MAN301T: Entrepreneurship & Management functions

Session 8

https://sites.google.com/a/iiitdm.ac.in/vsudhir/courses/entrepreneurship-management

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Contents

Capital Requirements and Sources of Funds

Valuation of a Firm (& startups)

Estimating Financial Requirements

- Long-term funds (capital requirement). Long term funds can be estimated by
  - Listing fixed assets of various types, namely,
    - Land
    - Buildings
    - Plant & machinery
    - Acquisition of patents and
    - Trade investments (all these are blocked for a long period > 1 yr)
  - Computing the working capital requirement (part of it is considered as long-term)

- Short-term funds – working capital requirement
  - To pay for production (labor/material) & operating costs (sales & general admin)

Sources of funds

- Sources of long-term finance:
  - Shareholder funds
    - the amount raised by issue of equity or preference shares
    - the amount of retained profits not distributed amongst shareholders as dividend
  - Loans or debentures (long-term debt) – fixed rate of interest

  - Incubators / Angels / Venture Capitalists in the case of startups

Contents

Capital Requirements and Sources of Funds

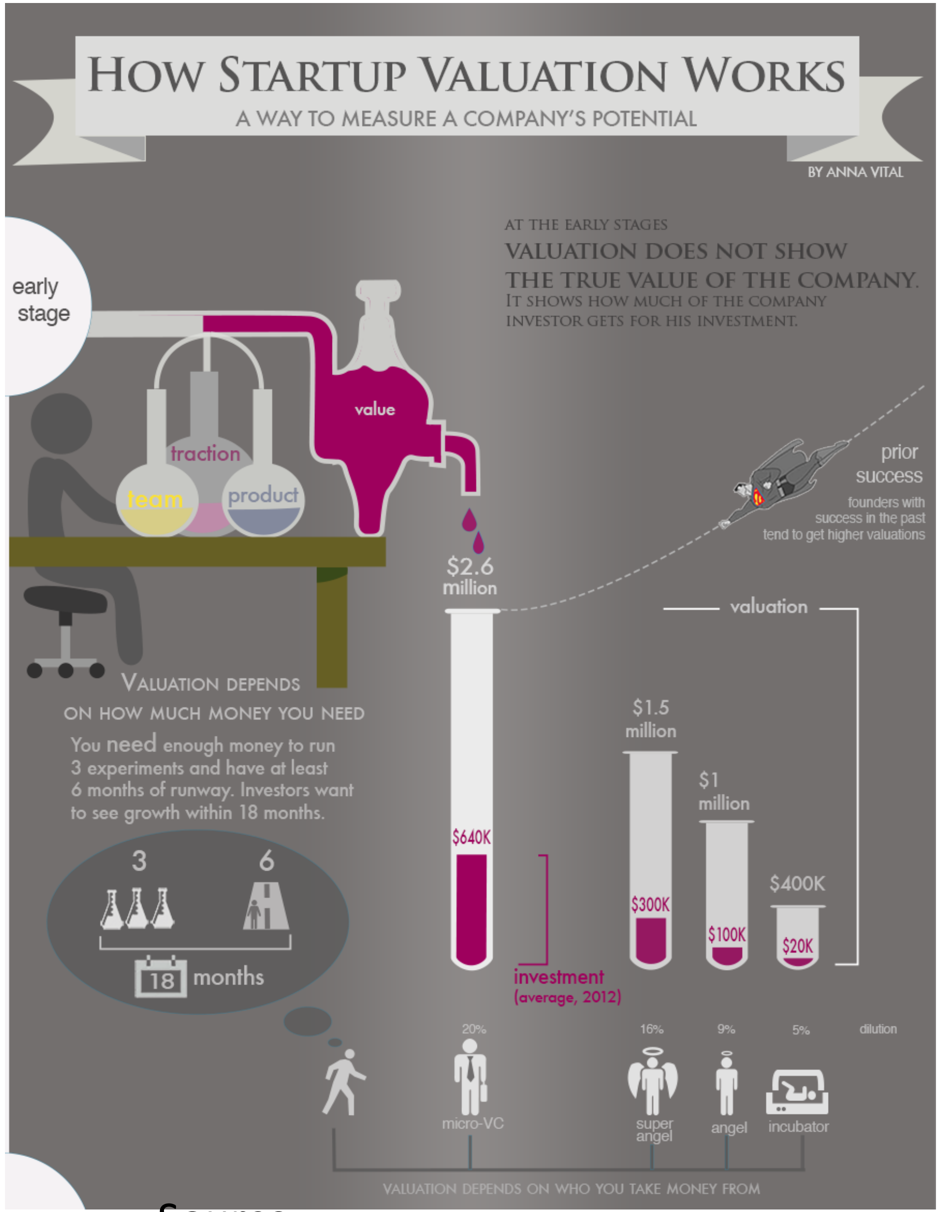
Valuation of a Firm (& startups)

Valuation

- Book value is simply the owners's equity in the balance sheet. But, the market value of the business – what an acquirer would pay for it – may be quite different
- Publicly traded companies can measure their market value every day – multiply daily stock price by the number of shares outstanding. A privately held company must estimate its market value
- Valuation usually refers to the process for determining the total value of a company.

Valuation of Startups?

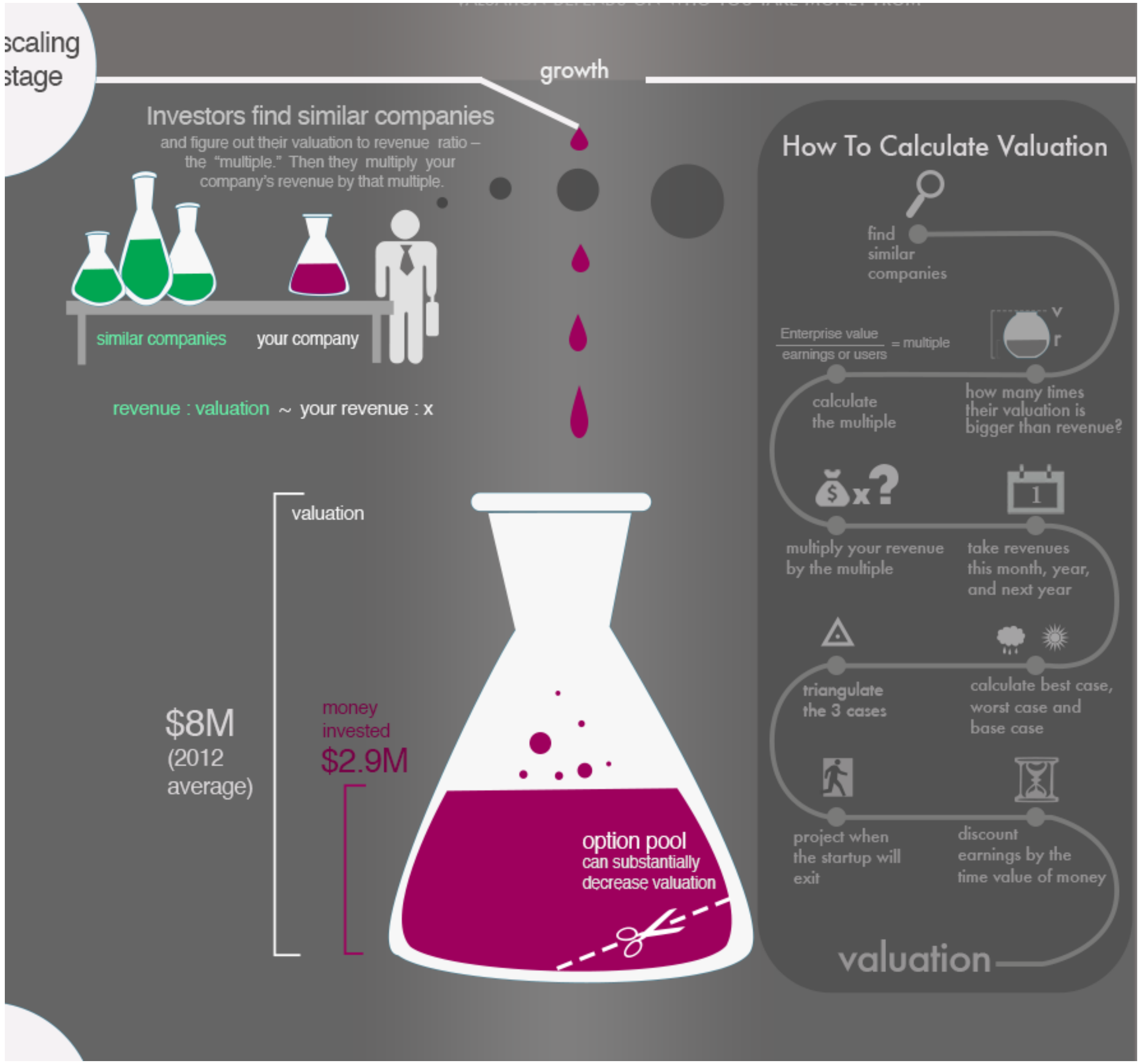
- It is a basis for deciding how much of the company's equity will the entrepreneur have to give up in order to raise required amount of capital?
  - An entrepreneur wants to project higher valuation to raise more capital
  - An investor wants the opposite so that it will give him access to more share of the company



Source:

How to do valuation?

- Three frequently used approaches
  - Estimate future cash flows and use an interest rate to compute its worth now (DCF)
  - Look at the market value of a publicly traded companies that are similar
  - Evaluate the company’s assets – tangible and intangible (patents/customer list)



Source:

Discounted cash flow

- Time value of money

  - What is the present value of $100 to be received next year?

    $PV = CF_t/(1+r)^t$

    If r = 10%, … risk associated with the cash flow

    PV = 100/(1+0.1) = $90.91

What is r? Required rate of return – usually 40-60% in VC situations

Market Multiples

- Apply valuation ratio of comparable firm to firm being valued
  - Examples: P-E, market value/book value, Market value/ Sales, EBITDA
  - Value of firm = Average P/E multiple in industry $\times$ EPS of firm
  - P/E method can be used when
    - firms in the industry are profitable (have positive earnings)
    - firms in the industry have similar growth (more likely for "mature" industries)
    - firms in the industry have similar capital structure
  - Market Value/Book Value is used more in manufacturing (where book value = equity)
  - EBITDA multiple is used more in software services (measures value of operations)

Things to work out before next class

Start preparing a 3-year income statement for your firm

Assess capital requirements

Arrive at the valuation

To be submitted with the final business plan