

THE BASICS OF STARTUP FINANCING

initial infusion of money needed to turn an **idea into reality**.

While starting, big lenders like **banks etc.** are **not interested** So that leaves one with option of **selling assets, borrowing against one's home**, asking loved ones i.e. **family and friends for loans etc.**

SOME OF THE INNOVATIVE WAYS TO FINANCE A STARTUP

Some of the sources for funding a startup:

- i. **Personal financing:** **Investors will not put money** if you have **not contributed** any money
- ii. **Personal credit lines:** **one's personal credit efforts.** Eg. Credit cards
- iii. **Family and friends:** These people **believe in you, without even thinking your idea works or not.**
- iv. **Peer-to-peer lending:** **group of people come together & lend money to each other.**
- v. **Crowdfunding:** **small amounts of capital from a large individuals** (Eg Keto)
- vi. **Vendor financing:** **company lends money to customers** so that he can **buy products from the company itself.**
- vii. **Factoring accounts receivables:** **when goods are sold on credit, factor will pay most of the sold amount up front.**
- viii. **Purchase order financing:** In **PO financing** companies often **advance required funds directly to supplier.**
- ix. **Microloans:** **small loans** given by **individuals at a lower interest** to a new business venture.

PITCH PRESENTATION

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.**

- i. **Introduction:** **brief account of yourself i.e. who are you? What are you doing? short and sweet.** talk about **most interesting facts** about **one's business**, as well as **any huge milestones achieved.**
- ii. **Team:** **introduce the the people behind the scenes.** Investors will want to know **people** who are going to **make product or service successful.**
- iii. **Problem:** **able to explain the problem he is going to solve** and solutions emerging from it.
- iv. **Solution:** important to describe **how the company is planning to solve the problem.**
- v. **Marketing/Sales:** The **market size of the product must be communicated to the investors.**
- vi. **Projections or Milestones:** **Projected f/s** can be prepared which gives a brief idea about where is the business heading. (*Balance sheet, Income statement, Cash flow statement*)
- vii. **Competition:** Every business has **competition** even if product is unique. **highlight as to how products or services are different from their competitors.**
- viii. **Business Model:** the way in which a company **generates revenue and makes a profit**
- ix. **Financing:** If **raised money**, talk about **how much money has already been raised**, who invested money into business.

MODES OF FINANCING FOR STARTUPS

(i) **Bootstrapping:**

An individual is said to be boot strapping when he found and build a company from **personal finances** or **from the operating revenues of the new company.** Some Methods are :-

- a) **Trade Credit:** If **suppliers are reluctant to give trade credit**, visit supplier's office or CFO and convince about the financial plan explaining about the business and the need to get the first order on credit in order to launch the venture
- b) **Factoring:** financing method where **accounts receivable is sold to a commercial finance company** to raise capital. **factoring also frees up money** that would otherwise be tied to receivables.
- c) **Leasing:** **take the equipment on lease rather than purchasing it. It will reduce the capital cost and also help lessee to claim tax exemption.**

(ii) Angel Investors:

Often, angel investors are among an **entrepreneur's family and friends**. They may provide a **one-time investment** to help business propel or an **ongoing injection** of money to support business. Angel investors **provide more favorable terms** compared to other lenders, **since they invest in entrepreneur** rather than business. **They are opposite of venture capitalists.** **Angel investors typically use their own money**, unlike **venture capitalists who take care of pooled money from many other investors.**

(iii) Venture Capital Fund:

Structure of Venture Capital Fund in India

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

A. **Domestic Funds:** Domestic Funds are usually structured as:

- i. a **domestic vehicle (Trust or Co)** for the **pooling of funds** from the investor, and
- ii. a **separate investment adviser** that carries those **duties of asset manager.**

B. **Offshore Funds:** Two alternatives: the "**offshore structure**" and the "**unified structure**"

<p><u>Offshore structure:</u> Under this structure, an investment vehicle (LLC or LP 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.</p>	<p><u>Unified Structure:</u> When domestic investors 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.</p>
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Concept of Venture Capital Fund

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.**

Characteristics of Venture Capital Financing

- (i) **Long time horizon:** **Minimum period** of investment would be **3 years** and **maximum 10 years.**
- (ii) **Equity Participation:** VC would be **investing in the form of equity & participate in management.**
- (iii) **Lack of liquidity:** **less liquidity** on the **equity** and they **adjust this liquidity premium against the price and required return.**
- (iv) **High Risk:** VC would **not hesitate to take risk.** It works on principle of **high risk and high return.**

Advantages of bringing VC in the company

- It **injects long- term equity finance**.
- VC is a business partner, sharing both **risks and rewards**.
- **provide practical advice and assistance**
- VC also has a **network of contacts** in many areas that **add value to the company**.
- VC may be capable of providing **additional rounds of funding**.
- Venture capitalists are experienced in the process of preparing a company for an **IPO**.
- They can also facilitate a **trade sale**.

Stages of funding for VC & indicative Risk matrix:

Financial Stage	Period (lock in)	Risk Perception	Activity to be financed
Seed Money	7-10	Extreme	support a concept or idea or R&D for product development.
Start Up	5-9	Very High	Initializing prototype operations or developing
First Stage	3-7	High	Start commercial production and Sales
Second Stage	3-5	Sufficiently High	working capital for co. that are selling product but not yet turning in a profit
Third Stage	1-3	Medium	Also Called Mezzanine financing, expansion money for a newly profitable company.
Fourth Stage	1-3	Low	Also called bridge financing , Facilitating public issue

VC Investment Process

The entire VC Investment process can be segregated into the following steps:

- 1) **Deal Origination:** VC operates **directly or through intermediaries**.
Before sourcing deal, VC inform intermediary/**employees** about the following so that they does not waste time : **Sector focus, Stages of business focus, Promoter focus & Turn over focus**.
- 2) **Screening:** The screening is **generally carried out by a committee consisting of senior level people of the VC**. Once screening happens, it select the company for further processing.
- 3) **Due Diligence:** the VC would now **carry out due diligence by verifying the veracity of the documents taken**.
- 4) **Deal Structuring:** **The deal is structured in such a way that both parties win**.
to facilitate exit, the VC may put a condition that promoter has also to sell part of its stake along with the VC. Such a clause is called tag- along clause.
- 5) **Post Investment Activity:**the **VC nominates its nominee in the board** of company. The company has to **adhere to certain guidelines like strong MIS, strong budgeting system, strong corporate governance**. If milestone **not met** the company has to **give explanation** to the VC.
- 6) **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)**' - **IPO or Private Placement** to other VCs.
 - b) The second way is - **promoter would give buy back commitment at a pre agreed rate**

STARTUP INDIA INITIATIVE

Startup means an entity, incorporated or registered in India:

- **Upto ten years** from the **date of incorporation/ registration** (Pvt Ltd., LLP or Reg. PF in India)
- Annual turnover not exceeding Rs 100 Crore in any FY since incorporation/ registration
- Working towards **innovation, development or improvement of products, processes or services** or with high potential of **employment generation or wealth creation**.

Provided entity **not formed by splitting up, or reconstruction**, of a business already in existence.

Some major reasons why India became such a sustainable environment for startups to thrive in : -

- (i) The Pool of Talent
- (ii) Cost Effective Workforce
- (iii) Increasing use of Internet
- (iv) Technology
- (v) Variety of Funding Options Available

Meaning of Succession Planning

It is a process of identifying the critical positions within an organization and developing action plans. It identifies future need of people with the skills and potential to perform leadership roles. It is an important priority for family owned businesses as most of them are managed by a non-family leader even though the ownership lies with the family.

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.

Why is there a need for succession planning?

Risk mitigation, Cause removal, Talent pipeline, Conflict Resolution Mechanism, Aligning

Business succession strategy

Step 1 - Evaluate key leadership positions Step 2 - Map competencies required for above positions
Step 3 - Identify competencies of current workforce Step 4 - Bridge Leader

Challenges

- Founder mindset might be different than the corporate mindset
- Premature for startups to implement business succession
- Founders are the face of startups

CONCEPT OF UNICORN

A Unicorn is a privately held start-up company which has **achieved a valuation US\$ 1 billion**.

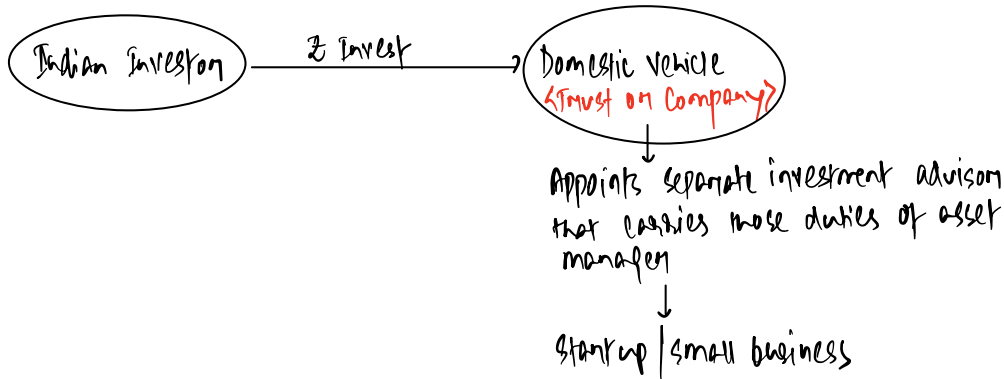
A start-up is referred as a Unicorn if it has following features:

- (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.**

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 Unicorn at one point of time and may not be at another point of time.

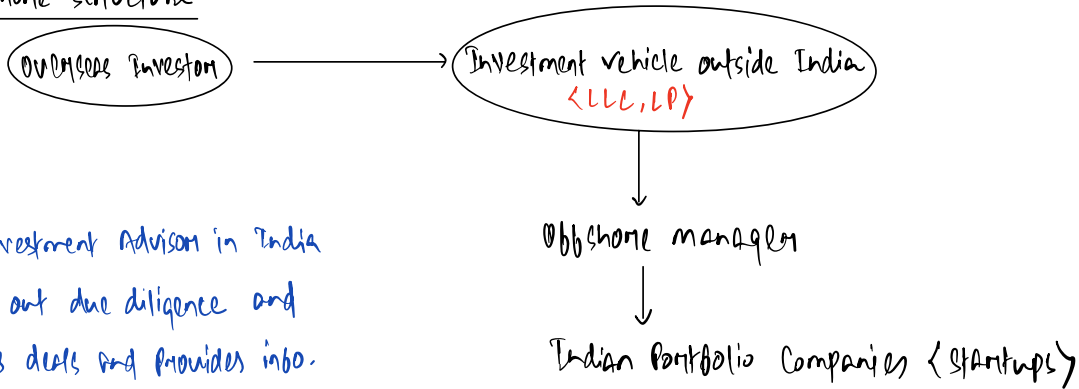
Structure of Venture Capital Fund in India (Explanation to Page No. 2)

1. Domestic Funds



2. OFFSHORE FUNDS

(i) offshore structure



Here, Investment Advisor in India carries out due diligence and identifies deals and provides info. to offshore manager.

(ii) Unbled structure (Both domestic & overseas investor)

