13

Financing Venture

LEARNING OBJECTIVES

- To learn about the need and importance of finance for an entrepreneurial venture.
- To learn about the different financial requirements for starting a venture and their relevance.
- To learn about what constitutes working capital requirements and the relevance of cash cycle in business.
- To know about the difference between debt and equity and the different types of equity funding.
- To know about the different exit options available to investors and their relevance.
- To understand the difference between seed funding, angel funding and venture funding.
- To understand the criteria that angel funders and venture funders use to invest.
- To learn about the criteria that banks use to invest in a venture.
- To learn about the different fund-based and non-fund-based funding options that a bank extends.
- To understand the importance and relevance of lease financing.
- To know about and understand the funding opportunities for start-ups in India.

ROBERT EDWARD 'TED' TURNER III AMERICAN MEDIA MOGUL

When you lose small businesses, you lose big ideas. People who own their own businesses are their own bosses. They are independent thinkers. They know they can't compete by imitating the big guys; they have to innovate. So they are less obsessed with earnings than they are with ideas.

—Ted Turner

Robert Edward Ted Turner was born on 19 November 1938 and is known for his entrepreneurial journey and as a philanthropist. He is one of the richest men in the world and is known as the founder of the Cable News Network (CNN), which was the first dedicated 24-hour cable news channel. It revolutionized news media, covering the Space Shuttle Challenger disaster in 1986. It pioneered the live broadcasting of breaking news from around the globe that enabled the whole world to experience the instant availability of happenings across the globe.

He is the owner of the Superstation TBS, TNT, CNN, the Atlanta Braves, Hawks Sports organizations and other channels such as Cartoon Network. Turner is one of the top 50 wealthiest men in the world. He is a media mogul who pioneered the concept of the TV 'Superstation' broadcasting to cable systems nationwide via satellite. Later on, the system was dubbed TBS (Turner Broadcasting Station), which is viewed in more than 160 million homes in 200 countries and nearly 40 languages. Turner became Time Warner's largest shareholder with 10 per cent of the company after TBS got 'merged' with Time Warner in 1996; Time Warner is the largest entertainment company in the world.

Turner has been very vocal about 'giving back'. As a philanthropist, he is known for his $1 billion gift to support UN (United Nations) causes, which led to the creation of the UN Foundation in 1998, a public charity that expands the support for the United Nations.

13.1 INTRODUCTION

Every venture that introduces a new product or service into the market requires financial funding at different stages of its growth for giving a shape to the idea that is assessed as an opportunity. Fundamentally, the money the entrepreneur has or can arrange from different sources makes a difference in their ability to give a shape to the business and keep it running. All entrepreneurs learn about this aspect sooner or later, irrespective of their background—technical, financial or general. Generally, a professional with a technical background as an entrepreneur hates this job and has a notion that they cannot do this job. They are more obsessed with dealing with customers, inspiring employees, building a winning team and innovating rather than dealing with financial matters. However, this aspect is very crucial for the success of a venture and, therefore, sooner or later, the entrepreneur develops a knack of either dealing with these aspects or inducting a professional to look after these aspects. There are varieties of financial possibilities. What matters the most is the appropriate finances in terms of quantum, timings and other associated terms and conditions attached to getting funds for promoting ventures. The entrepreneur needs to assess well the requirement of funds and the purpose for which these are required, so as to work on the possibility of sourcing the funds from the most appropriate source from the point of view of its relevance and other associated terms and conditions. It is important to know whether funds are required for research on the idea, proof-of-concept stage of an idea, prototype development, product testing on a large scale or launching the venture. However, in general, the entrepreneur thinks that capital is required for starting the business and keeps it operating for a certain period of time. Thus, finance inputs and the finance department play a crucial and an integral role in helping the business arrange for the necessary funds to meet its financial requirements and raise money that would be paid back or rewarded by way of distributing dividends to shareholders.

As such, if the start-up venture requires funds to be raised from the beginning, that is, over and above personal contributions, it is really a very tough job to raise capital in the *financing valley of death*, particularly as one may not have anything other than the idea and its worth in the eyes of funding organizations. It is also a phase for the start-up when there is no cash flow. In most cases, the start-up consists of little more than a person with an idea and a business plan. No one wants to invest at this stage unless the entrepreneur is a proven money maker for investors.[1] From an investor's point of view, putting in money in an unproven business idea is similar to putting good money into a pile and setting it ablaze. Generally, investors, from angels to venture capitalists and bankers, would like to back a venture that has sure chances of availing its services. Thus, the greatest challenge to an entrepreneur lies in creating sales without inducting requisite capital first.

As shown in Figure 13.1, start-ups before growing into a gazelle's stage go through tough times of ups and downs. The toughest phase usually lies in incurring cash losses in the beginning that persist far longer than expected (Company A). If a venture sustains this phase and has unique strengths, then it sees the light of the day while passing through a dark tunnel. Once it is able to come out of this phase, it either grows with certain minor ups and downs or keeps moving on the path of growth or passes through a similar phase of major downfall (Company B). However, due to its financial reserves, a company is in a position to better respond to financial crisis at a later stage of its growth when compared with the initial phase. There are, of course, start-ups that do not undergo major financial challenges in the beginning and have a relatively better and smooth growth from the beginning, as in case of Company C in Figure 13.1. Timely raising of the required financial resources from the most desired sources to meet such eventualities over and above the company's investment needs becomes the key to growth.

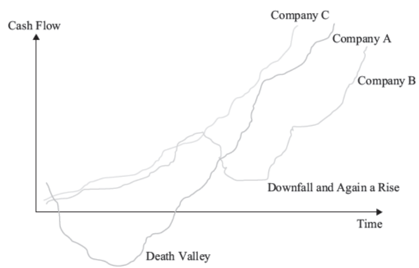


Figure 13.1 Growth Trajectory of Gazelles

13.2 WHY DOES ONE NEED MONEY?

It is easy to say that one needs ₹ 50 lakhs to start a business that one is looking forward to getting from bank loans or equity funding by self and others. One's business plan, which might have been prepared in a professional way, may show that if this money comes from a loan, it would be repaid along with interest within three years. If it comes by way of share capital, then one would be able to provide excellent returns to equity holders both by way of worthy shares in terms of business valuation and dividend payments. However, the picture just created and as depicted in the business plan leaves many pertinent questions, as mentioned next, completely unanswered (Fig. 13.2).

Pertinent Issues					
What Do You Need the Money For?	How Much Money Is Required?	What Type of Money Is Required by You?	When Exactly Do You Need Money?	What Is Stored for Investors in Offering You Money?	What Are the Exit Options Available to Investors?

Figure 13.2 Raising Finance-pertinent Issues

- What does one need money for?
- How much money is required?
- What type of money is required?
- When exactly does one need money?
- What is stored for investors in offering one money?
- What are the exit options available to investors?

13.2.1 What Does One Need Money For?

An entrepreneur may have a clear perspective about their financial requirements and the purpose for which they need the money. However, unless and until the investor can appreciate the requirements and the uses of funds they are going to put in the business, it would be of no use. At times, entrepreneurs just have an instinct that this business would require, say, ₹ 5 lakhs, and they have ₹ 10 lakhs with them, so they can enter into a business. However, such instincts or quick ways of measuring the requirement of funds for different purposes may turn out to be a

1. First of all, the entrepreneur needs to be realistic in their estimates about fund requirement. It is advisable for the entrepreneurial team to estimate their living expenses on food, housing, clothing, children's education, utilities and entertainment by putting in all austerity measures. These estimates should help them in their minimum requirements, say for a period of 15 to 18 months, depending on the lead time for the venture to start generating positive cash flow. The involved team should ensure they have sufficient money by way of savings to take care of their livelihood requirements. It is, therefore, said that if one is not married, then may be one's chances of success in a business may increase, because one may not have many requirements to take care of one's day-to-day needs.
2. If one has sufficient money to take care of the requirements just stated, then one may have to estimate one's fixed cost requirements, such as expenditure on plant and machinery, land and building, to begin with. Else, to begin with, it is always desirable to start from garage, home or rented premises, and arrange for fixed cost expenses on utilities and miscellaneous expenses and office equipment and furniture. Thus, the initial outlay on a business comprises fixed cost expenses that remain constant regardless of the level of production. These costs do not vary with the level of production activity and are been incurred whether one fully uses the capacity or underuses it or does not use it at all. Fixed cost per unit changes as the volume of business activity changes. This includes expenses on salaries of executives, interest expense, rent, depreciation and insurance expenses. They contrast with variable costs, that is, direct labour and raw materials costs that are distinguished from semi-variable costs. Semi-variable costs vary, but not necessarily in direct relation to sales. They may remain unchanged up to a particular level of sales and increase when sales enter a higher range. For example, the expenses associated with a delivery truck would be fixed up to the level of sales where a second truck is required. As such, no costs are purely fixed; the assumption, however, serves the purposes of cost accounting for limited planning periods. Cost accounting is also concerned with the allocation of portions of fixed costs to inventory costs, also called 'indirect costs', overhead, factory overhead and supplemental overhead.

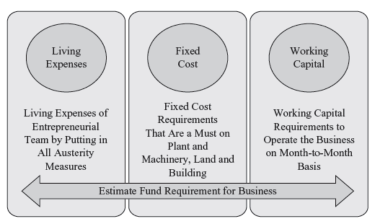


Figure 13.3 Financial Requirements for Start-ups

3. After having taken care of one's personal requirements and fixed expenses required for the venture, an entrepreneur needs to assess the money needed for working capital to operate the business on a month-to-month basis. This mainly consists of differences between the money that the venture would collect from selling the product/service and the money required to meet operating expenses. In the initial phase of the business, the difference between the two would be high. This difference keeps getting narrowed down as the business approaches break-even level of sales. As such, the entrepreneur may have to provide for meeting the cash losses that would be incurred till such time the venture starts generating profits. Thus, money requirements for working capital purpose and short-term financing (less than a year) are called 'working capital management'. The purpose of working capital management is to make certain that the firm is able to continue its day-to-day operations as planned and that it has sufficient cash flow to satisfy both maturing short-term debt and upcoming operational expenses. Many ventures land up into problems after having invested in fixed assets but not having sufficient money to use those assets optimally. This could cause the business to bear the interest on money raised for creating fixed assets but having no inflow of money because of its inability to use those assets by feeding inputs—raw materials and labour. There are a number of businesses that have gone into liquidation because of lack of or non-availability of working capital. Therefore, the entrepreneur has to be extra vigilant and careful while estimating the requirement of working capital for various

While estimating working capital, the entrepreneur needs to precisely estimate the current assets and current liabilities for the venture. The difference between the two gives the net amount of working capital.

Thus, current assets constitute the following points:

- stock of raw materials
- work-in-progress inventory
- finished goods inventory
- debtors or receivables
- expenses paid in advance
- minimum estimated cash required

The current liabilities constitute the following:

- creditors for purchase of raw materials
- creditors for expenses
- advances received from customers
- dues payable to the statutory bodies

From the current assets just indicated, the current liabilities are subtracted to arrive at a working capital gap that needs to be taken care of for running the business.

Working Capital Gap = Current Assets – Current Liabilities

Estimation of working capital requirement requires preparation of cash flow. One measure of cash flow can be determined by the cash conversion cycle, that is, the number of days from the outlay of cash required for raw materials to receiving payment from the customer. As a management tool in the hands of an entrepreneur, this provides the inter-relatedness of decisions relating to inventories—raw materials, work in capital and finished goods, accounts receivable and payable and cash. The entrepreneur needs to minimize it as it is cash that is tied up in the business operations and is unavailable for other activities.

It is also called 'cash cycle', which is calculated as a sum of the inventory holding period in number of days plus the sales outstanding period in number of days minus the payable outstanding period in number of days. It is calculated in the following manner:

Cash Cycle = Number of Days Inventory Outstanding + Number of Days Sales Outstanding – Number of Days Payable Outstanding

Thus, it accounts for the length of time between when a company pays for purchases of inventory and when it receives cash from its own customers who purchase the inventory. For example, a manufacturer orders for raw materials on 5 March with payment due on 25 March. The goods produced are sold on 10 April with payment received from customers on 30 April. The cash conversion cycle is 37 days: the difference between 25 March, when the company pays its suppliers, and 30 April, when the company receives payment from its own customers. A short cash conversion cycle allows a business to quickly acquire cash that can be used for additional purchases or debt repayment.

Pollan and Levine (1990) have suggested a simple technique for start-up ventures to realistically estimate the following points:

- **Monthly Fixed Costs**—Expenses that do not vary with volume of production such as rent, fees, advertising, water, electricity, insurance, depreciation and maintenance of premises.
- **Estimate Monthly Variable Cost**—Costs that vary with volume of production such as raw materials, packaging charges, sales commission and other direct costs of production.
- **Estimate the Price That Can Be Charged for Products/Services**—Estimate the price that a customer will be willing to pay in the backdrop of competitors, market conditions, industry norms, uniqueness of product/service and any legal stipulations on charging price.
- **Estimate Contribution Margin**—Contribution margin is the difference between sales price and variable cost of production. For example, if the price is ₹ 10 per unit and the variable cost of production is ₹ 4 per unit, then the contribution margin will work

- **Estimate the Sales**—Estimate the sales that would result in a break-even level.
- **Project Cash Flow**—The difference between income and expenses each month will give rise to cash flow from the venture. These need to be estimated by considering customer payment terms, supplier payment terms, pay back terms for loans and requirement of funds for reinvestments in the business.
- **Estimate Working Capital Requirements**—Working capital requirements for a start-up will be the shortfall in cash flow till break-even level and, thereafter, it would mainly depend on the working capital cycle.

The total fund requirement will be initial outlay plus the working capital requirements. It is better to keep an additional cushion of 15 to 20 per cent over and above the estimated requirements to take care of uncertainties and imponderables.

One should remember the key lesson in financing a venture—that one will usually need more money than one has expected due to unexpected costs and/or delayed income. Therefore, it is always advisable to keep a financial reserve while planning by way of insurance, extra funding and personal sources of funds to manage uncertainties. Further, it is not always a good strategy to borrow all the money one can get, as one should manage funds very well, more so in the initial phase of launching a business and growth thereafter. Lack of 'money' can cause great problems for the business, as is true of having excessive money. It is easier to raise money when an entrepreneur owns funds. Basically, what is important is to make a meticulous plan about fund requirement and then look for appropriate sources.

13.2.2 What Type of Money Does One Require?

Thus, broadly two types of capital are generally needed to start a business (Fig. 13.4)—permanent and working capital. Since they do not always come from the same sources, it is important to understand the difference between these two types of capital before attempting to obtain financing. Permanent and long-term capital includes funds for land, buildings, equipment, furniture and fixtures. Financing for meeting these expenses should come from long-term sources such as mortgages, owner's capital sale of stocks, venture capitalists and long-term lease agreements. Working capital or short-term funds include capital for cash, inventory and accounts receivable. Financing for these items will come from commercial banks and other financial institutions in the form of note payable, accounts-receivable financing, inventory financing, lines of credit and personal loans; from trade credit, in the form of accounts payable; and from credit unions and life insurance companies, in the form of intermediate loans.

Another way of differentiating sources of financing is by the way they are raised—by debt or by equity. Business ventures use debt and equity financing to leverage capital expenditures, project development and operational expansion. Without using financial leverage, a company's financial growth is mainly constrained by internal surpluses leading to retained earnings. Thus, for availing growth opportunities, debt and equity financing are often considered vital to business expansion. Both debt and equity financing have their own advantages and disadvantages. Keeping in view the associated advantages and disadvantages, an entrepreneur needs to decide about the appropriate mix between the two.

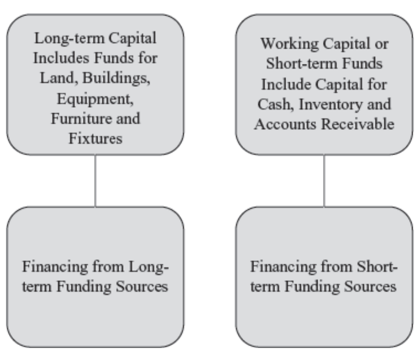


Figure 13.4 Types of Funding Requirements

Debt is borrowed money from different sources such as banks, over time to a zero sum balance without any further obligation to the lender. Debts for a short term that are less than a year are used for working capital, whereas long-term debts are used for purchase of plant and machinery, land and building, that is, fixed assets that give benefits spread over a long period (more than a year).

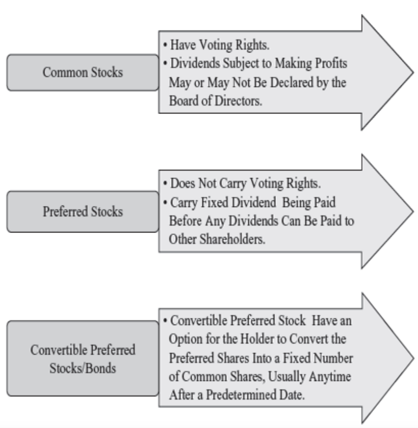
Funds raised through debt should eventually be paid back, usually by a schedule stipulated by a contract. Individuals and financial institutions lending funds to a firm expect the funds to be repaid as principal and interest payments over the period for which the loan is outstanding. The timely and regular debt repayment is of utmost importance to the entrepreneur, as, in future, lending institutions will judge the loan applications on that basis.

Traditional lenders usually evaluate a project by focusing on parameters such as how long the business has been in existence and prospects for income from business, and they look for collaterals for the loan. Bankers usually keep charge of all assets financed by them and ask for further securities to safeguard them by way of pledge of share and mortgage of land and building. Over and above, these bankers would ask one for personal guarantee for the repayment of a loan or at times may look for corporate guarantee of some other good company of one's own. The greatest disadvantage of debt financing is a fixed obligation to repay interest and principal amount, which puts a burden on the cash flows of the company.

Debt financing includes collateralized bonds, debentures, bank loans and lines of credit. Generally, debt financing comes with an interest rate somewhere between 8 and 13 per cent depending on the type of loan and the comfort level to the lenders in terms of risk of default. Debt financing is usually tax exempted, as interest payments are a part of expenses for the business, which get taken care of before arriving at pretax profits. For this reason, debt financing can be less expensive than equity financing.

The benefit of equity financing or venture capital is that one receives money in exchange for equity in one's business in the form of stock. A key benefit of this type of financing is that typically there is no monthly payment requirement to investors. Instead, one gives up one's ownership interest in the company. Equity funds come from individuals and institutions that invest money without expecting a specific rate of return on that investment, or a specific date by which that money would be returned. Equity investors expect returns from the earnings of the company in the form of dividends and/or an increase in the value of the stock of the firm. Equity investors are thereby interested in the long-term profitability of the firm rather than the short-term cash flows.

The shares issued by the company could be common or preferred. Common stock typically carries voting rights that can be exercised in corporate decisions. Preferred stock mainly differs from common stock in that it typically does not carry voting rights but is legally entitled to receive a certain level of fixed dividend payments before any dividends can be paid to other shareholders. Convertible preferred stock is preferred stock that includes an option for the holder to convert the preferred shares into a fixed number of common shares, usually anytime after a predetermined date. Shares of such stock are called 'convertible preferred shares'. Equity financing can also take the form of employee stock options, which replace direct pay in the form of corporate benefit. In the case of common and preferred shares, equity financing can be variable based on stockholders' expectations, that is, the higher the expectations, the higher the cost of financing (Fig. 13.5).



There is a hybrid nature of fund raising that has the character of debt as well as equity called 'convertible bonds/debentures'. These have a fixed interest payment commitment and part or full principal is convertible at some future date into equity, thus providing a mixed character to such funds.

13.2.3 When Exactly Does One Need Money?

An entrepreneur taps money from different sources, for different durations with different quantum, depending on the purpose for which money is required. What is more important is to estimate the exact period when money is required, so that the venture does not suffer and, at the same time, there is hardly any excessive money that should lie with the entrepreneur. For example, money for renting a building or buying a land for construction of a building would be required far ahead of time than the money required for plant and machinery. Even the timings for the money required for plant and machinery depend on the machinery being imported or indigenously acquired and the terms and conditions for their repayment. Further, the money required for working capital would be required only after production facilities are ready for entering into the production phase. Even the quantum of working capital requirements will be different for different months during the initial phase of production till such time as production stabilizes to an optimum level.

13.2.4 What Is Stored for Investors in Offering Money to an Entrepreneur?

Raising money for the venture requires offering terms that an investor should not be in a position to refuse. Each stage of funding and the purpose of funding require different sources of funds to be tapped by offering different terms and conditions. An entrepreneur should approach an investor after doing a thorough homework about their business and the alternate source of investments that can be tapped. The entrepreneur should be ready to face different questions from investors before they come to the conclusion of associating with the business and offer them term sheet. For example, a loan required under hire purchase scheme for buying a vehicle does not involve many complications, as it involves low risk and scheduled repayments. The entrepreneur may have just to approach someone who can expeditiously process their request and offer better terms in terms of repayment instalments and schedule. However, a term loan from a bank may involve complications in terms of handling interest issue, security matters, repayment schedule, terms of release of money and moratorium required for repayment to begin. Similarly, the process may get further complicated when an entrepreneur is looking for investment from a venture capital firm. The entrepreneur has to decide how much of equity stake is to be offered at what terms.

13.2.5 What Are the Exit Options Available to Investors?

As an entrepreneur, one will have a long-term plan to grow the business and enjoy building it over the years, but an investor may not be much concerned about all this except for expecting reasonably good returns at the earliest. That is why a majority of investors look forward to a planned exit strategy that they work out at the time of making investments. Therefore, it is always advisable for the entrepreneur to work out the ideal exit strategy for potential investors before seeking funding. Investors basically look forward for a maximum return on their initial investment that should be commensurate with their risk. It is the well-thought-out exit strategy that provides them with the incentive to invest in one's venture. Venture capitalists often have a number of investments with which they get associated, depending on their size of funds. They basically attempt to 'hedge their bets' by depending on one of the investments making it really big. Some of the exit routes that investors look forward to are as follows:

- disposal of business to a large company having synergy with the business
- share repurchase at some specified terms by the entrepreneur
- public share quotation in stock market and using the platform to exit
- plan for franchise business opportunity. It is a successful strategy for the large-scale growth potential of a business
- using merger as a route that provides an opportunity to use combined resources of two businesses for growth, thereby leading to scope for the investor to receive increased worth for their investment

13.3 DIFFERENT STAGES OF FINANCING

The definitions of the types of start-up funding are divided into 'early-stage', 'expansion' and 'acquisition/buyout' financing (Kuratko and Hodgetts 2007) (Fig. 13.6).

Pre-seed stage funding involves a relatively small amount of capital provided to an entrepreneur to prove a specific concept having a potentially profitable business opportunity. The concept is yet to be developed and proved. However, it may have a lot of potential commercially, as and when it gets established. The funds are provided for product development purpose as against pure research.

Seed-stage funding is provided to newly formed companies for use in completing the product development stage to take it to the test marketing stage and in initial marketing. These companies may be in the process of being organized or may have been in business for a short while. As such, this funding is more prominent for the incubates associated with established incubators for the promotion of entrepreneurial ventures. As such, the product is yet to be taken to the commercial stage. Thus, 'seed financing' is a relatively small amount of capital provided to an inventor or entrepreneur to prove a concept and to qualify for 'start-up' capital. This may involve product or service development, market research, building a management team and developing a business plan.

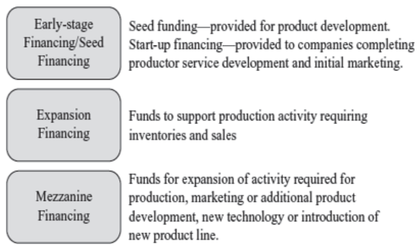


Figure 13.6 Different Stages of Financing

'Start-up financing' is provided to companies for completing product or service development and initial marketing. These companies are generally in business for less than one year and have not yet sold their product or service commercially. Such firms have usually made market studies, assembled key management, developed a credible business plan and are ready to do business.

'First-stage financing' is provided to companies that have expanded their initial capital and require funds to initiate full-scale manufacturing or servicing. Thus, the purpose of funding at this stage is to the companies that have expended their initial capital and now require *funds to initiate commercial-scale manufacturing and sales*.

13.3.2 Expansion Financing

'Second-stage financing' is working capital for the initial expansion of a company that provides services, or produces and ships products, and has growing accounts receivable and inventories. A company needs funds to support its production activity requiring inventories, and sales might result in cash with some time gap, thus resulting in a need for financing receivables. The company might not be earning profits at this stage. However, a progressive company is expected to generate profits soon.

'Third-stage financing' or 'mezzanine financing' is required by the company whose sales volume is increasing and that has achieved its break-even level of sales or has even started earning profits. The required funds by the venture at this stage of funding are used for the expansion of activity requiring funds for production, marketing or additional product development, new technology or introduction of a new product line.

'Bridge financing' basically refers to short-term funding requirements pending the flow of funds expected from different anticipated and expected sources. This is mainly used to maintain the required liquidity in the system. It also helps IPO (initial public offering)-driven companies to obtain short-term financing that will be repaid when the IPO funds are received by the company. Usually, pending receipt of IPO funds, these funds are supplied by investment banks or the banks underwriting the public issue. Bridge financing is also extended by the banks underwriting an issue for raising money through bonds/debentures. The job of underwriters is to subscribe to the issue in the eventuality of not getting full subscription from the public for shares or bonds. It can come in the form of stand-alone subordinated debt or by way of equity. Usually, pending receipt of IPO funds, it is obtained by way of subordinated debt.

Bridge financing is also used when a restructuring is undertaken if there are early investors who want to reduce or liquidate their positions, or types, namely, closed bridging and open bridging. Closed bridging finance is where one has a date for the exit of the bridging finance and is sure that the bridging finance can be repaid on that date. This is less risky for the lender and, thus, the interest rates charged are lower. As against this, in open bridging, the funds raised may not have a stipulated date for exit linked to the receipt of the funds by the company against which bridge financing is received.

Usually, bridge financing is so structured that the arising obligations towards repayment are met from the proceeds of expected tied-up source. Bridge financing can also involve restructuring of major stockholder positions through secondary transactions. This is done if there are early investors who want to reduce or liquidate their positions. This might also be done following a management change so that the ownership of the former management (and relatives or associates) can be purchased before the company's going public. [2]

13.3.3 Acquisition/Buyout Financing

'Acquisition financing' provides funds to finance an acquisition deal to expand a business by acquiring whole or part of another business entity. 'Management/leveraged buyout financing' enables an operating management group to acquire a product line or business from either a private or public company. The acquisition could also be related to the purchase of select assets or stock.

A leveraged buyout (or *LBO* or 'bootstrap' transaction) occurs when an investor, typically a financial sponsor, acquires a major stake in a company's equity and where a significant percentage of the purchase price is financed through borrowed funds. The assets of the acquired company are usually used as collateral for borrowing funds. Typically, leveraged buyout uses a combination of various debt instruments from banks and debt capital markets. The bonds or other papers issued for leveraged buyouts are commonly considered not to be of investment grade because of the significant risks involved. [3]

13.4 SOURCES OF FINANCE

13.4.1 Bootstrapping

While thinking of starting a venture, the first and foremost way to raise money that should be considered is bootstrap financing, that is, using one's own money to get one's business off the ground. This is the simplest, easiest and the best form of internal funding, because it uses one's own money or internal generations for meeting capital requirements to launch a venture, meet operational expenses or for expanding one's business. It is a way of starting a venture or expanding one's operations without depending on outside sources of funding. It is the best source, as the whole equity of the venture remains with the entrepreneur who need not get loaded with paying interest on borrowed money. Further, having pumped in one's own money, the entrepreneur is bound to be far more creative in running the business to earn higher profits.

13.4.2 Sources of Bootstrapping

There are a number of sources of financing available through the bootstrapping method. Some of the prominent ones are given as in Figure 13.7.

Trade Credit Trade credit is a typical source of bootstrap financing. Many financers are willing to offer credit to a new business through the use of normal credit cards or through extended terms. To obtain credit from major suppliers, entrepreneurs should meet suppliers and give them a copy of the business plan highlighting what benefits they may draw from the business in the future. They should clearly state how much of credit would be required immediately and how much in the future. The suppliers would try to give extended terms of credit to secure the firm's goodwill in the future without charging interest. However, when one starts a business and does not have any track record with the supplier, the supplier may ask one to pay in advance or cash or cheque on delivery. After having established a track record, one can negotiate the terms of payment and should attempt to get as long a credit period as the supplier can stretch. Despite its advantages and the incentive to stretch trade credit period, it is always advisable to use trade credit as a source of capital to meet relatively small, short-term needs. It should not be used to finance long-term requirements of the business. It is important to remember that stretching the terms of payments to creditors may result in depriving the access to other, more competitive suppliers who might offer lower prices, a superior product, better discounts on prices and reliable deliveries. It is advisable for the entrepreneur to estimate the cost of trade credit and work out exact benefits, if any, that may accrue to the business by availing of trade credit or otherwise. For example, assume one makes a purchase from a supplier who is willing to extend credit to one. The supplier is willing to offer 3 per cent cash discount with 10 days and a net date of 30 days. As such, the suppliers are saying that if one pays within one 54 per cent of the total cost of the items one purchases from this supplier!

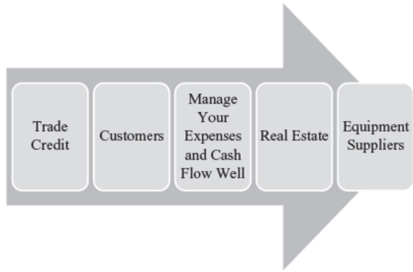


Figure 13.7 Methods of Funding Through Bootstrapping

Customers Customers are also an excellent source of bootstrapping. One entrepreneur used this type of financing when installing a distribution system for their first customer. The entrepreneur designed and installed the system, but the customer purchased all the materials, thereby eliminating the need for more customers and the entrepreneur's expense to purchase them. Another way of obtaining bootstrapping from customers is by having them pay the full amount in advance. It would be feasible to get it depending on the intense need for the product or service by the customer who does not have any other alternative to meet the same. Further, the entrepreneur may ask for partial or progressive payments on jobs that extend over a long period of time. This is typical of new firms, particularly in the contracting or construction business. Another way of customer financing is by asking the customer to write a Letter of Credit (LC) to the entrepreneur. For example, suppose one is starting a business manufacturing oxygen cylinders used in industries. A large number of industries place an order with one's firm for a steady flow of these cylinders. The major supplier from whom one proposes to procure material for manufacturing cylinders is located in India. In this scenario, one obtains an LC from one's customer when the order is placed, and the material for the cylinders is purchased using the LC as security. One will not be required to spend any money for the purchase of materials.

Manage One's Expenses and Cash Flow Well An entrepreneur can improve their bootstrap financing dramatically by keeping a strict control and vigil over expenses. This would require one to only spend on items that are a must and productively contribute to business growth. Further, one should keep inflows high and outflows low. One has to always keep working for ways and means to persistently widen the gap between the two, so that surplus cash is generated. Cash flows are fundamentally the lifeblood of any business. For improving cash flows, the entrepreneur should monitor constantly to improve accounts receivable by collecting them quickly. The entrepreneur should shed any excess inventory and see whatever time one can buy for paying one's creditors without straining the relations or inviting any penalties.

Real Estate Owning real estate for running a business may be prohibitively expensive for the start-up. It is usually not possible to own the land or office space that is used to set up the firm in the initial phases itself. Hence, many ventures start their operations from garage or home. Another better way could be to take land and building on lease or rent to save the much-needed cash input. However, the judicious and better use of already owned capital can be an excellent source of bootstrapping. The entrepreneur may own real estate that has reasonably appreciated in value over time. Loans on commercial or residential property can be borrowed to the extent of 75 per cent of the appraised value and may be amortized for over a period of 10 to 25 years. For example, the entrepreneur may own a house that was purchased for ₹ 20 lakhs five years ago, and still has to repay about ₹ 5 lakhs on the mortgage. Now, the appreciated value of the house may be about ₹ 45 lakhs. The owner can obtain another loan on the part of the appreciated value of the house, the original mortgage interest remaining the same. The owner could also refinance the home, meaning that they could pay off the loan amount of the initial mortgage and obtain the difference in the value of the property as investment for their start-up.

Unless and until it is a must from long-term growth prospects of the business and the requirement of owned land and building, it is always better to take such facilities on lease or rent. This helps in reducing start-

Equipment Suppliers If an entrepreneur spends a substantial sum of money on purchase of equipment, they may find it difficult to have sufficient working capital to keep their business going in the initial phase of growth. Therefore, instead of outright purchase of equipment out of one's cash, it would be desirable to take it on lease.

It is common for businesses to lease real property for retail facility, office space, production plant and farmland. There are multiple advantages that it offers to the small-business owner (lessee) as well as the property or equipment owner of that property or equipment (the lessor).

The lessee is the party in a business transaction who enters into a contract to use the property or equipment for a specific period. The business transaction is regulated by the terms and conditions of lease agreement. In return for the privilege of using the equipment or property for the specific period as agreed to, the lessee agrees to pay the owner or lessor regular payments called 'lease rentals' which are in accordance with the terms specified in the lease agreement.

The lessor enjoys all tax benefits and may gain from capital appreciation on the property, as also make profit from the lease. The lessee benefits by making smaller payments, retaining the right to walk away from the equipment at the end of the lease term and being able to negotiate built-in maintenance provided by the lessor. If provision of the lease agreement provides, the entrepreneur may also derive the advantage of terminating the lease before expiry of the period as per the specified terms. Lease terms can be modified by way of lower down payment, maintenance cost as built in the lease package, extension of the lease term to cover the entire economic life of the property and a purchase option, which can be added to the lease, thus allowing one to buy the property after the lease period has expired.

Equipment can also be procured from suppliers by entering into two types of credit contracts to finance equipment purchases [4] :

1. *The conditional sales contract*, in which the purchaser does not receive title to the equipment until it is fully paid for.
2. *The chattel-mortgage contract*, in which the equipment becomes the property of the purchaser on delivery, but the seller holds a mortgage claim against it until the amount specified in the contract is paid.

By getting equipment suppliers to finance the purchase of required equipment for the business, the entrepreneur reduces the sum of money required upfront for starting the business. Banks and financial institutions also finance 75 to 80 per cent of the equipment value by hypothecating the equipment as security. Such loans are repayable in monthly instalments spread over three to five years, or the useful life of the equipment, whichever is earlier.

Thus, bootstrapping is best applicable to small start-up firms that need low levels of investments in terms of office space and equipment, such as consultancies, construction firms, designers, architecture firms and general stores. Varied combinations of bootstrapping should also be considered while funding the start-up. Start-up ventures can benefit a lot by resourcing to bootstrapping. The availability of bootstrap funding depends on the entrepreneur's ingenuity and the effectiveness of the business plan, goodwill of the entrepreneur and the entrepreneur's ability to manage initial input costs. It is important to highlight in the business plan about the benefits that the creditors tend to gain in the long term. Above all, the entrepreneur should carefully plan the funding process with regard to what amount of credit would be required initially and what amount would be needed at later stages and how bootstrapping can help them in reducing the cost of funds.

Example: Aldrich and the Yankee Candle Company—The Classic Bootstrapper [5]

Aldrich, who lives in Topsham, Maine, started his company in 1992 with $20 borrowed from a friend. Applying profuse amounts of Yankee ingenuity, frugality and hard work, he grew his business to $30 million in annual revenues after seven years. Seven timeless bootstrapping rules emerge from his story:

Rule 1: Defy adversity. Aldrich had been without steady employment for two years when he began, at age 38, to indulge in a candle-making hobby at his kitchen table. His hot-tub distributorship, Heaven on Earth Hot Tubs, had gone bankrupt in 1990, and Aldrich had applied for as many as 20 to 30 jobs a week. 'I was losing out to people with master's degrees for menial management jobs,' he recalls. His wife, Sally, supported the family on her $50,000 nurse practitioner's salary and moonlighted on the

Rule 2: Know an opportunity when one sees it. 'I would give the candles away to family and friends, and they would ask for more,' says the soft-spoken Aldrich. 'I was so excited about making candles that sometimes I'd wake up at 3 A.M. and start melting wax.' Yankee Candle, now a $185-million company in South Deerfield, Mass., was then the best-known American candle maker. Aldrich differentiated his products from Yankee's by using square, rather than round, containers and by fitting his candles with two wicks instead of one. He began selling them at local crafts shows.

Rule 3: Look for freebies everywhere. Similar to every good bootstrapper, Aldrich did not allow his limited resources to dissuade him. He researched glass manufacturers in the Thomas Register, a directory of corporations organized by products, calling only those with 800 numbers. Identifying himself as a candle manufacturer, he cajoled them into giving him free samples. 'Every day the UPS truck would drop off containers of glass,' says Aldrich.

Rule 4: Carpe diem. On a trip to Florida in December 1992, Aldrich acted on a whim. 'I was driving through the Poconos, and I saw billboards for a candle store,' he recalls. 'So I stopped in and told the owner that I had a bunch of candles in apothecary jars that I was giving as Christmas gifts.' The owner trudged out to Aldrich's Dodge Caravan, took one look at the candles and told Aldrich to call him as soon as he returned to Maine. 'He was my first customer,' says Aldrich. 'It was a 3,400 order.'

Rule 5: Draft one's family and friends. Aldrich and his wife set up production in the kitchen of their three-bedroom split-level home, enlisting weekend help from family and friends, who were 'paid in candles.' Even Aldrich's seven-year-old daughter pitched in, as did his two older daughters, on weekends. 'I'm sure we violated child-labor laws,' Aldrich quips. Neighbours commented on the aromas wafting from the Aldrich home, but few had any idea that the family was running a full-blown business in the residential area. 'I'd have to load the candles in my minivan and go meet the trailer truck at the edge of the neighborhood,' Aldrich relates. Once, he tried to sneak a truck into the neighbourhood; the driver blew his air horn at 6 A.M., virtually blasting Aldrich and his neighbours out of bed.

Rule 6: Think of cash as king. Similar to many entrepreneurs who are initially strapped for capital, Aldrich never forgot his early cash-flow lessons. He has always ranked his customers as an A, B or C, according to how quickly they paid him. In the peak season, he used to take care of his 'A' customers—those who paid him within 35 days—first, which lowered his average accounts-receivable turnaround to 36 days. (Aldrich's research revealed that the industry-wide figure at the time was 42 days.) That speedy return, coupled with the 45-to-60-day payment terms that he negotiated with major suppliers, secured a critical cash-flow edge in his favour.

Rule 7: Remain true to one's humble beginnings. Since Aldrich took on a manufacturer's representative to market his candles at gift stores throughout New England, Village Candle's annual growth averaged more than 100 per cent. However, Aldrich remained cautious. 'We only grew within our means,' he says. 'I could have grown the company 200 per cent to 300 per cent a year if I had wanted to borrow money, but then you lose quality control.' Thoroughly committed to using internal financing, Aldrich has rejected overtures from bankers wanting to lend the company money to fuel faster growth. 'Our philosophy,' he explains, 'has always been to build the business one brick at a time.' [6]

13.5 SEED FUNDING

Seed funding is at times misunderstood with start-up capital, but as such, they are two different things. Seed funding is mainly meant for developing a business idea, creating the first product and test marketing the new product or service for the first time. Ventures eligible for seed funding are usually in their initial phase, and have never created a product or service for commercial sale.

Seed funding is most commonly provided by government bodies, angel or other private investors with a basic motive of creating new entrepreneurs. While seeking seed funding support, one should make sure that there is a clear exit plan for the investor in place after a few years. In order to qualify for this sort of financing through an investor, it is important that there are substantial market prospects for one's product or service.

Individual venture capitalists interested in providing budding entrepreneurs with seed and start-up financing are commonly called 'angels'.

An angel investor is an affluent individual who provides capital for a business start-up, and usually looks forward for an equity stake in the company. Unlike venture capitalists, angels typically do not manage the pooled money of others in a professionally managed fund. However, angel investors often organize themselves into angel networks or angel groups to share research and pool their own investment capital. [7] Angel funders mainly fill up the gap between friends, family and fools and venture capitalists in fund requirement by the start-ups. This is also, therefore, called 'second round of funding' for high-technology and high-growth start-ups. Since they take a high risk through funding new ventures, they expect a high return on investment that may range between 10 and 20 times their investments within five years, with a well-defined exit strategy. Capital from angel investors is likely to cost no less than 10 per cent of a company's equity and, for early-stage companies, perhaps more than 50 per cent. In addition, many angel investors charge a management fee in the form of a monthly retainership.

Therefore, it is also called 'high cost funding', which start-ups may have to bear, because banks may not be keen on funding early-stage ventures.

According to the Centre for Venture Research at the University of New Hampshire, these informal investors invest $10 to $20 billion in more than 30,000 ventures annually. Business angels, unlike other venture capital investors, prefer to invest their money in a new business as early as possible. They usually take a smaller share of one's business than a venture capitalist and stay out of the day-to-day operations. They understand high risk and expect high return (Chandrakanth).

The key advantages and the value that a venture receives by getting funds from angel investors are getting their advice based on experience in technology and marketing; networking with customers for sales; contacts for raising further money and, above all, they are relatively far less intrusive and interfering in business dealings and operations when compared with venture capitalists. They mainly assess the worth of a venture to get associated with based on enthusiasm of the entrepreneur and their team, trustworthiness, market potential for the venture/idea, niche market vis-à-vis competition, growth potential for the venture under consideration and, above all, the perceived financial gains that they can fetch. They also look for other aspects such as proved prototype, strategic alliances, if any, that the entrepreneur has entered into or plans to enter, sustainable competitive advantage, exit strategy and the pre-money valuation of the venture. The best way to find angel investors is through personal introductions. One could try to cold-call angel groups near one, but angels, similar to venture capitalists, (VCs) will pay more attention to deals recommended by someone they respect.

Deal terms for funding from angels differ a lot. There are no broadly accepted standard terms and conditions. Sometimes, angels' deal terms are as complicated and thought provoking as VCs. However, there are others who invest in the earliest stages, with simple terms in a two-page agreement. Angels who make occasional investments as individuals may not themselves know what to stipulate. Their main concern is just investment in a particular start-up. At times, an angel asks his lawyer to create a vanilla agreement, and the terms end up being whatever the lawyer considers suitable and reasonable. In practice, it may result in entering into an agreement that the lawyer finds lying around their firm in similar situations. However, there are instances wherein the term sheet is created professionally from scratch with the help of professionals.

What is important for a start-up is to look for an angel who goes with a simple, understandable term sheet and is keen on getting associated with the venture by releasing funds in time. As such, the funding delays are a big distraction for founders, who are passionate about their venture and would spend maximum time in thinking about giving it a concrete shape rather than wasting their time and energy in worrying about investors. Therefore, it is always advisable for start-ups to create a competition for the investor by simultaneously lining up few genuinely interested investors. When an investor knows that there are other investors lined up, they will be serious enough to close the deal at the earliest, mainly because they would realize the worth of a venture, as other investors are also interested. A similar situation arises with acquisition deals. No one would be interested in acquiring one till someone else is equally and genuinely interested in one. Therefore, the key to closing deals lies in never stopping to pursue alternatives. The knack lies in confirming the seriousness on the part of investors or acquirers based on negotiations and the steps taken by them to reflect their seriousness.

Angel investors fall in different categories, as depicted in Figure 13.8.

Corporate Angels These are usually senior professionals at Fortune for business development. They may also look for senior positions such as business development in the venture. Investments usually range from $200,000 to $1 million.

Figure 13.8 Different Types of Angel Funders

Entrepreneurial Angels These are the most prevalent investors. Most of them own and operate highly successful businesses and are really looking for synergy with their current business, a way to diversify their portfolio or a way to prepare for life after their current business no longer requires their attention. These angels almost always take a seat on the board of directors but rarely get into day-to-day operations by accepting regular positions. They make fair-sized investments, typically from $200,000 to $500,000.

Enthusiast Angels These angels are keen on entering into deals for funding start-up ventures. They are usually old and independently wealthy from success in a business that they started and have an abbreviated work schedule. For them, investing and encouraging new start-ups is a hobby and, thus, they generally do not seek a role in management or a place on the board. They tend to invest in technologies that can bring out a major change in markets in future as also in people and ideas. Their investments tend to be small, from $10,000 to $200,000.

Micromanagement Angels These are very serious investors. Some are born wealthy, but the vast majority attain their wealth through their own efforts. They look forward to having a controlling position in the company they invest in. Though they generally do not seek an active role in company management, they usually demand a board seat and expect to play an active role in company strategy. They generally invest $25,000 to $200,000.

Professional Angels The term 'professional' in the context of angel investors refers to the investor's occupation, such as doctor, lawyer and, in some instances, accountant. Professional angels like to invest in companies that offer products or services in which they have a rich professional background and are, thus, offering their sector expertise to the investee company without getting deeply involved in the business. Thus, their association helps a venture in getting an additional value through legal, accounting or financial advice for which one would otherwise have to pay a fee to receive. These angels generally invest between $25,000 and $200,000.

Angel funding is most appropriate for early-stage companies with no revenues. Thus, ventures looking for equity capital from angel investors should welcome the outside ownership and perhaps be willing to relinquish some control. To successfully accommodate the interest of angel investors, entrepreneurs should also be able to provide an exit to these investors in the form of an eventual public offering or buyout from a larger firm. Typical companies seeking angel funding range from companies developing a product to those with an established product or service for which they need additional funding to execute a marketing program. In addition, angel investors are appropriate for companies that have increasing product or service sales and need additional capital to bridge the gap between the sale and the receipt of funds from the customer.

13.5.2 Where to Look for Angel Funding

Angel investors are difficult and also easy to find. The situation is similar

Universities According to Bob Tosterud, Freeman Chair for Entrepreneurial Studies at the University of South Dakota, angel investors tend to hover near university programmes because of the high level of new business activity they generate through research in developing new technologies. Therefore, it is advisable for ventures to get associated with universities having strong entrepreneurship development programmes. A liaison and association with such centres can be very helpful in getting links to angel investors.

Business Incubators A business incubator is a facility designed to assist business ventures to become established and sustainable during their start-up phase. For this, incubators provide various services, including shared premises, business advice, business services, access to investor, market and international networks, mentoring and a fulltime, hands-on management team.

According to the National Business Incubation Association (NBIA), there are about 1000 business incubators in North America. At first blush, incubators appear to be the mere bricks and mortar facilities that offer entrepreneurs reasonable rents, access to shared services, exposure to professional assistance and an atmosphere of entrepreneurial energy. However, according to NBIA President and CEO Dinah Adkins, many business incubators offer formal or informal access to angel investors.

The Department of Science and Technology (DST), Government of India, promotes entrepreneurship and has extended financial support to around 45 incubators spread across every nook and corner of the country.

According to the latest data from AngelSoft, which pairs entrepreneurs with angel groups in a particular city or ZIP code, only 1 per cent of the companies that approach for angel funding manage to secure the capital. The top 10 action items for those looking to land angel funding are given next [8] :

- First incorporate one's business.
- Have a harmonious and experienced team.
- Launch a Web site.
- Defend real intellectual property, if any.
- Build a prototype product.
- Be clear about one's business model and hit the high notes.
- Prepare an investment-grade business plan.
- Finalize one's financial model.
- Close at least one customer.
- Network should be ahead of time.

Above all, while accepting money from angel investors, one should be clear in one's mind that one is inducting another partner in the business. Therefore, one should ensure that their vision, values and expectations align with one and one's team. One should try to look for an angel investor who can offer one—more than money—their expertise in industry, entrepreneurial experience and networking opportunities.

13.5.3 Seed Support System—Technology Development Board (TDB)

The purpose of the seed fund is to provide a technology-driven start-up with the much-needed early-stage financial support for deserving ideas/technologies requiring up-scaling and related work. The financial assistance to technology start-ups is basically extended to take care of early-stage support requiring upscaling of innovations and related work. It should be used for commercializing innovations. The total upper ceiling of financial assistance to be disbursed to an incubate is limited to ₹25 lakhs for the entire project. The disbursement of funds is usually tied up to certain milestones. The broad areas covered under the financial assistance are product development, testing and trials, test marketing, mentoring, professional consultancy to engage professors/experts with small firms and filing of Indian/international patents.

The TDB seed fund is meant for start-up ventures in high-technology areas for development, tests and evaluation necessary for establishing proof of applicability of a product, process or application; costs of a capital—including cost of acquisition of technology of foreign origin, which is a 'proof-of-concept' or design stage requiring substantial indigenous technology development; fabrication, testing and trial of prototypes; setting up a pilot/demonstration plant including testing and trials; industrial product design; field trials (including limited market development, except as stand-alone activity); setting up the first or demonstrator commercial-scale manufacturing unit using the innovative technology; cost of studies, surveys and blue or grey-collar training necessary or incidental to what has been just mentioned; R&D/engineering consultancy for prototype/pilot plant/trials and testing.

Start-ups and growing businesses need capital. There are a number of alternative sources to tap it. Venture capital is a means of equity financing for rapidly growing private companies having high growth prospects. The fund support by such ventures may be required for alternate uses such as start-ups, development/expansion or purchase of a company. Venture capital firms invest funds on a professional basis, often focusing on a limited sector of specialization (e.g., IT, infrastructure, health/life sciences and clean technology).[9]

Venture capitalists are often viewed by start-up ventures as deep-pocketed financial gurus who are keen to invest their money in new ventures. However, the fact remains that they most often look forward to three- to five-year-old companies with high growth potential to become major national or global players and who would return higher-than-average profits to their shareholders. It is important for an entrepreneur to realize that getting a positive nod from venture capitalists is not easy, as they may scrutinize thousands of potential investment opportunities every year, but only invest in a handful. The long-run possibility of an IPO by the company is one of the key considerations for them, as it improves their worth of investment and provides a good scope for exit. They too focus on the team and the management backing the venture and the niche that a venture would have because of its competitive or innovative advantage. Venture capitalists have different approaches to management of the business in which they take a stake. Their general approach is to passively influence a business, but will react when a business does not perform as expected and may insist on changes in management or strategy. Therefore, to keep the doors open, they enter into terms of equity that provide them with such leverage.

The venture capitalist acquires an agreed proportion of the equity of the company in lieu for the funding. The fundamental advantage that the entrepreneur gets is having funding that has no timely obligation for payment of interest and principal, as equity capital funded by venture capitalists is a 'patient' capital that seeks a high return through long-term capital gain. They take the whole hog risk of failure of the venture and losing their equity in the company. Therefore, the venture capitalist has to necessarily look to investment opportunities in companies that have the ability to grow fast and provide extraordinary returns to compensate for the ventures that fail in the process. Venture capital firms are willing to invest in companies that have more risk than most individuals are willing to take. Managers of venture capital firms are capable of evaluating risky proportions and judging the growth prospects of start-ups. Usually, the purpose of a venture capital firm is to help a company grow very rapidly and then sell out. This means that the firm accepting venture capital should be willing to go public or be acquired by a larger firm in the future. VC funding may be used for everything from financing product development to expansion of a proven and profitable product or service. It is most appropriate for high-growth companies that are capable of reaching at least $25 million (or around ₹ 50 crores) in sales in a span of five years. Thus, venture capitalists have the following key characteristics to fund ventures (Fig. 13.9):

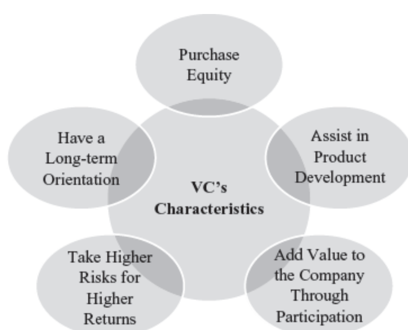


Figure 13.9 Key Characteristic of Venture Capitalists

- Purchase equity securities.
- Assist in the development of new products or services.
- Add value to the company through active participation.
- Take higher risks with the expectation of higher rewards.
- Have a long-term orientation.

They follow a basic philosophy of investment as given here:

- These funds are then invested in several fledging enterprises, which require funding, but are unable to access them through the conventional sources such as banks and financial institutions.
- Venture capital funding may be done by way of investment in the equity of the new enterprise or a combination of debt and equity, though equity is the most preferred route.

The investment process followed by them contains the following criteria (Fig. 13.10):

- Stages of financing.
- Due diligence.
- Investment valuation.
- Pricing and structuring the deal—Reasonable reward, given the level of risk, sufficient influence on the management of the company through board representation, minimization of taxes and ease in achieving future liquidity on the investment.
- Value addition and monitoring.
- Exit—The precise timing of exit depends on several factors, such as nature of the venture, the extent and type of financial stake, the state of actual and potential competition, market conditions, the style of functioning, perception of VCIs and so on. The disinvestment channels that venture capitalists look for are going public, sale of shares to entrepreneurs/employees, trade sales/sales to another company, selling to a new investor and liquidation/receivership.

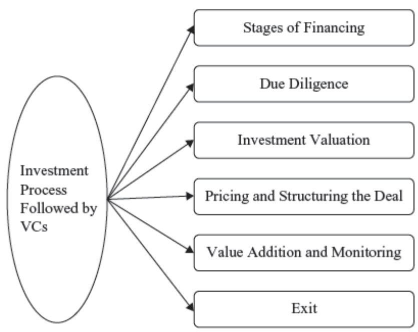


Figure 13.10 Investment Process Followed by VCs

13.6.1 Advantages of Venture Capital Funding

Venture capital funding provides the following advantages:

- It provides long-term funding in a way that acts as a base for attracting further equity for growth from other sources.
- It acts as a business partner who shares associated risks and rewards from the venture. It mainly gains through enhanced valuation of business arising as a result of business success by way of capital gains.
- Venture capitalists are a great strength in terms of advice, networking and mentoring to the company based on their past experience with other companies.
- The association of a venture capitalist provides access to other sources of funding for growth.
- It acts as an instrument in developing strategic partnerships for growth of the business.
- Having taken a risk to associate with the venture, venture capitalists usually provide a second round of funding, if badly needed for stabilizing the business.

13.6.2 Selecting a Venture Capitalist

Before approaching a particular venture capitalist, the entrepreneur should understand their financial and other needs very well and particularly how far their needs match with investment preferences set down by the venture capital firm. Usually, venture capitalists have specific preferences for particular stages of investment, quantum of investment depending on the size of their investment funds, industry/sectors specialization and geographical location. For start-ups, the minimum time good working relationship with the entrepreneur. Due to very many imponderables and uncertainties that arise in the implementation phase, usually start-ups fall short of their projections about cash inflows as projected, and, therefore, would badly need additional doses of funding to come out from a tough initial phase of business. The entrepreneur should ensure from the past dealings of the venture capitalists whether they have been supporting genuine cases of second round of funding during the initial phase of the business.

Using a 'shotgun approach' means that one sends one's business plan or some derivative thereof to as many venture capitalists as possible and hopes that the numbers alone will strike someone who has been looking for a deal such as one's own. The shotgun approach has its proponents and its critics. Gordon Baty, a partner with Cambridge, Massachusetts-based venture outfit Zero-stage Capital, says, 'Of every 100 plans that we get, 90 are completely irrelevant because they do not match our investment criteria regarding the industry, stage of development, geographic location, or the amount of capital we typically invest.' Of this misguided bunch Baty says, 'our receptionist can weed out their business plans.' However, the shotgun approach has one significant advantage over the rifle method. The latter relies on intensive research that is based on a venture fund's past investment patterns. What one's research will fail to turn up is all the available venture capital funds that have now decided to focus their energies on restaurant deals, business service companies, publishing companies or Internet-content businesses. In many cases, one's mail will be well off the mark, and one's letter will be weeded out by the receptionist or the college intern sorting the mail. For instance, some venture capital firms might specialize in wireless communication companies from the so-called 'first stage' onwards, whereas one's company, which makes disposable medical devices, is in the development stage. A more reasonable approach might be to take at least one pass through one's institutional venture capital sources and weed out the obvious misses for one's particular line of business. Even a quick screen prevents many obvious misses. Of course, such an effort, although seemingly logical, undermines one of the chief benefits of the shotgun approach to begin with. That is, it lets one reach investors who may have changed their historical investment criteria and are now looking for companies similar to one's own. If one can mail one's letter, business plan summary and business reply card for 50 cents each, then it is worth going after the 1,200 to 1,800 traditional sources of institutional venture capital. The rifle approach, which favours limiting one's search to 15 to 20 well-researched targets, is the one favoured by most attorneys, accountants, consultants and other assorted experts. Venture capitalists seem to favour it because a highly targeted approach by entrepreneurs replaces an abundance of irrelevant opportunities with a manageable number of interesting ones. The rifle approach is simple but time consuming. Basically, one searches by five variables and then ranks one's candidates by how well they meet these criteria. The five key search variables are given in Figure 13.11.

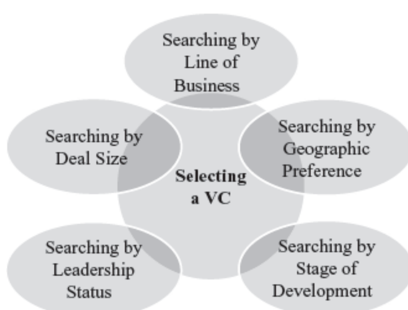


Figure 13.11 Selecting a Venture Capitalist

Rifle Approach for Selecting a Venture Capitalist

Searching by Line of Business—Most venture capitalists specialize in one or more industries. The focus on a particular technology, industry or business supposedly lets them pick winners in their formative stages. This specialization is good news, because it allows one to easily identify venture capitalists who would be interested and those who probably will not be.

Searching by Geographic Preference—The very hands-on find it difficult to invest in companies that are 2,000 or 3,000 miles away. Many do, mind you. However, more venture capitalists stick to well-defined geographic regions. One should search one's source material and weed out venture capital investors who do not look at deals in one's area.

Searching by Stage of Development—In the same way that venture capital investors specialize in one industry or another, they also specialize in different stages of development. That is, some companies invest in early-stage companies, whereas others invest in more mature companies. This intuitively makes sense. After all, from a venture capitalist's standpoint, a company that is trying to make a better mousetrap requires much different care and feeding than one that has already figured this out and is on the brink of national distribution.

Searching by Leadership Status—In the world of venture capital investing, there are leaders and followers. The leaders, also known as 'lead' firms, are those that have recognized expertise and who conduct extensive due diligence on their prospective portfolio companies. The followers, known as 'follow-on' investors, are more passive. They simply invest alongside the lead firms. Lead firms can be helpful when one is trying to raise one's second, third or fourth round of venture capital, because their presence alone can attract other investors for these later rounds. However, they are of no help when one is trying to raise one's first round of venture capital. One should review one's source material and weed out the firms that do not act as the lead investors in deals.[10]

Searching by Deal Size—Institutional venture capitalists generally place upper and lower limits on the sizes of their investments. These limits are closely related to the overall size of the fund the venture capitalist is managing. VCs with $250 million to invest typically do not want to look at one's $500,000 deal. Why? This is because to invest the entire fund in $500,000 increments means that the firm would have to invest in 1,000 deals. Consider this number in the context of venture capitalist John Martinson's experience. Specifically, Martinson looks at 2,000 business plans each year to invest in an average of 10 companies. To do 1,000 deals, he would have to look at 200,000 business plans.[11]

Above all, while choosing a venture capitalist, the entrepreneur should consider not just the amount and terms of investments, but also the additional value that the venture capitalist can bring to the company in different ways such as industry expertise, fund raising, strategic planning, identification and recruitment of key personnel, mergers and acquisitions and access to international markets and technology.[12]

In India too, VC funding has been picking up momentum over the last few years. Some of the prominent industries funded by VCs in India are IT and IT-enabled services, software products (mainly enterprise-focused), wireless/telecom/semiconductor, banking, media/entertainment, bio-technology/bio-informatics, pharmaceuticals, contract manufacturing and retail.

Some of the key lessons that need to be taken care of while looking for funding from venture capitalists highlighted by Boyett and Boyett (2001) are as follows:

- Venture capital is a rough game.
- Unless one has an introduction from someone they know, most venture capital firms will not even talk to one.
- Venture capitalists do not invest in financial projection; they invest in people.
- Expert pre-money valuation is a major stumbling block.
- Venture capital presentations are gruelling.
- Venture capitalists will drag the process out.
- Venture capitalists drive a tough bargain.
- If a venture capitalist suggests a party, they will stick one with the bill.

13.7 FUNDING FROM BANKS

Banks have a variety of schemes to extend support for promotion of industries. Usually, banks fund promoters having a well-established business or launching a business having a well-established product in the market. Some banks do have specific schemes to promote start-up ventures or extend venture capital assistance by their subsidiaries.

It is important to realize that more than the project, a lender would like to requests for financial assistance. The purpose of these guidelines, coupled with the expertise of the credit team analysing the proposal, is to help in constructive credit decisions to help customers achieve their financial goals, coupled with ensuring that bank funds are protected in terms of getting due returns on them. Credit appraisal exercise focuses on the strengths and weaknesses of the proposal in the light of various key criteria used. The weight given to different criteria varies depending on the uniqueness of the proposal and the circumstances of the loan request.

Here is some insight into the criteria used by bankers while making lending decisions (Fig. 13.12)[13]:

- **Character**—The character of an entrepreneur relates to their past track record, credit history, if any, educational background, work experience and achievement therein and experience, if any, in running a business. As stated earlier, even the best business ideas cannot succeed if not backed up by strong management and a committed team with values in management.

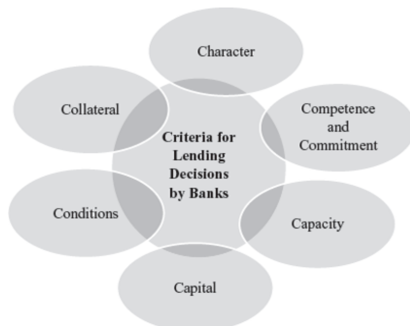


Figure 13.12 Criteria Used by Bankers for Lending Decisions

Thus, the character of a lending decision is basically understood and examined to ensure the customer's willingness and determination to repay the loan, regardless of unforeseen adversity. Character basically includes values and traits such as honesty, openness, integrity and self-discipline. Any business involves growing pains, liquidity problems, losses and adverse market conditions that a customer should be able to withstand and effectively respond to.

- **Competence and Commitment**—The entrepreneur's competence, as can be found out from their past experience and track record of managing ventures coupled with knowledge in the area, becomes an important aspect of the bank's appraisal. Their ability to negotiate various aspects with different stakeholders such as bankers, customers, government agencies, employees and partners becomes an important skill to be evaluated. Above all, the entrepreneur's commitment to the venture as evident from their deeper involvement in various aspects and working to see to it that the venture becomes successful in spite of all imponderables and uncertainties is an important aspect to be examined.
- **Capacity**—Capacity refers to the customer's ability to generate more than sufficient cash flow from the business to ensure timely repayment of principal and interest on loan. Thus, the banker is required to realistically examine the various assumptions and arrive at future expected cash flows from the business vis-à-vis the loan burden. This would require an expertise to appraise from market perspective and arrive at demand and prices for the product or service. The entrepreneur should be able to thoroughly test their business model and revenue model to ensure making realistic assumptions about demand and pricing. Estimating the capacity for repayment is relatively easy for the existing businesses looking for expansion or diversification when compared with new businesses. However, industry norms and averages help bankers in evaluating new businesses and their potential for repayment.
- **Capital**—It includes the entrepreneur's personal and corporate net worth, that is, the amount they are prepared to contribute in the business from their personal financial resources. Here, the banker would also like to examine the entrepreneur's resourcefulness in accessing financial reserves from other sources—friends, relatives and angel funders. The banker's main concern is to ensure that the

come to them and, therefore, it is only adequate availability of capital that can help in sailing through difficult times in the business. The ability of a customer to withstand or overcome adverse economic business conditions through financial controls and timely induction of money is assessed to ensure that they have sufficient capital to take care of business uncertainties.

- **Conditions**—The banker needs to carefully assess the business environment in which the entrepreneur is going to launch their business. This requires ability and insight, coupled with experience on the part of the banker, to understand the market and conditions in which the venture is going to operate. The banker should assess the nature of the industry and what phase of business the life cycle industry is passing through. What are the current political, environmental, social and technological issues affecting the industry? To gain insight, the banker analyses data from industry associations and government and regulatory bodies, as also from consulting and marketing research firms.

After having analysed the business environment and agreed, in principle, to lend money, the banker has to judiciously sort out by negotiating with the entrepreneur the stipulation of terms and conditions for the loan. The credit factor called 'conditions' has to clearly specify the purpose, loan amount, use of funds, interest rates and terms of repayment. The amount and purpose of the loan should be constructive, and the repayment terms should be realistic for the customer to repay the loan, along with the timely interest. It is important to sanction adequate loan to complete the project along with the entrepreneur's own contribution. In addition to the loan agreement, the terms and conditions may need to be supported by a letter of understanding, loan agreement, additional collaterals and guarantees—personal and corporate, appropriate insurance coverage and other special conditions as deemed fit.

- **Collateral**—Keeping in view the risk involved, the banker looks for taking collateral to protect their interest in the eventuality of the loan becoming non-performing. As such, bankers get a first charge on all assets financed by them and look for additional charge on assets to protect their loan further. The lesser the debt equity ratio and the greater the security coverage available to the banker, the better it is for them.

While looking for collateral, the banker either should have in-house expertise or use the expertise of others to value the assets to be mortgaged or charged against the loan as collateral. All valuations of real estate should be undertaken based on market value, keeping in view the property's intended use, and contain sufficient details to reflect the complexity of the property and market. Real-estate valuations are usually carried out by chartered registered valuers in conformance with the Uniform Standards of Professional Appraisal Practice and other regulatory requirements. Therefore, before accepting collateral for a loan, it is necessary to get it valued by qualified experts. Similarly, one may have to have an expertise for accepting pledge of shares or gold, fixed deposit receipts and bonds as collateral for loan.

13.7.1 Bank Loans

Banks mainly extend two type of facilities, namely, fund-based and non-fund-based facilities, depending on the nature of business. Fund-based limits involve money given to the company in the form of cash, whereas non-fund-based limits involve a commitment without outflow of cash unless and until such a facility devolves on to the bank. The need of term loans and working capital funding are the basic vanilla commercial loans that are extended by banks. The term loans typically carry fixed interest rates and monthly or quarterly repayment schedules and include a set maturity date. The working capital limits are segregated into cash credit, bills, pledge and receivables that are of rolling nature with an upper ceiling limit sanctioned and carry a stipulated interest that is payable on a monthly or quarterly basis. The bank's primary role is to lend money. After all, the only way it makes an above-average return is by lending what customers deposit. However, since a bank lends other people's money, it operates in what is known as an 'abundance of caution' mode. That is, banks by design are only allowed to make loans in situations of absolute safety. Working with emerging growth companies means a few instances of absolute safety; hence, the challenge of loan financing.

Bankers tend to classify loans into two categories:

Long-term loans fund capital expenditure for setting up new units, expansion and modernization projects, under infrastructure and non-infrastructure sectors. These loans are commonly set for more than three years. Most are between three and seven years, and some may run for as long as 10 years and above. Long-term loans are collateralized by a business' assets and typically require quarterly or monthly payments derived from profits or cash flow. These loans usually carry a clause that repay the loan. These loans are well suited for the established small businesses that can leverage sound financial statements and substantial down payments to minimize monthly payments and total loan costs. Repayment is typically linked to future earning capacity. Term loans require collateral and a relatively rigorous approval process because of inherent long-term risk involved in extending such loans. Before deciding to finance equipment, borrowers should be sure they can make full use of ownership-related benefits, such as depreciation, and should compare the cost with that of other modes of funding such as leasing and hire purchase. Loans of this type are best used for firms involved in construction, major capital improvements, large capital investments, such as machinery, working capital and purchases of existing businesses.

The degree of financial strength required to receive loan approval can vary tremendously from bank to bank, depending on the level of risk the bank is willing to take on. These could be relatively inexpensive provided the borrower can pass the financial litmus tests for the sanction of such loans.

Working Capital Finance to Units in Various Sectors in the Form of Fund-based Limits Banks extend cash credit limits to meet the working capital requirements of the company against hypothecation of stock and debtors. While extending cash credit limits, banks use different methods to arrive at a requirement mainly by deducting trade creditors and asking for a part of the working capital gap to be met by the company by way of margin money. A company opens a cash credit account with the bank that allows it to withdraw up to the limit sanctioned at any given point of time.

Working Capital Term Loan (WCTL) At times, a borrower may fail to immediately induct their margin commitment, which may necessitate the bank to sanction WCTL, which is expected to be adjusted as soon as possible. At times, when the normal cash credit account of the company becomes irregular and finds it difficult to continue with optimum production operations, then a bank may convert an irregular portion of the account into WCTL. Usually, a working capital term loan carries a higher rate of interest.

Factoring This is a financial transaction whereby a business entity sells its accounts receivables to a third party called 'factor' at a discount in exchange for immediate money with which to finance continued business. Factoring services by the banks offer a comprehensive receivables and payables management solution that includes transaction financing, credit protection, sales ledger administration and payment collection. Factoring is very helpful in expanding the business when there are slow paying invoices, although certain to be received. It helps particularly small and medium enterprises to have instant money against their sales to expand, take on new work, meet payroll and pay bills. It eliminates the entrepreneur's collections worries and allows valuable time to be spent on core business instead of chasing money!! It involves the selling of a company's accounts receivables at a discount to a factor who, in turn, assumes the risk of collection. Factoring services are available for international factoring, domestic factoring, channel financing and import factoring. There are specialized institutions such as SBI factors, global trade finance and IFCI factors which provide factoring services for domestic as well as international sales.

Ad Hoc Limits Ad hoc limits are extended by bankers to their existing clients having a satisfactory track record to meet sudden spurt in bulk orders that would require additional working capital facilities or pending renewal or enhancement of existing limits to accommodate expansion in activity. Ad hoc limits are also sanctioned for such other genuine needs of the borrower to temporarily accommodate their need by extending fund-based limits.

Overdraft (OD) A bank overdraft is a limit on borrowing on a bank current account. The word 'overdraft' means the act of overdrawing from a bank account. In other words, the account holder withdraws more money from a bank account than has been deposited in it. With an overdraft, the amount of borrowing may vary on a daily basis. The overdraft facility provides flexibility to the borrower within limits, and the borrower is required to pay higher interest for the same. However, the bank can change the limit at any time and ask repayment of the money even earlier than expected. Overdraft is allowed against securities such as financial instruments like shares, units of mutual funds and surrender value of LIC policy and debentures. Some overdrafts are even granted against the perceived 'worth' of an individual. Such overdrafts are called 'clean overdrafts'.

Bill Discounting Under this type of lending, a bank takes the bill drawn by a borrower on their customer and pays them immediately after deducting some amount as discount/commission. The bank then presents the bill to the borrower's customer on the due date of the bill and collects the total amount. It becomes the responsibility of the seller's bank to send documents and bill of exchange to the buyer's bank for onward forwarding to the buyer for the acceptance and collection of dues. The which the buyer will pay the bank against that bill of exchange. If the bill is delayed, the borrower or their customer pays the bank a predetermined interest depending on the terms of the transaction. The major advantages of bill discounting facility for the bank are that it is a self-liquidating mode of financing; it is easy to monitor the genuineness of transactions; the quality of receivables can be ascertained; the banks have recourse to the drawer as well as the drawee; the bank earns a fee-based income; facility of rediscounting and a relatively far higher disciplined way of lending.

One of the problems faced by banks in bill discounting is the discipline on the part of the buyers to pay against the bills on time, which adversely affects the banking system. For improving the payment discipline, the clients can back up their credit availments from banks with post-dated cheques from the respective debtors.

Banker's Acceptance Banker's acceptance is a time draft or bill of exchange drawn on and accepted by a bank as its commitment to pay a third party. The parties involved in the banker's acceptance are the drawer (the bank's customer—importer or exporter), the acceptor (a bank or an acceptance house), the discounter (a bank that could be the accepting bank itself or a different banker at a discount house) and the re-discounter (another bank, discount house or central bank).[14] Banker's acceptance is the only accepted mode after the bank writes on the draft agreement to pay it on maturity. In turn, the bank becomes the principal obligator of the bill or draft of exchange drawn on and accepted by it.

Line of Credit It is an arrangement between the bank and the borrower that enables the borrower to draw up to a specified limit loan from the bank. The advantage that the borrower gets is that they can draw down on a line of credit at any time, as long as it does not exceed the specified sanctioned limit. Another advantage is that the bank usually does not charge any interest on the unused part of the line of credit. The line of credit, depending on the nature of agreement, can be classified as a demand loan, implying that the outstanding balance has to be paid immediately at the request of the bank.

Packing Credit This is a loan or advance granted by a bank to an exporter for financing the purchase, processing, manufacturing or packing of goods before shipment, on the basis of an LC opened in their favour or in favour of some other person, by an overseas buyer or a confirmed and irrevocable order for the export of goods from the producing country or any other evidence of an order for export from that country having been placed on the exporter or some other person, unless lodgement of export orders or LC with the bank has been waived.

Packing credit basically provides the exporters with working capital during the intermittent period between the time of the receipt of the order and the time of shipment to arrange for the production or procurement of goods. It is especially important for small-scale manufacturers and exporters who do not possess sufficient financial resources to meet the expenditure involved in the production of goods for export.

The bank appraises the proposal for packing credit based on a number of factors such as honesty, integrity and capital of the borrower, exporter's experience in the line, security offered, the margin of interest and the bank's experience about the exporter to ensure that their name does not appear on the caution list of the Reserve Bank.

The security for the packing credit may be provided in the following forms:

- letter of credit (LC)
- confirmed order as evidence of having received an order
- relevant policy issued by the Export Credit Guarantee Corporation
- personal bond in the case of party(ies) already known to the banker

Banks also lend packing credit in foreign currency so as to make export credit available at internationally competitive rates. Such credit facility is extended at rates linked to LIBOR (London Inter-bank Offer Rates).

13.7.2 Non-fund-based Limits

Banks provide a variety of non-fund limits to business ventures for their smooth business operations. Non-fund-based limits involve credit facilities extended by the banks where actual bank funds are not involved. Keeping in view the overall requirement to operate at the optimum level, banks sanction fund-based and non-fund-based limits together and monitor the account to see to it that working capital management is being handled well. Banks get income by way of commission for extending non-fund-based limits and only in the eventuality of an unforeseen devolvement, these may get converted into fund-based limits. Some of the important non-fund-based limits sanctioned by banks are given next.

of a facility when it desires to purchase machinery or goods on credit from inland. The Deferred Payment Guarantee (DPG) contains an undertaking on the part of the bank to guarantee due payment of the deferred instalments by the customers on the due date and declare that in the event of default in payment, the bank would make the payment. The bank usually extends this facility for a period up to five years. In exceptional cases, it may be extended for a maximum period up to 10 years on merits of each case. The customer is expected to maintain a cash margin of 25 per cent on the cost of machinery/equipment to be acquired less initial advance paid to the supplier plus interest portion, that is, on the DPG amount. This facility is usually extended against security in the form of deposits or other acceptable tangible security, insurance policies having adequate surrender value and easily marketable shares or mortgage of immovable property.

Issuance of Bank Guarantee in Lieu of Security Deposit/EMD/Performance Guarantees Banks extend guarantees in favour of government departments, such as railways and PWD, who may require guarantees from their contractors in lieu of tender money or performance of contracts to supply goods; sales tax/income tax authorities in respect of payment of taxes; companies of repute towards payments in respect of supply of materials; suppliers of machinery and plants on deferred payments basis require bank guarantees in respect of instalments and interest payable by their purchasers.

Besides these, several other commercial transactions involve execution of bank guarantees. These guarantees are also secured by securities as just mentioned, along with margin requirements to be fulfilled by the customers.

Deferred Payment Guarantee Deferred payment guarantee is used when buyer and seller have a close working relationship, which, in turn, results in the seller financing purchase by allowing the buyer a grace period for payment of the amount. Thus, under DPG, an affixed time period is allowed after shipment or presentation of prescribed documents. The main purpose of DPG facility is

- to protect the seller of a business who has been required by the buyer to agree to a deferred consideration on completion, whereby the buyer defers paying some of the sale price over an agreed period of time
- to provide a guarantee to the seller that they will receive the full deferred amount, whether the new owner of the business succeeds or not, thus providing financial security for the seller

It is mainly utilized by the entrepreneurs for acquisition of capital goods (plant/machinery including generators) and where there is provision for suppliers credit by the manufacturer/supplier in tune with the credit extended by the manufacturer. Banks usually have a first charge on fixed assets financed by them under DPG and look for collateral security and personal/third-party guarantee, wherever found necessary.

Letter of Credit (LC) Letter of credit is usually opened for customers who enjoy credit facilities with the bank. Banks may fix a regular limit towards LC for consumption of items to be procured through LC from within the country (inland) or other countries (foreign). These could be of different types as suited to meet the customer needs, such as clean, documentary, revocable, irrevocable, with recourse, without recourse and revolving. Inland letters of credit are usually opened for periods ranging between three and six months, and in case these are to be opened for longer periods, then there should be justifiable grounds.

In international trade, the buyer and the seller who are located in different countries may not know each other and, hence, the fundamental problem that arises is of the buyer's creditworthiness that may come in the way of trade between the buyer and the seller. To mitigate this problem, the seller always requests the buyer to arrange for an LC to be issued by the buyer's bank. On issuance of an LC, the buyer's bank replaces its own creditworthiness with that of the buyer; it undertakes to reimburse the seller for the value of the LC 'irrevocably', provided two underlined conditions are fulfilled by the seller, namely, all the documents stated in the LC are presented and all the terms and conditions of the LC are complied with. The key advantage of the LC is that if the two conditions just mentioned are fulfilled, then the issuing bank will effect payment to the beneficiary, irrespective of whether the applicant reimburses to the issuing bank or not. In the process, there is an applicant involved who arranges for the LC to be issued; *beneficiary* is the party named in the LC in whose favour the LC is issued; *issuing bank* is the applicant's bank that issues or opens the LC in favour of the beneficiary and substitutes its creditworthiness for that of the applicant; an *advising bank* may be named in the LC to advise the beneficiary that the LC was issued; the *paying bank* is the bank nominated in the LC that makes payment to the beneficiary, after determining that documents conform, and on receipt of funds from the issuing bank or another creditworthiness for that of the issuing bank. It ultimately assumes the issuing bank's commitment to pay.

The LC should be 'sight' LC or 'usance' LC. In case of 'sight' LC, the payment is made immediately to the beneficiary on the presentation of required documents within the stipulated time frame. However, 'usance' LC payments are made on a specified future date on presentation of the required documents.

Some of the general criteria that an entrepreneur can apply before associating with a bank for funding are as follows:

- Check up from friends and closely known people about where they bank and how they find services of the bank.
- Develop relationships with the bank long before one actually approaches them for a loan. This helps in understanding their approach in dealing with customers.
- Look out for alternative sources by doing proper spadework to find out who would be in a better position to meet one's needs at competitive rates.
- Always approach multiple organizations to meet one's financial requirements. There is no harm in sharing that one has been negotiating with alternate organizations.
- Negotiate for a complete package and attempt one's best to get the most favourable terms.

Example: Arthur Lipper and the British Far East Holdings Company on Loan Guarantee

According to Arthur Lipper III, chair of British Far East Holdings in Del Mar, California, which provides and arranges financing as well as advisory services, 'To get such a deal done, entrepreneurs need three ingredients: two banks and one guarantor.' Providing loan guarantees to high-octane growth companies is a subjective undertaking, Lipper says, and there are many ways a deal might be structured. However, a typical one-year loan for $1 million might be put together in the following manner:

First, the investor purchases an LC from their bank. It stipulates that the investor's bank will pay the entrepreneur's bank $1 million on a certain date within one year in the future. Lipper says that to issue such a letter, the bank charges 1 to 2 per cent of the amount of funds being guaranteed—in this case, $10,000 to $20,000 as a fee. Since it is a bank, and banks tend to avoid risks, it will also require the investor to deposit $1 million in government securities or $2 million in marginal securities (so-called marginable securities are those that can be borrowed against a determination that is made by the Federal Reserve). These assets collateralize the LC that the bank issues.

Now, with a rock-solid LC for $1 million protecting it, Lipper says, the entrepreneur's bank will then lend them the $1 million needed to grow the business.

Following are some of the costs the entrepreneur is expected to pay in such a transaction:

1. First, there is the guarantee fee. Remember, the investor has to pay their bank a fee to get it to issue the LC, in addition to depositing funds into the bank. 'The way the investor tends to think,' Lipper says, 'is that it's the entrepreneur's loan that is being guaranteed, not mine; therefore, the entrepreneur should pay the fees.'
2. Next, Lipper says, the investor typically collects 5 per cent of the loan as a fee for putting the deal together. For our hypothetical $1 million deal, that is another $50,000.
3. Then, there is the interest to the bank. For deals such as this, banks typically charge the prime rate, plus 1 per cent, says Lipper. 'It's absolutely outrageous for them to charge a premium like that,' he maintains, 'since there is no risk to the bank whatsoever.' Moreover, to avoid any possibility of default, the bank issuing the LC will probably stipulate that the interest on the loan be taken out of the proceeds upfront, as shown in the example just cited. The only positive thing one can say about all these fees is that they generally do not come out of one's pocket. In most deals, they come out of the loan fees, so one as the borrower ends up paying them in the form of a higher effective interest rate.[15]

13.8 LEASE FINANCING

The major advantage that accrues to the lessor is that they need not pay the cost of the asset at the time of signing the contract of leases. Lease contracts are more flexible, allow lessees to negotiate the terms of lease and structure the leasing contracts according to their needs for finance. They also provide an advantage by way of not incurring a massive amount on assets in the beginning of the venture itself and also safeguard the lessee from high technological obsolescence of plant and machinery.

The major advantages of leasing as a way of funding start-ups or well-established businesses are as follows:

- **Minimizing Initial Capital Investment**—The full cost of plant and machinery gets funded by the lessor, and, thus, the lessee saves initial capital investment on a venture. It does not involve any margin requirement or down payment on the part of the lessee. Thus, saved financial resources can be channelized by an entrepreneur for more productive uses such as inventories and other day-to-day expenses on production.
- **Flexibility in Availing Funding**—A lease agreement providing for lease rentals, periodicity of payment of lease rental and other terms and conditions could be negotiated as per the convenience and requirements of all lessees.
- **Better Cash Flow Planning**—It enables the lessee to have a better control over cash flows. They can pay the lease rentals from the income generated by use of lease assets.
- **Provides Greater Liquidity**—Leasing opportunity to the lessee improves their liquidity position by adopting the sale and lease-back technique.[17]

Equipment leasing is basically a loan in which the lender buys and owns equipment and then 'rents' it to a business at a flat monthly rate for a specified number of months. At the end of the lease, the business may purchase the equipment for its fair market value (or a fixed or predetermined amount), continue leasing, lease new equipment or return it.

Leasing has been a vital industry over the years in the United States and the United Kingdom and spread to other countries during the present century. In India, the concept was pioneered in 1973 when the First Leasing Company was set up in Madras, and the eighties have seen a rapid growth of this business. Lease finance involves a contract whereby the ownership, financing and risk taking of any equipment or asset are separated and shared by two or more parties. Thus, the lessor may finance, and the lessee may accept the risk through the use of it, whereas a third party may own it. Alternatively, the lessor may finance and own it, whereas the lessee enjoys the use of it and bears the risk. There are various combinations in which the characteristics just mentioned are shared by the lessor and lessee.[16] Thus, lease finance involves a contract between the lessor, an owner of an asset and the lessee—the user of the asset for the right to use the asset during a specified period and, in return, the lessee pays a specified lease rental periodically.

Lease finance is suitable for any business at any stage of development and, more particularly, to the start-up ventures. For start-up businesses with no revenues, 'small ticket' leases are a feasible option on the personal credit of the founders or owners who are willing to make monthly payments as lease rentals. This type of financing is most suitable for financing equipment purchases or specific machinery items commonly required for a variety of businesses such as generators. With more and more money flowing into the markets, numbers of leasing companies are increasing to assist entrepreneurial ventures. Although lease financing is relatively more expensive than bank financing, in most instances, it is more easily obtained and provides inbuilt flexibilities to the user, which offsets the additional cost that they have to bear.

Example: Venture Leasing

Ed Bartlett brought his Harvard Business School training to his new job as president of a start-up company. He had eight years of experience with big-company finance. However, he did not bring any illusions. He knew the long list of financing options available to an established company would be quite a bit shorter at Nationwide Remittance Centres Inc. (NRC). He just did not realize what living with a short list would be like. Talking to one financier, he remembers, 'was like dealing with a hit man at the end of the desk.'

been discovering that the list of alternatives is growing. Bartlett, a 42-year-old convert to small-company life, is using a new, little-known financing technique called 'venture leasing'. Venture lessors rent equipment to brand-new companies in return for a low rental rates along with a slice of the company's equity. Banks and traditional leasing companies do not usually deal with start-ups, or they look for a large cash deposit to the tune of 30 to70 per cent of the price of the equipment from the customers. This, in turn, raises the cost of leasing enormously. More important, it ties up capital that is almost always desperately needed someplace else in the business by the start-up ventures. In contrast, venture lessors' charges are relatively painless: A buried interest rate at least two percentage points higher than an established, creditworthy company would pay and an equity stake that is usually less than 2 per cent of the company. There is a catch, though. Most venture lessors will lease only to companies that have already been financed by venture capitalists. That way, they figure, they are more likely to get a customer who is well funded and well managed. However, some will make exceptions, and their number may increase as the industry grows.

Back in early 1987, when Bartlett was looking for lease financing, NRC had two venture backers and a business plan, but not much else. Getting some kind of leasing arrangement was critical. First, Bartlett wanted to hold onto the precious $2 million of venture capital cash he had raised. At a total cost of about $500,000, the equipment he needed would chew up a quarter of it.

Second, NRC's entire operation depended in a large part on its equipment—25 data general minicomputers. NRC's business is to collect money for companies faster than they can collect it themselves. For example, to help an insurance company gather the premium payments that its customers send in from all over the country, NRC accelerates two processes: the time that a cheque spends travelling through the mail and the time it takes to clear through the banking system. The minicomputers, to be installed in 25 banks around the country, were essential to the second part of NRC's service. Of course, the equipment had to be in place before NRC could begin to take on customers.

Initially, Bartlett tried to get Data General (DG) Computers to finance the computers. After all, who would be better motivated to make a deal? To do its analysis, DG Computers used a Citibank programme that evaluates potential lessors on their cash flow. NRC, of course, had none.

The next stop was venture lessors. Of the handful of companies doing venture leasing at the time, Bartlett liked San Francisco-based Dominion Ventures Inc. best. Geoffrey Woolley, managing general partner at Dominion, describes himself as an 80 per cent venture capitalist. 'You don't take the risk on the leasing side of the business. You take the exactly same approach that a venture capitalist does,' he says.

Not that the equipment in question does not matter. Dominion did not turn cartwheels over NRC's choice of DG Computers, for example. 'Although DG is known as a good hardware company, its reputation is weak when it comes to software and service,' Bartlett explains. DG Computers is likely to be worth less at the end of NRC's lease. So, Dominion forecast a lower 'residual value' for the gear, which raised the cost of the lease financing.

NRC's total leasing costs were also higher than they had to be, because, eager to get the business started, it had bought the computers before it struck a deal with Dominion. This meant that it had to sell the computers to Dominion before it could lease them. This sale/lease-back feature required NRC to pay the sales tax on the computers twice—a $25,000 expense—and to take a $78,000 loss on the sale of the equipment to Dominion. It would have been cheaper and less of a paperwork nightmare to let Dominion buy the machines in the first place.

Here is how the deal worked: Dominion offered NRC a $750,000 lease line, which could be drawn on during a four-month period. After four months, the $500,000 that NRC used turned into a loan, to be repaid over the course of three years.[18]

Table 13.1 helps evaluate the sources in a brief way and shortlist the source for evaluation using the model. Though there can be a few sources that appear to be most relevant to the venture, it would be advisable to evaluate with regard to all the sources, as in the example just mentioned, in order to get more appropriate information for planning the financing mix.

Table 13.1 Alternate Sources of Funding Ventures at Different Stages of Growth

Source of Funding	Range of Funds Available	Best Use	Availability
Bootstrapping	₹5 to 10 lakhs	Seed stage; small firms involving low capital and operational costs—construction firms, architecture, designing and consultancies	Plenty—depends on the factors such as real estate owned and creditor goodwill
Venture capital	Wide range	Growth stage; firms that have a proven product or service	Limited—convincing VC firms involves an effective business plan
Angel investors	₹10 lakhs to ₹3 to 4 crores	Seed or start-up funding; early-stage firms with no revenues	Abundant but expensive; can be difficult to negotiate
Bank loans	₹2 to 3 lakhs and greater	Start-up or growth phase; small and established business	Inexpensive and plenty
Lease financing	Wide range	Start-up phase; companies that involve a large number of equipment with long economic life	Abundant supply; depends on a good purchase option at the end of the lease period in the lease agreement
Royalty financing	₹3 lakhs upwards	Growth phase; generally involves an established service to be provided in the future	Substantial supply; product or service to be offered in the future should be a proven one and should be of importance to the investor

13.9 FUNDING OPPORTUNITIES FOR START-UPS IN INDIA

13.9.1 Department of Scientific and Industrial Research (DSIR)

This extends funding support up to ₹75,000 with a ceiling of 90 per cent of the approved project cost by way of grant for creating a lab model/computer model for technology development purpose to encourage budding entrepreneurs. This grant can be availed by students or entrepreneurs involved in developing technologies to promote ventures. Under another scheme of DSIR, funds are available for technology scale-up and validation purpose through conversion of invention into working prototypes. The ceiling on funding amount is ₹ 1,500,000 subject to 90 per cent of total project cost under the scheme. It also has another scheme that encourages protection of patents and scaling up of technologies under which the grant is mainly available for carrying out value-added work such as product features, protection by patenting and aesthetic design. DSIR extends fund support to the tune of ₹ 750,000 subject to 90 per cent of total project cost under the scheme.

DSIR also has provision under international technology transfer programmes to fund up to ₹ 1 crore by way of a grant to promote international technology transfer and trade including exports of technologies, projects, services and technology-intensive products. Thus, there is a range of schemes by DSIR that promotes technology venture-related investments for different purposes to encourage budding entrepreneurs, professional and students to contribute in entrepreneurship development.

Example: DSIR—Seed Money for Product Development

Reetesh Kumar Singh and Rajiv Shankar Sinha, students at IIT-Kanpur, were beset by the classic start-up conundrum—surfeit of ideas and lack of capital. The duo, who wanted to set up their own product development company, finally turned to the DSIR for seed money to roll out their venture.

Sinha designed a machine that detects fake currency notes, which received ₹15 lakhs from DSIR's Technopreneur Entrepreneurship Programme (TePP), whereas ₹20 lakhs came in as seed funding from IIT-Kanpur's incubation centre—SIDBI Innovation and Incubation Centre (SIIC). Soon after, Singh also got a TePP grant of ₹6 lakhs for a product called the 'Nano-positioner', a device that holds and positions devices used in microscopy.[19]

13.9.2 Ministry of Micro Small Medium Enterprises (MoMSMEs)

'Support for Entrepreneurial and Managerial Development of SMEs: Through Incubators' provides a grant to technology start-ups for prototyping and getting mentoring to build their companies. The main objective of the scheme is to promote emerging technological and knowledge-based innovative ventures that seek the nurturing of ideas from professionals beyond the traditional activities of micro, small and medium enterprises (MSMEs). Such entrepreneurial ideas have to be fostered and developed in a supportive environment before they become attractive for venture capital. Hence, the need arises for incubation linkages with other constituents of the innovation chain for commercialization of their developments. This initiative is now being taken up by the ministry of MSME—the nodal ministry for the development of entrepreneurship and creation of self-employment and more employment avenues.[20]

The cost may vary between ₹ 4 and 8 lakhs for each incubate/idea, subject to the overall ceiling of ₹ 62.5 lakhs for each business incubator. The scheme covers the cost on items such as technology fee, telephone, fax, computer facility, electricity and accommodation charges, machinery hiring or leasing from outside and guidance fee per annum for mentors/handholding persons.

Implementing agencies for this scheme have been identified as Indian institutes of technology (IITs); national institutes of technology (NITs); engineering colleges; technology development centres, tool rooms and other recognized R&D and/or technical institutes/centres; development institutes of Department of Industrial Policy and Promotion (DIP&P) in the field of paper, rubber and machine tools.

MSMEs also have a scheme to encourage small and medium enterprises to participate in exhibitions for marketing their products and extends a grant support up to ₹ 5 lakhs for attending domestic and international exhibitions.

13.9.3 Department of Science and Technology

Instrumentation is one of the major areas of science and technology that makes a great impact on vital sectors of national activities such as education, scientific research, industry, agriculture and medicine and health. The DST has been promoting the area of instrumentation through its Instrumentation Development Programme (IDP).[21]

The objectives of the DST programme are to focus on strengthening the indigenous capability for research, design, development and production of instruments in the country leading to indigenous development and production of instruments; continuous updating of the technology of instruments and innovations in the area of instrumentation.

To develop analytical, environmental monitoring, laser-based, medical, food processing, geo-scientific, agri-electronic instruments and sensors, in particular, the scheme provides fund support to scientists/technologists/entrepreneurs. DST has sanctioned up to ₹ 35 lakhs in recent projects, grant for technologists in academic institutions/soft loans or equity partnership with entrepreneurs under the scheme to promote development of instruments leading to promotion of ventures.

DST's programme on 'water technology initiative' is another major initiative that promotes R&D activities to provide safe drinking water at affordable cost and in adequate quantity using appropriate science and technology interventions. The scheme focuses on developing holistic solutions to the problem of water contamination and water scarcity through development of indigenous systems/devices to provide safe and adequate drinking water to households. The main objective of the scheme is to come up with the development of simple, cost-effective and easy-to-operate-and-maintain technologies in the area of safe, neat and clean drinking water to households at large.

The scheme provides funding support to scientists, technologists and R&D laboratories for the purpose. DST has sanctioned up to ₹ 1 crore grants for technologists in academic institutions. The grant covers 50 per cent cost of consumables for industry–institution partnerships to develop low-cost domestic purification technologies, options for disposal of scientific waste and initiating applications of nano-technology.

Technology Development Board (TDB)

TDB aims at accelerating the development and commercialization of indigenous technology or adapting imported technology to wider domestic applications. The board provides financial assistance in the form of equity, soft loans or grants. For the development and application of indigenous technology in a dynamic economic environment, the Government of India enabled the placing of proceeds of the R&D cess on the import of technology into a fund called the 'fund for technology development and application'. To administer the fund, the government also constituted a TDB on 1 September 1996, under the provisions of the Technology Development Board Act, 1995. The TDB funds industry, entrepreneurs, institutions and incubators to extend assistance by way of loans, equity or grants. The loan carries a nominal interest at 5 to 6 per cent. The board also extends

Examples

Eicher Motors Limited, Pithampur

The introduction of the four-cylinder E483 engine has been a landmark in terms of innovative new design, concepts related to planning and manufacturing, experimentation and validation achieving the various targets set forth in the beginning of the projects. The engine developed is among the best of its class in naturally aspirated engines producing 18.5 kw/l meeting India 2000 emission norms.

Shantha Biotechnics Pvt. Ltd, Hyderabad

The company has pioneered the development of recombinant DNA-based Hepatitis-B vaccine, a healthcare product. The company has pioneered this development in India using innovative technology that has resulted in a successful product that is much cheaper and, therefore, available to a wider section of the society.

Shantha Biotechnics Pvt. Ltd got the first ever National Technology Award 1999, instituted by the TDB, Government of India, for successful development and commercialization of indigenous technology.

The award was presented by the Honourable Prime Minister of India, Atal Behari Vajpayee, in recognition of the company's success in commercializing the production of recombinant DNA-based Hepatitis-B vaccine.[23]

13.9.4 SIDBI Venture SME Growth Fund

To meet the venture capital needs of SME units and enable them to achieve rapid growth by taking advantage of opportunities in the emerging sectors, SIDBI Venture Capital Ltd has set up SME Growth Fund. The fund has a targeted corpus of ₹ 500 crores with a life of eight years. The fund seeks to achieve attractive risk-adjusted returns for its contributors through long-term capital appreciation by investing in SMEs.

The main focus of the fund is to invest in unlisted entities in the small and medium enterprises in manufacturing as well as services sector, as also businesses providing infrastructure or other support to SMEs. The fund also has a provision to invest in listed companies on a highly selective basis to avail of the attractive opportunities in growing companies. The fund mainly invests in companies at an early stage as well as in the second-round financing for those with a track record of proven technology or business model and opportunities for growth and earnings.

SME Growth Fund provides financial assistance primarily by way of equity or equity-linked capital investment. It also endeavours to provide mentoring support and other value addition to enable the funded companies achieve rapid growth and achieve/maintain their competitive edge in domestic and international markets.

The scheme provides for funding in the range of ₹ 2 to ₹ 25 crores by way of equity investment in a wide range of growth sectors, such as life sciences, retailing, light engineering, food processing, IT, infrastructure-related services, healthcare, and logistics and distribution.

13.9.5 Department of Bio-technology

The Department of bio-technology has initiated a scheme called 'Small Business Innovation Business Research Initiative' (SBIRI) phase 1 and phase 2 to promote entrepreneurship in the area of bio-technology. Under phase 1, the provision exists for extending ₹ 1 crore, of which ₹ 50 lakhs can be given by way of grant and the remaining by way of soft loan for early-stage funding for high-risk, innovative ideas/products for commercialization. The provision exists for extending soft loan up to ₹ 10 crores in phase 2 for early-stage funding for high-risk, innovative ideas/products for commercialization. The unique features of the scheme are that it assists small and medium business units, including new enterprises, with not more than 500 employees in R&D; offers phase 1 funding for early stage, pre–proof-of-concept innovative research and provide phase 2 funding towards commercialization of research leads. Pharma, biotech companies and any other enterprises focusing on scientific innovations are eligible to apply. The eligibility for funding requires the submission of an application by an Indian company/ies solely or jointly with a public partner (universities or national institutes); more partnerships would be eligible for SBIRI support, where the entity created meets the requirements just mentioned.

13.9.6 National Research Development Corporation (NRDC)

NRDC has a number of schemes that promote technology-driven entrepreneurship. It promotes, through flexible funding schemes, the development of marketable technologies in close association with industry and national R&D institutions. It evaluates the technological merits and commercial potential of incipient or mature technologies by conducting techno-economic surveys; technology and business forecasts and investment appraisals; pre-emptively protects intellectual property rights (IPR) worldwide; designs and engineers manufacturing plants of commercial scale; shapes and manages technology contracts that are fair and equitable; tests market products; assists in obtaining certifications for products and their quality, where these are prerequisites for entering commerce. NRDC takes care of all expenses for protecting technologies and innovations through IPR under their scheme of financial and technical support for patenting of inventions. It also has a scheme to extend awards under different categories in the range of ₹ 1 to ₹ 5 lakhs for stimulating the spirit of inventiveness. More than financial assistance, entrepreneurs can get multiple help by way of information on the latest technologies developed around the world and particularly in India; an objective assessment of the commercial potential of inventions; national and international patenting; identification of potential manufacturers for new technologies; negotiation of licensing agreements to provide worthwhile value for the patents; legal backup for royalty collection and share in license income and other unexpected gains.

13.9.7 Department of Information Technology (DIT)

DIT's main objective is promoting e-governance in the country, and it encourages R&D efforts in the area to promote these. It facilitates by different means the promotion of providing e-infrastructure for delivery of e-services; promotion of electronics hardware manufacturing and IT/ITES industry; support for creation of innovation infrastructure in emerging areas of technology; support for development of e-skills and knowledge network and securing India's cyber space.

The Indian Information Technology-Information Technology-Enabled Services (IT/ITES) industry has been performing a key role as the most consistent growth driver for the economy. Service, software exports and BPO remain the mainstay of the sector. The IT/ITES exports have grown to a staggering $46.3 billion in 2008–09. The IT sector currently employs 2.2 million professionals directly and another 8 million people indirectly and accounts for more than 5 per cent of GDP. A majority of the Fortune 500 and Global 2000 corporations are sourcing IT/ITeS from India, and it is the premier destination for the global sourcing of IT/ITES, accounting for 55 per cent of the global market in off-shore IT services and garnering 35 per cent of the ITES/BPO market.[24]

DIT assists by funding to industry and industry–R&D institution partnership projects to encourage R&D projects in the fields of ICT and to create indigenous products/packages. It has funded projects in the areas of Bio-informatics; Nanotechnology Initiative Division Projects; Microelectronics Development Division Projects; Industrial and Electronics Application Development Division Projects; Electronic Components and Materials Division Projects; Photonics Development Division Projects; Semiconductor ICs Layout Design Division Projects and Medical Electronics and Telemedicine Division Projects.

13.9.8 Risk Capital and Technology Finance Corporation Limited (RCTC)

The IFCI Venture was originally set up as a society by the name of Risk Capital Foundation (RCF) in 1975. The society provided institutional support to first-generation professionals and technocrats for setting up their own ventures in the medium-scale sector. In 1988, RCF was converted into a company, Risk Capital and Technology Finance Corporation Ltd (RCTC). To reflect the shift in the company's activities, RCTC's name was changed to IFCI Venture Capital Funds Ltd (IFCI Venture) in February 2000. Over the years, the IFCI Venture acquired expertise and experience of investing in technology-oriented and innovative projects. Since its inception, it has provided finance to more than 350 ventures and supported commercialization of more than 50 new technologies. It has pioneered efforts for widening its entrepreneurial base in the country and has catalyzed the introduction of venture capital activity in India.[25]

13.9.9 Angel Capital to Start-ups

Angel funding to start-ups comes by way of equity and/or debt for promoting technological advancement through new technologies and innovative products. Angels also promote successful commercial exploitation of the technologies by providing financial support to entrepreneurs. Angel fund provides a great advantage to both in five deals in 2008, which have increased to $7.3 million in nine deals in 2010. The three key factors that have set Angel investors apart are smaller investments in the range of $250,000 to $1.5 million, fast route to funding and relatively smaller stake in the equity being in the range of 10 to 25 per cent.

The angel investing formula is simple: invest in multiple companies (most super-angel funds have more than 50 investments), invest small amounts, take small stakes and work closely with the company. In most cases, the start-up turns ripe in two or three years for another round of funding or an acquisition, and the super-angel fund exits. This vibrant ecosystem has also attracted the attention of established venture funds. Big names such as Reliance Venture Asset Management and Sequoia Capital swoop down on early-stage deals when an opportunity arises (Syal 2011).

Some of the prominent angel investors in India are the Mumbai Angels, Indian Angel Network, Emergic Ventures, Factorial Software and Chennai Angels.

13.9.10 Venture Capital Funding in India

At the emerging opportunities for funding in knowledge economy, venture capital is taking deeper roots in India. The venture capital funding started in 1988 with the formation of Technology Development and Investment Corporation of India (TDICI) and regional funds. GVFL Limited (formerly Gujarat Venture Finance Limited) is widely regarded as a pioneer of venture capital in India. It is an independent, autonomous board-managed venture finance company based in Ahmedabad, Gujarat, India. GVFL ushered in the dawn of venture capital in India. Founded in 1990 at the initiative of the World Bank, GVFL has supported ventures working on cutting-edge technology as well as encouraged entrepreneurs with innovative ideas. During 1995–99, a number of foreign venture capital funds entered into India to promote technology-driven enterprises. Subsequently, a number of global venture capitalists started actively participating in funding ventures in India. At present, there are around 150 active venture capital funds—government, foreign and corporate—operating in India. In 2006, $7.5 billion was invested by venture capital funds in 299 deals across sectors. However, ITES remained the most favoured sector, and a majority of the deals in number as well as the amount of funding was in favour of late-stage funding as against early-stage and growth-stage funding. Some of the venture capital firms operating in India are 2i Capital (India) Pvt. Ltd; Ambit Pragma Ventures Pvt. Ltd; Ascent Venture; Canaan Advisors Pvt. Ltd; Canbank Venture Capital Fund Ltd; Global Technology Ventures Ltd; Helion Ventures Pvt. Ltd; ICICI Ventures; IDFC Pvt. Equity; iD Ventures America, LLC; iLabs Group; Caspian Advisors Private Limited; Gujarat Venture Capital Fund Limited; HSBC Private Equity Management (Mauritius) Ltd; IDFC Private Equity Co. Ltd; IFCI Venture Capital Funds Ltd; IL&FS Venture; Providence Equity; Reliance Technology Venture Pvt. Ltd; Standard Chartered Private Equity Advisory India Pvt. Ltd; VentureEast Fund Advisors and Walden India Advisors Pvt. Ltd.

Venture capital funds in India are governed by the Securities and Exchange Board of India (SEBI). SEBI is the nodal agency for registration and regulation of both domestic and overseas venture capital funds. Accordingly, it has made the following regulations, namely, Securities and Exchange Board of India (Venture Capital Funds) Regulations 1996 and Securities and Exchange Board of India (Foreign Venture Capital Investors) Regulations 2000. These regulations provide broad guidelines and procedures for the establishment of venture capital funds both within India and outside it; their management structure and set-up as well as size and investment criteria of the funds.

13.9.11 Banks and Financial Institutions Funding Ventures

The major post-independence institutional innovations of relevance to long- and medium-term finance for the industry can be grouped into four major categories:

1. National Level Industrial Development Banks.
2. Specialized Financial Institutions.
3. Investment Institutions.
4. Other Banks Offering Financial Assistance.

13.9.12 National Level Industrial Development Banks

Development banks (DB) are those banks that were established to finance and nurture industrial development in the country during the post-independence era. The main purpose was to promote entrepreneurship in the country. These banks differ from the other banks, mainly in terms of their main involvement in creating a climate for entrepreneurial ventures. Their main function involves the funding of medium- and long-term loans to the industries, subscription to the share and debenture of the industries, and underwriting of the new issues. They have their network of presence across the country that caters to the widespread effect of funding

The various DB set up are SIDBI, NIDC (established in 1954), IDBI, ICICI (Industrial Credit and Investment Corporation of India) and IFCI (Industrial Finance Corporation of India). There are various institutions such as SCBs, SIDC and SIIC that look after needs at the state levels.

13.9.13 Industrial Finance Corporation of India

The first development bank in India was incorporated immediately after independence in 1948 under the Industrial Finance Corporation Act as a statutory corporation to pioneer institutional credit to medium- and large-scale industries. It is a 50 per cent subsidiary of IDBI, and the rest of the shares are held by banks and insurance corporations. It provides assistance in all forms, such as loans, underwriting and subscribing to the share and debentures. Its lending suffered from the high rate of defaults. The newly established DFI was provided access to low-cost funds through the Central Bank's Statutory Liquidity Ratio (SLR), which, in turn, enabled it to provide loans and advances to corporate borrowers at concessional rates. By 1991, it was recognized that there was a need for greater flexibility to respond to the changing financial system. It was also felt that IFCI should directly access the capital markets for its funds' needs. It is with this objective that the constitution of IFCI was changed in 1993 from a statutory corporation to a company under the Indian Companies Act, 1956. Subsequently, the company's name was also changed to 'IFCI Limited' with effect from October 1999.

13.9.14 Industrial Development Bank of India

Established in 1964 by an Act of Parliament to meet the credit demands for the industries, this was wholly owned by RBI. It was an apex institute to finance the industries, and it also coordinates with other banks for financing. In 1976, it was converted to an autonomous body. It provides finance to look after the export or import needs of the industries. It also provides the facility of refinancing by subscribing to the term finance of the SCBs, ICFI against the loan provided by them, thus refinancing the loans. It mainly provides short-term and long-term loans to the industries. It served a great purpose of developing industrialization in the country during the post-independence era.

Some of the institutions built by IDBI are National Stock Exchange of India (NSE); National Securities Depository Services Ltd (NSDL); Stock Holding Corporation of India (SHCIL); Credit Analysis & Research Ltd; Export-Import Bank of India (Exam Bank); Small Industries Development Bank of India (SIDBI); Entrepreneurship Development Institute of India and IDBI Bank, which is now owned by the Indian Government, though for a brief period it was a private scheduled bank.

Keeping in view the changing role of development banks and the need for converting these institutions into commercial banks, the IDBI (Transfer of Undertaking and Repeal) Act 2003 was passed by Parliament in December 2003. The Act provides for repeal of IDBI Act, corporatization of IDBI (with majority government holding) and its transformation into a commercial bank. The notification facilitated formation, incorporation and registration of Industrial Development Bank of India Ltd as a company under the Companies Act, 1956, and a deemed banking company under the Banking Regulation Act, 1949, and helped in obtaining requisite regulatory and statutory clearances, including those from RBI. IDBI Bank, with which the parent IDBI was merged, was a vibrant new generation bank. The bank was the fastest-growing banking company in India and was a pioneer in adapting to the policy of the first mover in tier two-cities.

IDBI Bank Ltd is a universal bank with its operations driven by a cutting-edge core banking IT platform. The bank offers personalized banking and financial solutions to its clients in the retail and corporate banking arenas through its large network of branches and ATMs, spread across the length and breadth of India. The bank also set up an overseas branch at Dubai and has plans to open representative offices in various other parts of the globe for encashing emerging global opportunities.

13.9.15 Industrial Credit and Investment Corporation of India (ICICI)

It was established in 1955 as a private sector development financial institution under the Companies Act of 1913 to provide finance to the large private enterprises and industries. It basically issues money by the underwriting of the new securities and subscribing to the stocks and debentures of the company. As a result of high growth in operations and with the development of the capital market, ICICI increased its equity, as well as domestic and international borrowing, and changed its shareholding pattern. ICICI's operational activities mainly consist of extending funding support in different ways by way of medium and long-term loans in local and foreign currencies to assist in the creation, expansion and modernization of medium and large industrial enterprises, predominantly in the private sector. ICICI has played a critical role for a number of years in extending foreign exchange financing. It also makes equity investments, underwrites new shares and debenture issues and

However, after liberalization of the economy since 1991, ICICI strategically pursued the path of becoming a financial supermarket by offering a wide range of financial services to cope with growing opportunities and competition. ICICI set up in the post-liberalized era specialized subsidiaries for the following activities: investment banking, commercial banking, fund management, investor services and broking. In addition, ICICI has diversified its own range of activities into several fee-based services, including custodial services to cater to the needs of foreign and domestic institutional investors. ICICI also provides technology financing for development and commercialization of technology. ICICI is now considering the financing of infrastructure projects in line with the government's efforts to develop infrastructure in the country.

In 2002, the board of directors of ICICI and ICICI Bank approved the reverse merger of ICICI, ICICI Personal Financial Services Limited and ICICI Capital Services Limited into ICICI Bank. After receiving all necessary regulatory approvals, ICICI integrated the group's financing and banking operations, both wholesale and retail, into a single entity. It is the second largest bank in India and the largest private sector bank in India by market capitalization. It provides almost all facilities as a universal bank to meet the requirements of small, medium and large entrepreneurs.

13.9.16 Industrial Reconstruction Bank of India

The Industrial Reconstruction Corporation of India Ltd, was set up in 1971 for the rehabilitation of sick industrial companies in the private sector, mainly with a view to nurse and rehabilitate sick industries that were pre dominantly present in the state of West Bengal. It was reconstituted as Industrial Reconstruction Bank of India in 1985 under the IRBI Act, 1984. It became a government-owned undertaking with shareholding with IDBI, UTI and LIC. It mainly performed the role of rehabilitation of sick units across the country to salvage capital that had become unproductive and were identified as viable units from a long-term perspective. With a view to converting the institution into a fullfledged development financial institution, IRBI was incorporated under the Companies Act, 1956, as Industrial Investment Bank of India Ltd (IIBI) in March 1997. IIBI offered a wide range of products and services, including term-loan assistance for project finance, short-duration non-project asset-backed financing, working capital/other short-term loans to companies, equity subscription, asset credit, equipment finance and investments in capital market and money market instruments. Subsequently, from 2003 onwards, its operations were curtailed a lot, and the government slowly sold off its assets to different banks and institutions as its own viability for existence was being questioned.

13.9.17 Shipping Credit and Investment Company of India (SCICI)

The SCICI is a special financial institution catering particularly to the deep-sea fishing sector providing term loans in rupees and foreign currencies for such purposes. Besides this, SCICI also provides financial guarantees, buyers/sellers lines of credit, leasing finance and merchant banking services for raising funds in the capital market. In selected cases, it also offers participation in equity. The rates of interest charged by SCICI are 18 to 20 per cent per annum on rupee loans. On foreign currency loans, the rates are 11 to 12 per cent per annum on fixed-rate loans and 2.5 to 3.5 per cent over LIBOR on floating-rate loans. The promoters' contribution is expected to be 20 per cent of project cost and the debt/equity ratio required is 2:1. SCICI takes up financing of larger projects in the range of over ₹ 5 million.

Subsequently, SCICI was merged into ICICI with effect from 1 April 1996. The merger resulted in the largest amalgamation of two financial institutions in the subcontinent. As a result, ICICI has grown in size to build an asset base of almost ₹ 1 trillion, largely through its strategy of aggressive mergers and acquisitions. The main purpose of the merger was consolidation resulting in mega-sized institutions that can compete well in the globalized markets. The need for a giant financial institution was particularly evident in the emerging fully convertible rupee era when India would come closer to the global financial world, as the country's real interest rates will also level out with international norms.

13.9.18 Small Industries Development Bank of India (SIDBI)

Small Industries Development Bank of India is an all-India financial institution working for the cause of growth and development of micro-, small- and medium-scale enterprises in India. It was set up on 2 April 1990 through an act of the Parliament. It was incorporated in the beginning as a wholly owned subsidiary of Industrial Development Bank of India. Its shareholding is widely spread amongst various state-owned banks, insurance companies and financial institutions. SIDBI is an apex institution for formulating, coordinating and monitoring policies and programmes for the development of small-scale industries. It initially acted as a refinancing agency to banks and state-level financial institutions for meeting their credit needs to small industries. However, also playing a key developmental role in supporting micro-finance institutions for capacity building.[26]

It mainly focuses its efforts on funding small-scale industrial units, which contribute significantly to the national economy in terms of production, employment and exports. Small-scale industries are the industrial units in which the investment in plant and machinery does not exceed ₹ 10 million. In addition, SIDBI's assistance flows to the transport, healthcare and tourism sectors and also to the professional and self-employed people setting up small-sized professional ventures. It extends finance assistance by way of direct loans, bills finance, refinancing to the banks, international finance and handles government subsidy schemes for promotion of small and medium enterprises in the country.

SIDBI has a number of schemes that extend financial and other support to the new entrepreneurs. Its promotional and development scheme for new entrepreneurs aims at development of the small industries by partnering with NGOs, associate financial institutions, corporate bodies, R&D laboratories and marketing agencies for national-level programmes. Its Rural Industries Programme (RIP) aims at development of viable and self-sustaining tiny/small enterprises in rural and semi-urban India by harnessing local entrepreneurial talent. The Programme attempts to address problems such as rural unemployment, urban migration and under-utilization of local skills and resources, and is designed as a comprehensive business development services programme. Its Technology Upgradation Programme (TUP) for new entrepreneurs focuses on creation of awareness on new product/process technologies, skill upgradation, development of technology-related common facilities for the cluster, provision of unit-specific modernization package, energy conservation and introduction of environment friendly technologies.

SIDBI has launched SIDBI Foundation for micro credit with a mission to create a national network of strong, viable and sustainable Micro Finance Institutions (MFIs) to provide financial support to micro enterprises. It provides financial assistance to the manufacturing sector involving investment in plant and machinery (original cost excluding land and building and the items specified by Ministry of MSME, the then Ministry of Small-Scale Industries, vide its notification No. S.O. 1722 (E) dated 5 October 2006) for micro enterprises up to ₹ 25 lakhs, small enterprises in the range from ₹ 25 lakhs to ₹ 5 crores and medium enterprises in the range from ₹ 5 crores to ₹ 10 crores. While in the service sector, investment limit in equipments for micro enterprises is up to ₹ 10 lakhs; in small enterprises, in the range from ₹ 10 lakhs to ₹ 2 crores and in medium enterprises, in the range from ₹ 2 to ₹ 5 crores.[27]

13.9.19 Tourism Finance Corporation of India (TFCI)

The Government of India, pursuant to the recommendations of the National Committee on Tourism, namely, Yunus Committee, set up a separate All-India Financial Institution for providing financial assistance to tourism-related activities/projects in 1988. Accordingly, Tourism Finance Corporation of India Ltd (TFCI) came into existence to function as a specialized All-India Development Financial Institution to cater to the financial needs of the tourism industry. The main objectives of the institution are to provide financial assistance to enterprises for setting up and/or development of tourism-related projects, facilities and services, such as hotels, restaurants, holiday resorts, amusement parks, safari parks, ropeways, cultural centres, and travel and tour operating agencies.

It provides financial and non-financial assistance through rupee loan, underwriting of public issues of shares/debentures and direct subscription to such securities, guarantee of deferred payments and credit raised abroad, equipment finance, equipment leasing, assistance under suppliers' credit, working capital financing, takeover financing and advances against credit-card receivables.

TFCI provides financial assistance to projects with a capital cost of ₹ 3 crores and above. In respect of projects costing between ₹ 1 crore and ₹ 3 crores, TFCI considers financial assistance to the extent of unavoidable gap, if any, remaining after taking into account the assistance from state-level institutions/banks. Unique projects, which are important from the tourism point of view and for which assistance from state-level institutions/banks is not available, may be considered on an exceptional basis even though their capital cost is below ₹ 1 crore. Financial assistance is considered on similar lines for heritage and restaurant projects. Projects with high capital cost may be financed along with other All-India Financial/Investment Institutions. TFCI considers assistance even if the total cost is less than ₹ 3 crores for existing concerns with satisfactory performance and for renovation/upgradation.

Financial assistance is extended against first charge on movable and immovable fixed assets, personal guarantees of the promoters and corporate guarantee of the group concerns and, if necessary, pledge of the

13.9.20 State Financial Corporations (SFCs) and State Industrial Development Corporations (SIDC)

In pursuance of the SFCs Act, 1951, SFCs were set up mainly to finance small- and medium-scale units. Their area of operation in general is restricted to the concerned states. SFCs also assist small-scale units for their modernization and technology upgradation programmes by providing soft loans, restructuring the sick small-scale units through rehabilitation schemes and through equity-type assistance under SIDBI's seed capital scheme.

State Financial Corporations (SFCs), operating at the state level, form an integral part of the development financing system in the country. They function with the objective of financing and promoting small and medium enterprises for achieving balanced regional socioeconomic growth, catalyzing higher investment, generating greater employment opportunities and widening the ownership base of industry.

At present, there are around 18 SFCs (including TIIC, which was set up as a company) in existence for more than 40 years and operating as Regional Development Banks. The SFCs have played an important role in the evolution and growth of small- and medium-scale industries in their respective states in the country ever since 1951. They provide financial assistance to industrial units by way of term loans, direct subscription to equity and guarantees. Over the years, SFCs have expanded their activities and coverage of assistance. The general conditions for getting loans from SFCs are governed by their eligibility criteria; technical/economic viability of the proposed project; promoters' contribution; capacity to repay loans and collateral securities and guarantee. Loans are also offered under some special schemes, such as Prime Minister's Rozgar Yojana (PMRY). This scheme is mainly meant for the purpose of generating self-employment.

The SFCs operate a number of schemes and equity-type assistance on behalf of IDBI/SIDBI, in addition to the schemes for artisans, and special target groups such as SC/ST, women, ex-servicemen and physically handicapped. The SFCs (Amendment) Act, 2000, which became effective in 2000, provides greater flexibility to the SFCs to cope with the challenges posed by the deregulated financial system.[28]

The state industrial development corporations (SIDCs) were set up under the Companies Act, 1956, as wholly owned undertakings of the state governments with the specific objectives of promoting and developing large industries in their respective states/union territories. These corporations extend financial assistance in the form of rupee loans, underwriting subscriptions to shares/debentures, guarantees and also open letters of credit on behalf of their borrowers. SIDCs undertake promotional activities including preparation of feasibility reports, conducting industrial potential, survey entrepreneurship training and development programmes, and developing industrial areas/estates. Some SIDCs also offer a package of developmental services that include technical guidance, assistance in plant location and co-ordination with other agencies. With a view to providing infrastructural facilities for the establishment of industrial units, SIDCs are involved in the setting up of industrial growth centres. To keep pace with the changing economic environment, SIDCs have initiated various measures to expand the scope of their activities and have entered into various fee-based activities.

Of the various SIDCs in the country, those in Andaman and Nicobar, Arunachal Pradesh, Daman and Diu, Dadra and Nagar Haveli, Goa, Manipur, Meghalaya, Mizoram, Nagaland, Tripura, Pondicherry and Sikkim also act as SFCs that provide assistance to small and medium enterprises and act as promotional agencies for this sector.

13.9.21 Commercial Banks Funding to Entrepreneurs

The commercial banking industry encompasses 28 public sector banks, 29 private banks and 31 foreign banks. Together, they operate a network of more than 65,000 branches and 17,000 ATMs. Government-owned banks are thriving since the two waves of nationalization occurred in 1969 and 1980 and have contributed a lot to the overall development of the country in general and industrial development in particular. The era between 1969 and 1991 is also characterized by developmental banking with a greater focus on the priority sector lending, including small-scale industries and agriculture. However, the character of many banks has undergone a change in the liberalized environment by coming up with IPOs and, in turn, inviting public equity. In 1993, an amendment to the Banking Regulation Act introduced additional liberal policies that permit new private competitors to enter more easily into the banking industry. Regarding SME financing, enhancing regulation has recently been issued by the RBI—the banking system regulator—in compliance with the 2006 Micro, Small and Medium Enterprises Development Act. In particular, state-owned banks have been requested to ensure a 20 per cent year-on-year increase in the amount lent to SMEs.[29]

The biggest commercial bank continues to be the State Bank of India Group, whose assets amount to more than $100 billion. In the private

Thus, there are multiple sources for funding a venture. What matters the most is the nature of business, expected cash flows and prospects for growth of the venture and the stage at which funding is sought.

The best and the easiest source of funding a venture is bootstrapping, that is, to fund one's start-up on one's own. Accumulation of income through earnings provides a good leverage to take risks, as money belongs to one. Most of the highly successful ventures started small with their own funding and got outside funding as they grew in size and operations. The fundamental 'principles behind bootstrapping—watching every penny, weighing spending options versus return on investment, doing more with less—have merit regardless of your funding situation. Companies that raise lots of money tend to overspend (and spend poorly); they forget about running lean & mean'.[30]

The second vital source of money is friends and relatives. The key advantage of raising money from friends and family is that it is a relatively easy source to get from, because they trust one and will have confidence in one's venture. The major disadvantage of this source that should be remembered is mixing up one's business and personal life. They may not be that well connected as angels or venture firms, and they may not be accredited investors, which may have some adverse bearing from the business point of view. The size of funding and number of ventures that get funded by friends and relatives is large as evident from '...$100 billion 'friends and family' money is used annually to fund 3 million start-ups. This compares to only $25 billion through venture capitalists. The average amount invested by friends and family is between $20,000 and $25,000, and further, 58 per cent of the fastest-growing companies in the US started with $20,000 or less.'[31]

Valuation Advantages by Funding through Angel Investors and Venture Capitalists

Another better way to fund a venture is through consulting. A consulting project is one in which one can build whatever software one wants to sell as a start-up. Then, one can gradually transform oneself from a consulting company into a product company, and have one's clients pay one's development expenses. This process minimizes the risk of entering into a venture, as it becomes a gradual process to enter into a venture after having earned income through consulting and knowing one's customer well.

Angel investors are the next best source. Angels are individuals who have made money through technology ventures, and they understand start-ups well in terms of their strengths and weaknesses and have good networking. Their contacts and advice can be far more valuable and important for the start-ups, as compared with the money. Association with angels helps in getting networked with the right people and to give a boost to the business.

The association with angels or, for that matter, venture capitalists helps in viewing the venture from its valuation point of view, as they look for exit to fetch better returns on their funds invested. As such, someone buys shares in a company that implicitly establishes a value for it. If someone pays $20,000 for 10 per cent of a company, the company is, in theory, worth $200,000. We say 'in theory', because in early-stage investing, valuations are voodoo. As a company gets more established, its valuation gets closer to an actual market value. However, in a newly founded start-up, the valuation number is just an artifact of the respective contributions of everyone involved.[32,33]

Some of the venture capital firms have also started moving into developing early-stage programmes such as Y Combinator, which turned the entire early-stage funding market on its head. It was followed by a similar programme called 'Tech Stars' and many others. In between Y Combinator and VCs, one can see angel funds pop up similar to Montreal Start-up, which attempts to blend the VC and angel worlds into one. Jeff Clavier's new SoftTech VC II fund is another good example of this—a $12 million fund dedicated to seed funding between $100,000 and $500,000.[34]

Seed firms are similar to angels, but they invest relatively small amounts at early stages of the venture, but more similar to organized VCs, as they do it as a business rather than individuals making occasional investments on the side. The number of incubators in different countries is rising fast, and they contribute a great deal in seed funding support to start-ups. The fact that seed firms are more organized in their approach implies that their investment process is more standardized. Seed firms through incubators or otherwise usually have set deal terms they use for every degree of confidence to the entrepreneur to accept them. Seed firms mainly differ from angels and VCs in respect of their making exclusive investments in the earliest phases and often when the company is still just an idea. Angels and even VC firms occasionally participate in this phase too, but they mainly invest at later stages.

Thus, an appropriate funding decision with appropriate terms and conditions suited to a particular stage of growth of a venture is fundamentally a make-or-break question that an entrepreneur needs to decide at different stages of growth of a venture. This decision not only determines how much money one has as capital for one's start-up venture but also one's role in the venture and the way one works and lot more. It is a crucial question that needs serious thought before deciding and moving ahead.

CHECK YOUR PROGRESS

10 Things to Avoid at All Costs

This book is all about growing your successful business. However, it is a fact that many small businesses go bust and you need to know the warning signs to watch for. Occasionally though, it is really better to throw in the towel and start again.

1. **No Cash:** You never seem to have any money in the bank when you need it. Check your costings to see whether you are selling too cheap. You may be a 'busy fool'.
2. **Paying Late:** Stretching payments to suppliers gives only temporary relief to what is usually an underlying lack of profitability. If you should pay late, negotiate the terms.
3. **Falling Sales:** If demand falls, find out why quickly and either sell more or cut overhead costs. Delaying cost reduction is usually fatal. It is tough, but grasp the nettle!
4. **Tail Wagging Dog:** You have unwittingly become reliant on one or two large customers and they are starting to screw you down too tightly. You need more customers.
5. **Cash Deals:** Perhaps you are not drawing a salary and the odd cash deal looks tempting. However, this can damage your reputation and get you into trouble too.
6. **Avoiding the Postman:** You would be surprised how quickly people get used to those nasty letters from angry creditors. Some check the post for cheques and then leave the bills in a pile unopened. Always open the post and face up to what is happening.
7. **Permanent Overdraft:** The bank balance, such as a cold snap in winter, never rises above zero. Was it always like this? Ask your accountant to look at the figures with you.
8. **The Cleaner Leaves:** Keeping the place tidy has become a luxury you feel you can do without. The workplace becomes depressing and oppressive. It is a downward spiral.
9. **Rumours Start:** People talk. If you are struggling, it will show and no one wants to trade with a failing company. Quash rumours if you can and try not to behave as if desperate.
10. **The Bailiff's Calling:** This is the final nail in the coffin lid on your ambition. An aggrieved creditor has the approval of the court to seize your assets. At this point, the game is usually over.

KEY CONCEPTS

- **Fixed Costs:** These costs are incurred on plant and machinery and land and building and remain constant in total regardless of the level of production.
- **Variable Costs:** These are incurred on direct labour and raw materials costs, which vary directly with the level of production.
- **Semi-variable Costs:** These costs vary, but not necessarily, in direct relation to sales. They may remain unchanged up to a particular level of sales and increase when sales enter a higher range.
- **Working Capital Gap:** This is the difference between current

- **Cash Cycle:** This is a sum of inventory holding period in number of days plus sales outstanding period in number of days minus payable outstanding period in number of days.
- **Contribution Margin:** This is the difference between sales price and variable cost of production.
- **Debt:** This is borrowed money from different sources such as banks, organizations and individuals that need to be repaid along with interest at regular stipulated intervals.
- **Equity:** This is stock or any other security representing an ownership interest in the venture.
- **Preferred Stocks:** This is ownership in a corporation that has a higher claim on the assets and earnings than common stock. Preferred stock generally has a fixed dividend that should be paid out before dividends to common stockholders, and the shares usually do not have voting rights.
- **Common Stocks:** These represent an ownership in a company, and holders of common stock exercise control by electing a board of directors and voting on corporate policy.
- **Convertible Preferred Stocks:** These involve fixed dividend payment commitment, and part or full principal is convertible at some future date into equity, thus providing a mixed character to such funds.
- **Conditional Sales Contract:** In this one, the purchaser does not receive title to the equipment until it is fully paid for.
- **Chattel-mortgage Contract:** In this one, the equipment becomes the property of the purchaser on delivery, but the seller holds a mortgage claim against it until the amount specified in the contract is paid.
- **Seed Funding:** This is mainly meant for developing a business idea, creating the first product and test marketing the new product or service for the first time.
- **Angel Investor:** This is an affluent individual who provides capital for a business start-up, and usually looks forward for an equity stake in the company.
- **Business Incubator:** This is a facility designed to assist business ventures to become established and sustainable during their start-up phase.
- **Venture Capital:** This is a means of equity financing for rapidly growing private companies having high growth prospects.
- **Shotgun Approach:** This means that one sends one's business plan or some derivative thereof to as many venture capitalists as possible and hopes that the numbers alone will strike someone who has been looking for a deal such as one's own.
- **Factoring:** This is a financial transaction whereby a business entity sells its accounts receivables to a third party called 'factor' at a discount in exchange for immediate money with which to finance continued business.
- **Ad Hoc Limits:** Ad hoc limits are extended by the bankers to their existing clients having a satisfactory track record to meet a sudden spurt in bulk orders that would require additional working capital facilities or pending renewal or enhancement of existing limits, to accommodate expansion in activity.
- **Overdraft (OD):** 'Overdraft' means the act of overdrawing from a bank account.
- **Bill Discounting:** The bank takes the bill drawn by a borrower on their customer and pays them immediately after deducting some amount as discount/commission.
- **Bankers' Acceptance:** It is a time draft or bill of exchange drawn on and accepted by a bank as its commitment to pay a third party.
- **Line of Credit:** This is an arrangement between the bank and the borrower that enables the borrower to draw up to a specified loan limit from the bank.
- **Non-fund-based Limits:** These involve credit facilities extended by the banks and where actual bank funds are not involved.

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CONCEPTUAL QUESTIONS

1. What is meant by 'valley of death' from financing of the venture point of view? Explain.
2. What are the pertinent issues that need to be precisely answered to explain the need for money for a start-up?
3. While estimating financial requirements of a venture, what are the three broad categories in which they need to be estimated?
4. What is the difference between fixed cost and working capital requirements for the venture? Explain.
5. Define 'working capital management'.
6. What are the key components of current assets? Explain.
7. Define cash cycle and its significance for the business.
8. Differentiate between debt and equity and preference stocks and common stocks.
9. What are the different exit options that are available to investors?
10. Differentiate between the three stages of financing.
11. Explain the meaning of bridge financing with the help of an example.
12. What are the key sources of funding through bootstrapping?
13. What are the major differences in getting a venture funded through angel investors or venture capitalists?
14. Differentiate between the five different types of angel funders.
15. What is meant by seed funding? Which are the important organizations in India that extend seed funding support to ventures?
16. What are the key characteristics of venture capitalists? Explain.
17. What is the process followed by venture capitalists?
18. What criteria should be used while selecting a venture capitalist?
19. What are the criteria that bankers use for lending decisions? Explain.
20. Differentiate between fund-based and non-fund-based facilities that banks extend to ventures with the help of examples.
21. What are the options available for entrepreneurs to avail seed funding support for their ventures in the Indian economy?

CRITICAL THINKING QUESTIONS

1. It is said that there should be a perfect balance between availability of funds for fixed cost and working capital. One without the other may jeopardize the growth prospects of the business. Explain by critically examining this statement with the help of examples.
2. The most critical phase is the duration and quantum of cash losses that are incurred till such time that the venture reaches its break-even level. The entrepreneur should ensure to tie up funds for all productive purposes and to meet cash losses in the initial phase of the business. What could be the key sources for funding cash losses and how can the magnitude of cash losses be minimized during the initial phase of business?
3. Why is it necessary for an entrepreneur to raise funds from long-term sources for meeting capital expenditure requirements on land, building and plant and machinery while raising short-term funds for working capital requirements? Explain by giving concrete examples of the rationale for this.
4. Why has it been said that the best source for financing a start-up is bootstrapping? Collect two cases each of businesses that borrowed heavily in the initial phase and another two businesses that started their business with bootstrap funding and analyse their paths for growth.
5. Identify two businesses that were started by funding through customers. Analyse the advantages or disadvantages that they faced through such funding. Is it advisable for the long-term growth of a business to depend on customer funding?
6. 'It has been said that the venture capital industry is yet to take roots in India and venture capitalist funding should only be taken after clear signals emerge about accelerated growth of the business.' Critically examine this statement.
7. What is meant by lease financing? Under what circumstances and what type of business, would lease financing be the best option for a start-up business?
8. Industrial Development Bank of India and Industrial Credit and Investment Corporation of India could not sustain their efforts in financing industrial ventures in the Indian economy and were converted into commercial banks by mergers. What have been the lacunae in their funding approach or otherwise that necessitated the merger of these two institutions into their subsidiary banks?

CASE 13.1: GO GOLD: HOW AND WHERE TO APPROACH FOR FINANCE?

'Go Gold', an initiative by Lucky, had been self-funded so far to come to a proof-of-concept stage. Lucky was working out the possibility of raising some angel investment so as to continue further with his efforts in the area of coming up with a Search Engine that was expected to have great opportunity. The emergent need for raising money to take the idea to the next stage was critical, as the proof of concept was far from what the final Go Gold was supposed to be. Lucky needed more people to work on the idea further and improved infrastructure facilities, so as to successfully come up with a product that could tap the potential market looking for effective search engines.

Lucky had decided, based on interactions with his other friends who had successfully launched their start-up ventures, that it may not be a worthwhile and desirable option to approach bankers or venture capitalists for funds at this stage of their product development. Therefore, he was basically planning to approach angel investors who would understand his technology-intensive venture and were likely to appreciate the prospects of future potential to approach angel investors. Lucky had done his homework and prepared a small demo and presentation to pitch on the idea before his prospective angel investors.

In his presentation, the focus was the possibilities, technicalities involved, prospects for success and potential users. Above all, emphasis was laid on the reason as to why natural language-based search could still be an effective tool. He also attempted to work out future financial projections that could show the possibility of increasing revenue and profit over the years based on some assumptions about advertising as a major source of revenue.

His own assessment of some of the presentations that he had pitched revealed the following shortcomings:

1. Go Gold gives better results for certain keywords and bad results for certain others. However, this was not duly taken care of in the demo presentation. Lucky was not fully prepared to respond to wide-ranging queries that could have resulted from demo and presentation on the product. He did not realize that the strong points of the demo matter the most and possibly areas that need further effort to come up with workable solutions need to be suppressed, especially before prospective financiers. His presentation was more focused on technicalities rather than on the business model as an outcome of technology application.

2. The presentation emphasized the prospects and possibilities of Go Gold with regard to user friendliness and the financial projections. However, the business model was completely missing. He realized that it would have been desirable for him to substantiate user experiences and responses to his search engine or to gather responses in writing from some of the prominent users who had the power to influence others.

3. Above all, his proposal lacked competitive analysis as also strategic thrust. He seemed to be completely in the dark as regards competitors and their competitive advantages as also revenue models were concerned.

Questions

1. After going through the case just mentioned, identify the many mistakes that were committed by Lucky, particularly from the point of view of pitching one's idea to fetch finances. Identify specific areas of improvement that can lead him to succeed in getting finances.

2. Do you think his decision to pursue angel investors was a right one? If not, suggest what could have been the other options to raise finance.

3. Is it advisable for a guy such as Lucky to seek financial support at this stage of product development? If yes, why, and if no, why? Justify your answer.

CASE 13.2: DEALS IN INDIAN ENVIRONMENT

Around 1995, entrepreneurs in Silicon Valley were mostly 23 to 30 years old. There was a trend mentioned by Sramana Mitra that entrepreneur and a strategy consultant in Silicon Valley since 1994. Her fields of experience span from hard core technology disciplines such as semiconductors to sophisticated consumer marketing industries including fashion and education.

As an entrepreneur CEO, Mitra founded three companies: Dais (off-shore software services), Intarka (sales lead generation and qualification Software; VC: NEA) and Uuma (online personalized store for selling clothes using Expert Systems software; VC: Redwood). Two of these were acquired, whereas the third received an acquisition offer from Ralph Lauren, which the company did not accept. In 2010, Mitra founded the One Million by One Million initiative to help a million entrepreneurs globally to reach a million dollars in annual revenue, build $1 trillion in global GDP and create 10 million jobs. In 1M/1M, she teaches the Entrepreneur Journeys (EJ) methodology to entrepreneurs around the world.

Similarly, Marc Andreessen was 23 years old when he started Netscape. Andreessen was born on 9 July 1971 and is an American entrepreneur, investor, software engineer and multi-millionaire best known as the co-author of 'Mosaic', the first widely used Web browser, and co-founder of Netscape Communications Corporation. He founded and later sold the software company Opsware to Hewlett–Packard. He sits on the board of directors of Facebook, eBay and HP, among others.

Erasmic Venture Fund was launched by three partners, namely, Subrata Mitra, Prashanth Prakash and Mahendran Balachandran. Mitra, before launching the Erasmic Venture Fund (EVF) in 2006, founded Erasmic Consulting to work with, mentor and invest personal time and capital into early-stage US/India cross-border companies along with his partner, Prashanth Prakash. Mitra was the chairman of Small-device (www.small-device.com (http://www.small-device.com)), now a part of Digital Chocolate (www.digitalchocolate.com (http://www.digitalchocolate.com)). He is also on the board of Mu Sigma (www.mu-sigma.com (http://www.mu-sigma.com)), a statistical modelling and analytics company with huge customer traction across multiple verticals. Prakash has more than 16 years of experience in the IT industry, Internet product development and consulting services. He started his fulltime career at S3 Technologies, a division of GSE Systems. Working for them in various capacities, he led a team that was responsible for building the next-generation case tools for real-time simulations (GemCase). Prakash also widely consulted for various companies in the United States before moving to Bangalore to set up NetKraft in 1998. Balachandran has more than 17 years of experience in the IT industry and was most recently the country manager of Apple Computers in India. He was instrumental in establishing a strong channel and retail presence for Apple as well as their success in the video and corporate segments. Under his leadership, the Indian operations became a high growth and profitable subsidiary of Apple in the Asia-Pacific region.

As per EVF, new technology and technology-led service businesses will emerge from India in the near future as evident from the buzz around start-ups in India. Therefore, many US VCs are getting interested in investing in Indian start-ups.

Availability of money for high-tech start-ups will not be a constraint in the Indian economy in the coming years. What would matter the most is where the deals are. The bigger/well-known companies have already been picked up with huge investments; for example, Indiatimes, MakeMyTrip, Yatra and Tejas Networks. There are a few more that people are running after, but nowhere close to the deal flows that can absorb $2 billion in capital. In addition, most VCs would like to invest in the order of $2 to $10 million per deal (even as initial commitment) at a time. Most India-focused funds also have larger corpus ($100 + million in size), and are, therefore, usually unable to invest less than $1 million at a time either.

The two Erasmic guys have looked at about 80 to 90 deals in the last 12 months. Not absolute zero-stage deals, but those with a little bit of validation, those that have already been set up with $10,000 to $20,000 of friends and family money. Of these, 20 qualified as worthy of further investigation, with only a few being fundable.

Erasmic claims to be the first of its breed of mentor capitalists in India, with a focus on moving ventures to the next level with extreme hands-on involvement. Their team has experience of running full-scale India operations, as well as of founding and existing companies in the United States and in India. They bring

Helion VC, another firm, is going to focus on early-stage deals in India (probably not seed stage, because $100 million is too large a fund to do seed-stage deals in India). Helion Ventures Partners is a $350 million India-focused, stage-independent venture fund, investing in technology-powered and consumer service businesses in sectors such as outsourcing, Internet, mobile, technology products, retail services, education and financial services. Their mission is 'Partnering with entrepreneurs to build world-class companies'. They have an access to world-class executives who can add a lot of value to the ventures and bring value to their portfolio companies. Their expertise also lies in building a high-quality board of directors/advisors. They also help in managing rapid growth by participating in future rounds of financing in syndication with other venture partners. Their previous experience in mergers and acquisitions (M&A) is also available to entrepreneurs in driving inorganic growth. [1]

Questions

1. 'Sramana Mitra and Marc Andreessen provide a distinct example of a particular category of entrepreneurs.' What are the distinct aspects of entrepreneurship that can be learnt from them?
2. What was the purpose of launching EVF by the three promoters in India?
3. In the Indian market, what particular gap exists in terms of funding start-up ventures? How can that be bridged?
4. What are the reasons for lack of deals for funding in the Indian market? How could it be overcome?
5. What is the difference between EVF and Helion Ventures Partners? Which approach, according to one, would be more suitable for what kind of ventures? Explain.

CASE 13.3: PHYZOK

Our present-day education system is a place where marks, grades and report card antics take precedence to a child's creative and inherent skills. The formative years spent in schools are the most conducive for a student in terms of the learning that takes place and gets ingrained in the child's memory. This sets the direction in which the child's acumen gets sculpted, and it is our responsibility as teachers, parents and mentors to provide a dynamic learning environment. This change can only be brought about by encouraging students not only to move away from rote learning but also to see things in a logical, rational and analytical way. The entire Indian education system now believes in providing education that does not burden the student and relies more on experiential learning. The focus is on moulding individuals into wholesome personalities.

One widely held perception which requires attention is that children experiment less and memorize more. Especially, in an environment where we are exposed to a lot of information and facts, we tend to assimilate and reflect others' opinions and ideas and in the long run lose out on the cognitive ability to think independently. There is a need to provide an environment and introduce methodologies where every child does not just quietly accept the things being taught but is urged to question and think.

Given that there is a growing demand for such educational services and the vast market remains untapped, we believe that there is potential to build a profitable business due to economies of scale. We, at Phyzok™, firmly believe that the better way of learning and nurturing one's thought process is by being analytical. The analytical thought process boosts scientific temper; it brings students to a state of mind where, before accepting anything new, they question the objective behind the thought being invoked, seeking knowledge and being satisfied only when things are proved with substantial evidence.

Phyzok aims at providing comprehensive educational solutions that can complement the existing framework of the school educational system by introducing technological innovations for content delivery to make the learning experience an enjoyable one. It transforms the way education is delivered.

Technology application from the point of view of content delivery has so far been very limited in the Indian educational system. The common phenomenon. NASSCOM report of 2005 reveals that 'Only one in four engineering graduates in India is employable, based on their technical skills and practical abilities.' In this backdrop, a perception that exists is that children experiment less and memorize more. Especially, in an environment where students are exposed to a lot of information and facts, they tend to assimilate and reflect on the limited framework that their teachers provide by way of reproduction from texts and, in turn, focus gets lost in children in developing a cognitive ability to think independently. There is a need for an environment where every child participates actively in the classroom, interacts constantly and is urged to question, analyse and involve oneself in wholesome learning.

Phyzok is a venture that addresses the issue of developing cognitive ability to think and contribute in developing an analytical frame of mind. The solution lies in having a comprehensive approach coupled with an effective technology-based delivery system that can address the issue. Phyzok aims at a comprehensive school package integrated with the school's regular system to revolutionize the education delivery system.

The package includes Phyzok's experimental and simulation kits, that is, hands-on activity kits associated to the curriculum that allows students to explore, experiment and innovate. These kits are composed of separable structures that can be assembled as per the instructions to create the required design for different concepts of learning. For example, if oscillations and the simple pendulum is being taught, the students would be required to create a pendulum using the rods, string and bob. This would be the first step towards engaging the student, but only physically. The next step is to engage them mentally, which is executed through the content and instruction manual for the teachers. For example, the teacher then explains oscillations using the design, which every student in the class has, and then the teacher demonstrates the change in the time period by changing the length of the string, by changing the weight of the bob and by oscillating it inside a tub of water. The teacher, then, reveals the required formula to the students and relates it to the activity they just did. Not just this, once the students have understood the whole phenomenon, the teacher goes a step beyond and creates different scenarios in the class such as taking a hollow bob, filling water in it and then asking the student to predict the change in time period; pricking a hole in the bob, letting the water drip out and then asking the student to predict the change in the time period. These contents and thought-provoking scenarios are provided to the teachers by teacher's training and a manual that guides them for each class.

The venture also provides a comprehensive and continuous evaluation mechanism to test the acquired knowledge and skill sets by the students and a feedback mechanism to improve on their performance by using the modules. A technology innovation, personal response system, a handheld portable device with keypads and sensor tags, which integrates the entire teaching program, will provide an engaging and inviting learning environment and maximize active learning for students, will improve teaching effectiveness as immediate feedback on the class' performance is available and will greatly reduce paperwork and faculty labour associated with attendance, test administration, grade recording and analysis. It will act as a single source of information for students—school updates and notices. A comprehensive school management system will be provided which integrates all that has been just mentioned to facilitate smooth operation that can also automate a school's diverse operations. Pedagogy of teaching-learning would be developed depending on the subject matter to be taught by using appropriate methods and techniques.

The team consists of Lohit Sahu, who studied mechanical engineering at BITS-Pilani. He was a member of the Centre for Entrepreneurial Leadership (CEL) and co-ordinated the Business Plan Workshop series. He was the president of Madhyansh (cultural association) at BITS and a member of the music club. Sahu has worked with the Department of Education, Government of Chhattisgarh, to implement a unique education delivery system in rural areas. He had won numerous national and international business plan competitions. On his graduation, the business plan was incubated under TBI by DST, Government of India, at BITS-Pilani. Since his graduation, Sahu has been working with the current students at BITS to develop an efficient education delivery for schools. He has been getting mentoring support from two of the professors of the institute having an expertise in the area of software development, educational technology and market research, respectively.

BITS-Pilani, Pilani campus. Sourabh has leadership qualities as evident from having played important roles in the Students' Union and in organizing some of the prominent activities on the campus. He has worked with NSS in improving the quality of education in rural areas. Sourabh is associated with Phyzok as a Team Lead for iSpire wing, and he has decided to pursue his career at Phyzok fulltime after his graduation.

Akshay, another co-founder of Phyzok, is a dual degree student at BITS-Pilani, Pilani campus, pursuing M.Sc. (Hons) Mathematics with BE (Hons.) Mechanical. Akshay has been associated with Phyzok for the past one and a half years. He has won various business plan competitions and intends to work with Phyzok fulltime on his graduation to develop the Phyzok lab kits.

Phyzok is to come up with this technology for improving the effectiveness of learning and making it a more enjoyable experience. It is expected that accelerated spread effect in terms of demand would occur with the benefits realized by the strategically selected schools in the beginning. The target classes to begin with have been identified as classes VII to X of schools in tier-2 and tier-3 cities, where the schools have realized the need to improve the delivery system and find it too difficult to attract good teachers. The proposed solution being more impactful and cost-effective is expected to find a better launch pad in this segment of the market, as the demand is high, and there is not a single player in the market that provides the solutions at this price. Some of the leading boards in the country such as Central Board for Secondary Education (CBSE) have initiated certain innovations during 2009–11, which are likely to be further intensified. As the first steps, the students at class X have an option to skip the board examination. The policy changes suggest that very soon the traditional examination system will be replaced by continuous comprehensive evaluation (CCE). The CCE guidelines have been released and the schools, at this point of time, are finding it difficult to introduce the same. Though CBSE has put programmes in place to channelize the schools during the transition period, the overhauling in the coming years provides a huge market for Phyzok to offer its services, similar to the case with state boards in Chhattisgarh, Madhya Pradesh and Uttar Pradesh.

The venture team has done successful pilot projects for Phyzok in the schools of Rajasthan, Madhya Pradesh and Punjab and is looking forward to further expanding the programme to states such as Uttaranchal and Delhi. In the last one year, the Phyzok sample kits have been demonstrated to more than 28,000 students in 30 schools, and the response has been overwhelming, as evident from their further enquiries and having paid a fee per student after the workshop. The schools were highly impressed by the performance and have already renewed the contract. In the North, certain prominent brands with chains of schools are in the process of negotiation to avail the services. The company is incubating under TBI by the Department of Science and Technology (Government of India) at one of the prominent and leading institutions in the country.

Phyzok envisions the classroom of tomorrow—a perfect mix of existing traditional methods infused with advancement in technology that can provide a dynamic learning environment for students. 'Phyzok classroom programme', which can be integrated with the regular curriculum in the form of workshop sessions or year-long programmes with exclusively designed content, would expose students to varied concepts in science, social sciences, economics and real-life scenarios through live concept demonstrations (Phyzok labs), simulations, activities (group and individual) and interactive sessions that nurture the analytical thought process, promote scientific temper and make students think beyond the textbooks, explore and understand the concepts taught in the classroom in a better way. Phyzok labs will be installed in schools for engaging students with the concepts through models, kits, simulations and experiments powered by PDCs (Phyzok development centres). Interactive questioning is facilitated through response systems.

Comprehensive and continuous evaluation will be conducted by exposing students to multiple, different and higher-order thinking platforms that provide continuous feedback for improvement. Customized supplementary content and evaluation materials aligned to the curriculum will be delivered as modules, which would consist of topic-wise case studies that evoke critical thinking and hands-on activity kits that allow the students to explore and experiment.

The Phyzok classroom programme will deploy 'Phyzok classroom environment and maximize active learning for students, improve teaching effectiveness as immediate feedback on the class's performance is available and greatly reduce paperwork and faculty labour associated with attendance, test administration, grade recording and analysis.

Phyzok school package would also include a complete school management system that would cater to the school's diverse operations (administration tasks).

Phyzok package includes an exclusively designed content that nurtures the analytical thought process and stresses on a case-study-based approach rather than lectures and provides a comprehensive evaluation system that tests students on different platforms that is stress free, thereby letting a student think beyond textbooks and exams and allowing them to explore, experiment and apply their learning in real life. Apart from exclusive content, Phyzok's innovative delivery mechanism that employ workshops, hands-on kits, case studies and the use of student response systems would engage every child in the classroom, democratizing learning, thereby providing a dynamic environment with improved teacher–student interaction.

The student response system can also be used for test administration, grading and attendance, which will greatly reduce the school's paperwork and faculty labour. Phyzok™ is the only programme that pioneers a unique classroom programme based on ATP (Analytical Thought Process) delivery across India. The emphasis is on moving away from rote learning while, at the same time, promoting higher-order thinking skills. The delivery model is unique and ensures the physical and mental engagement of students using the inquiry-based approach. Novel experiments, kits, models and simulations are introduced to the children rather than merely employing visual aids. This facilitates hands-on and minds-on learning. Phyzok's evaluation system comprises a mixture of methods from activity based to paper and pencil that do not stress a student. By utilizing student response systems, Phyzok will pioneer in technology introduction in the academic evaluation market. Phyzok also aims at providing a comprehensive school management solution system that automates the diverse operations of the school. Overall, Phyzok is a comprehensive solution for education delivery, evaluation and general management of the educational institutions, directed with an experiential- and enquiry-based approach.

There are a few companies that are working in the domain, but with a different product, such as Educomp, Edurite and NIIT. Phyzok differentiates from their products in terms of highly customized products with multiple-times more impact on the end users at a cheaper cost. The team has undertaken a detailed market research to identify their niche areas and have found that there is no player in the market operating with the concept and product that Phyzok is offering.

Phyzok aims at utilizing the funding to expand the R&D wing for product development and move into mass production of Phyzok lab kits (experiments, models, simulations—both physical and audio/visual). It will consist of content research, instructional designing, prototype modelling, testing and revisions. In addition, the funding will be used to initiate research and prototype modeling of student response system hardware and software. The venture in this phase of development is in need of ₹65 lakhs to be incurred as follows: on initial technology perfection—₹20 lakhs; for pilot runs taking care of development models, prototypes, software developments—₹15 lakhs; for final prototype manufacture and hardware and software integration—₹15 lakhs; for marketing initiatives mainly involving personal selling and some advertisement in the media—₹15 lakhs.

The major hardware and software expenses would be incurred on workstations, motion graphics software, imaging software, engineering designing software and materials to manufacture the kits' prototype.

Questions

1. What would be the best strategy from the long-term perspective to unfold the Phyzok venture? Explain.
2. Which stage of growth would one identify Phyzok with at present? Explain.
3. Viewing oneself as a funding organization, what are the information gaps that one would like to get filled in for

4. Which source of funding would one recommend to Phyzok and why at this stage of development? Critically examine different sources and their advantages and disadvantages to recommend a source of funding.

5. Would it be advisable for Phyzok to seek venture capital funding? Justify your answer by giving concrete reasons and rationale for your decision.

6. Would it be advisable for Phyzok to raise funding through equity or debt at this stage of their growth?

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