is brought in to ensure that the promoter retains the right to buy back the share.

Exit plan: At the time of investing, the VC would ask the promoter or company to spell out in detail the exit plan. Mainly, exit happens in two ways:

(a) One way is 'sell to third party(ies)'. This sale can be in the form of IPO or Private Placement to other VCs

(b) The second way to exit is that promoter would give a buy back commitment at a pre agreed rate (generally between IRR of 18% to 25%). In case the exit is not happening in the form of IPO or third-party sell, the promoter would buy back. In many deals, the promoter buyback is the first refusal method adopted i.e. the promoter would get the first right of buyback.