Accounting & Finance for Startups 101

October 10, 2022

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SCHOOL OF ENTREPRENEURSHIP

Two – Sided Marketplace

Seed Stage Build to Learn	Alpha Stage Build to Engage	Beta Stage Build to Grow	Stability Stage Build to Deliver
Problem/Solution Fit	Product/Market Fit	Growth, Take Share	Profitable at Scale
• Clearly defined pain points on both sides of marketplace that match • Determine if you can launch both sides, or have to start with one side first	• High percent of users that score trust • Network effects on both sides • Time-to-result: the ime or # of clicks to get a matching listing and conversion • Net new customer organic growth	• Total gross marketplace volume: the total dollar value of transactions over a time period. • Trading liquidity • Trust metrics: percent of users reporting high net promoter scores on both sides of the marketplace	• Moat from network effects • High lifetime value on both sides of marketplace • High net promoter score
Go/No Go: • Large addressable market • Value proposition meets pain point on both sides • Organic growth of customer and users on both sides	Go/No Go: • Proof of network effects growth • High percent of users score trust • Net new customer organic growth	Go/No Go: • Target gross marketplace volume • Target trading liquidity • Target NPS scores on both sides of marketplace	Continue: • Network effects continue • High LTV vs. CAC • High NPS

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Agenda

Managing Finances For Startups 101 (30 – 45 min)

- Literacy
    - Basic Financial Statements
    - Asset conversion cycle
    - Intro Value Chain – Unit Cost Economics

- How to Manage Cashflow in your Startup

Financial Statements

Income Statement
Flow

Revenue
-Cost of Goods Sold
Gross Margin
-Sales & Marketing Costs
-General & Admin Costs .
Net Operating Income (ebitda)

Statement of Cash Flows
Flow

EBITDA
+Depreciation
- Δ Accounts Receivable
-Δ Inventory .
Cash from Operating
+Cash from Investing*
+Cash from Financing* .
Net Change in Cashflow

Balance Sheet
Stock

Assets
=
Liabilities + Owners Equity

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* *Investing is your company buying other things*
* *Financing is your company raising money*

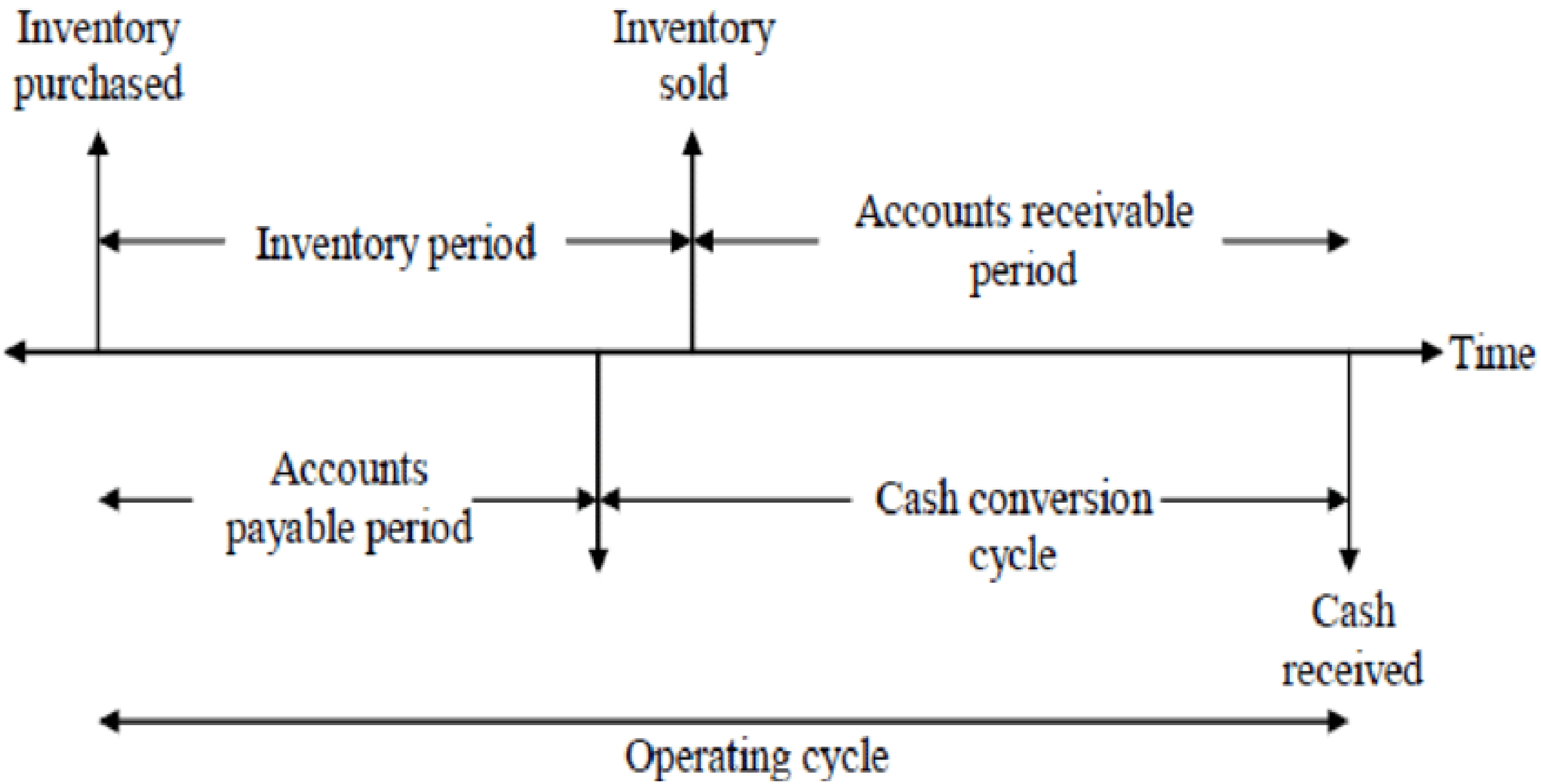
Balance Sheet

The Company's Assets are owned either by outside creditors or it's owners

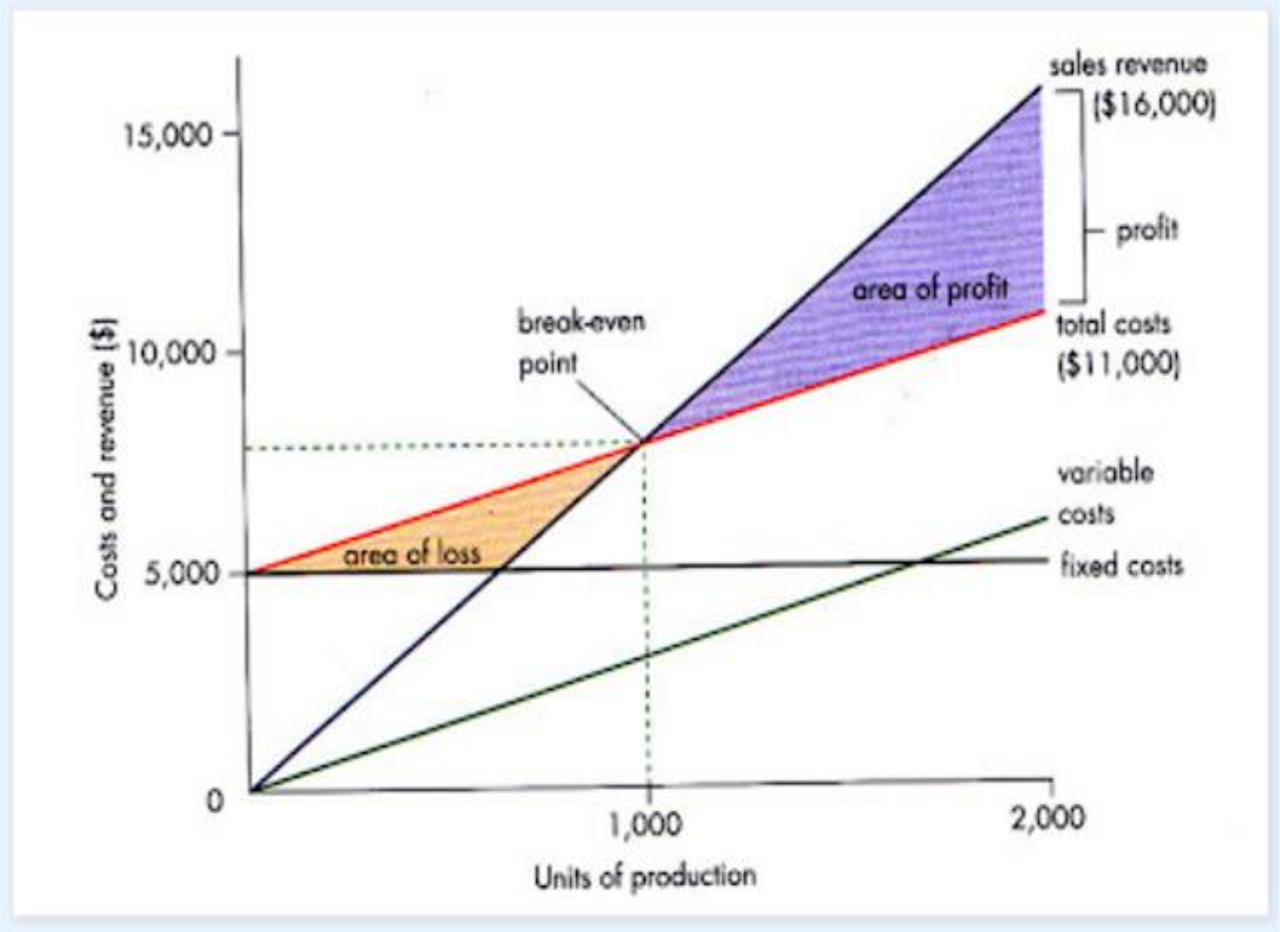
Assets = Liabilities + Owners Equity

Assets	Liabilities	Owners Equity
Cash Inventory Accounts Receivable Plant Equipment Real Estate	Unearned Revenue Accounts Payable Bank Loans ST Long Term Loans	Retained Earnings Preferred Stock Common Stock

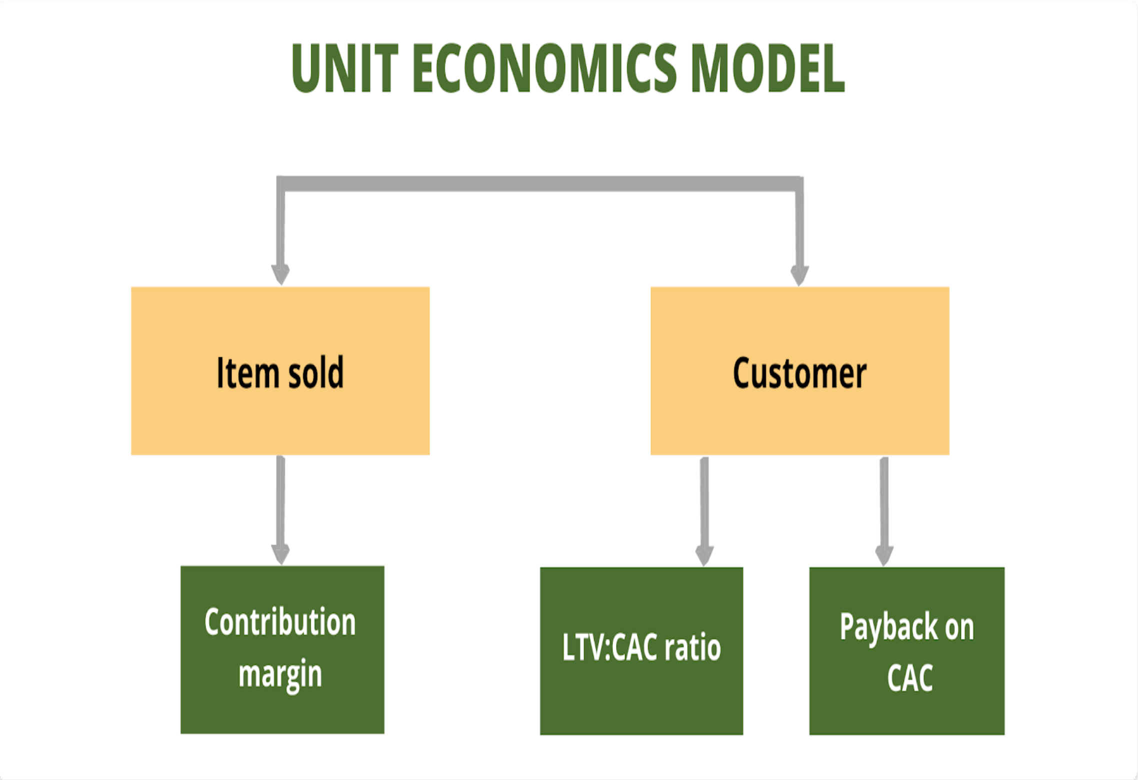
Cash Conversion Cycle



Unit Economics



Items sold



CUSTOMER LIFETIME VALUE

CLV = Average value of purchase x Number of times the customer makes a purchase each year x Average length of the customer relationship in years

CUSTOMER ACQUISITION COST

$$\text{CAC} = \frac{\text{Sales and marketing costs}}{\text{New customers won}}$$

KPIs: Key Performance Indicators

KPIs are the important metrics your business needs to run, and are different for each business. These models should be used to create your Model

Financial Metrics

- Revenue Growth MRR
- **Gross Margin %**
- **Churn**
- **Costs To Serve One Customer**

Sales Metrics

- Avg Sales to Cash Lead Time
- Customer Acquisition Cost (CAC)
- Customer Lifetime Value (CLV)
- Churn
- Average Annual Expenses To Serve One Customer

Process Metrics (Business Centric)

- Percentage Of Product Defects/Returns Net
- Promoter Score (NPS)
- New Product Development

Employee Metrics

- Avg EBITDA / Employee
- Attrition
- Employee NPS

<u>Customer Acquisition Costs & Life Term Value</u>**

CAC Payback Period

	Month 1
Sales and Marketing Expense	$5,600
Number of New Customers	10
Customer Acquistion Cost (CAC)	$560
New MRR	$500
Number of New Customers	10
Average New MRR	$50
Gross Margin	80.0%
CAC Payback Period	**14.0 Months**

‘How to’ manage finances at the early stage

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Keep close track of these Three ...

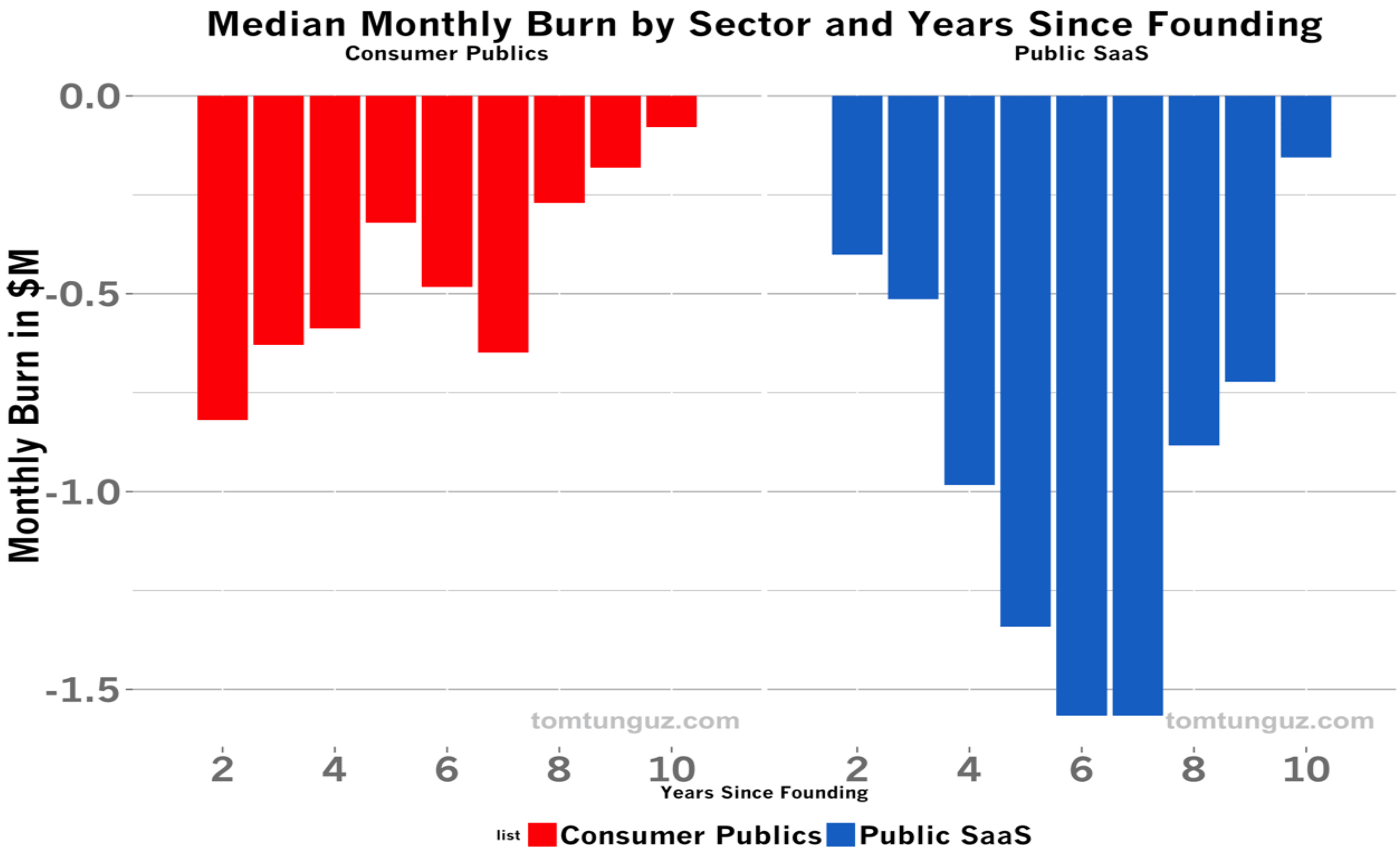
❶ **Bank balance** — **the reserve of cash on your bank account**

❷ **Revenue** — **the amount of cash that gets in**

❸ **Expenses** — **the amount of cash that gets out**

Burn	**Runway**	**Growth rate**	**Default alive**

Burn Rate : Month : Money Out – Money In



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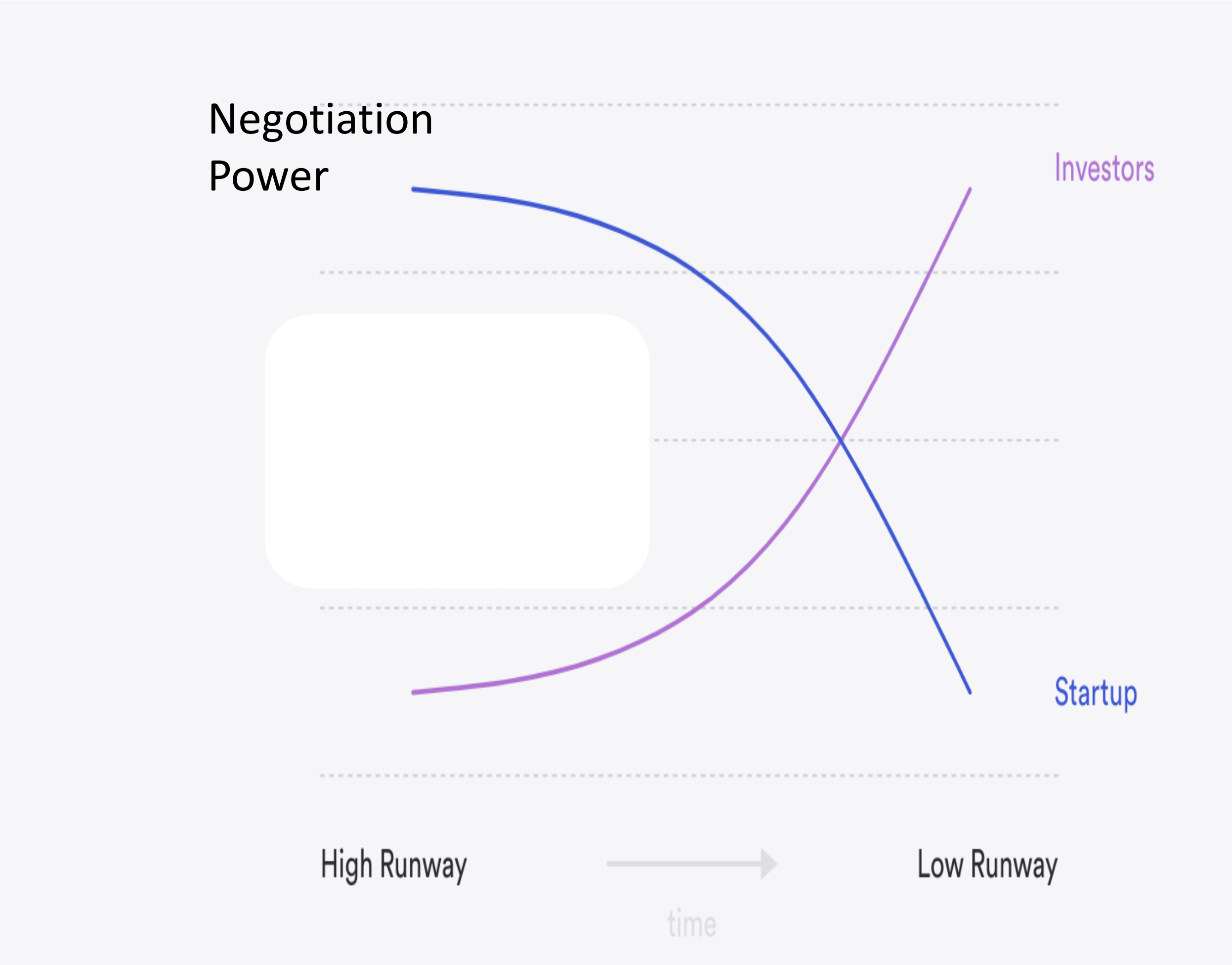
Credit : Tom Timgutz

Runway : #Months : bank balance / Avg burn

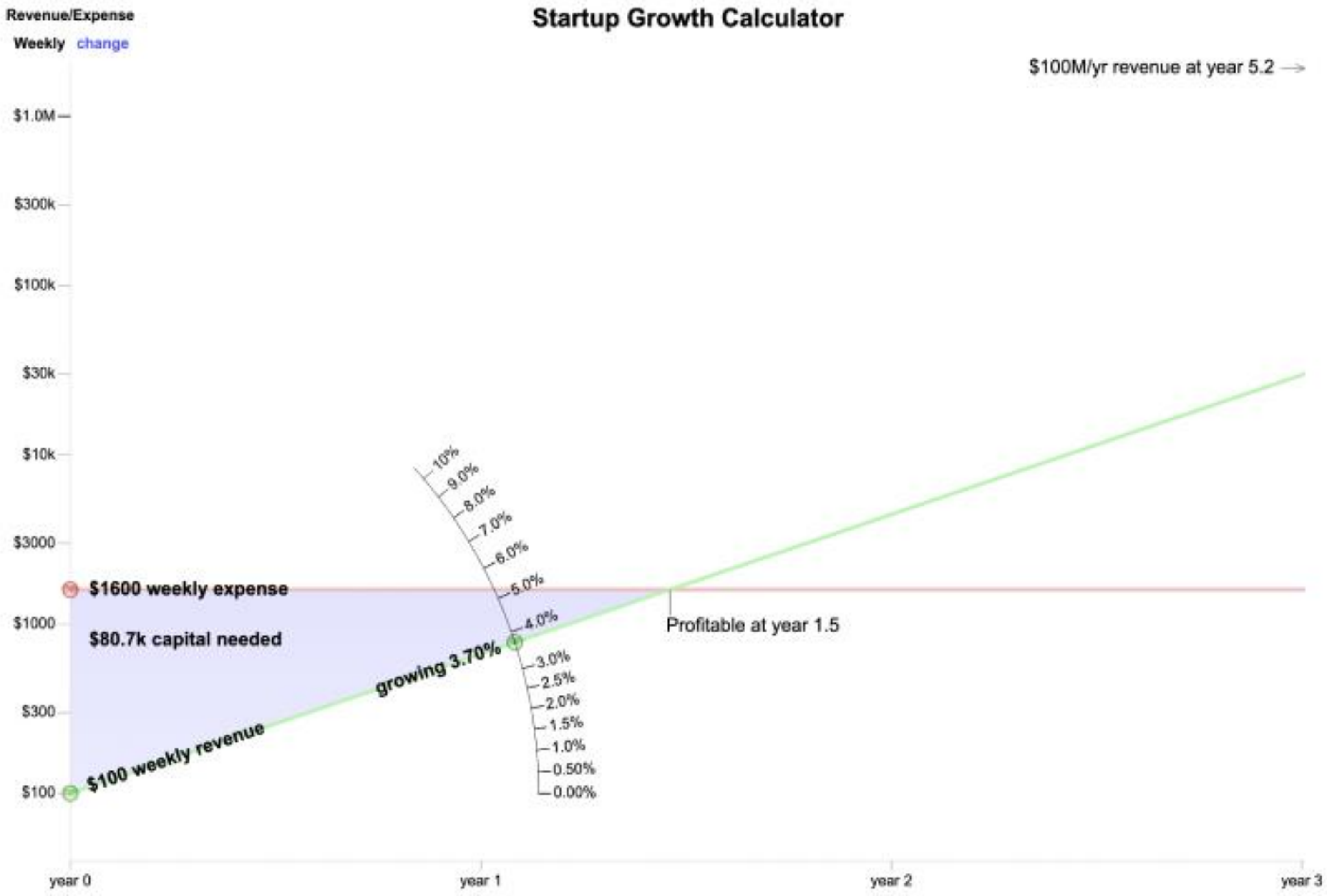
Time to Next Fund Close



Default Alive: Y/N : Revenue G, Exp K : Cash to Profitability ?

Revenue G =

(Money In_2 – Money In_1) / Money In_1)



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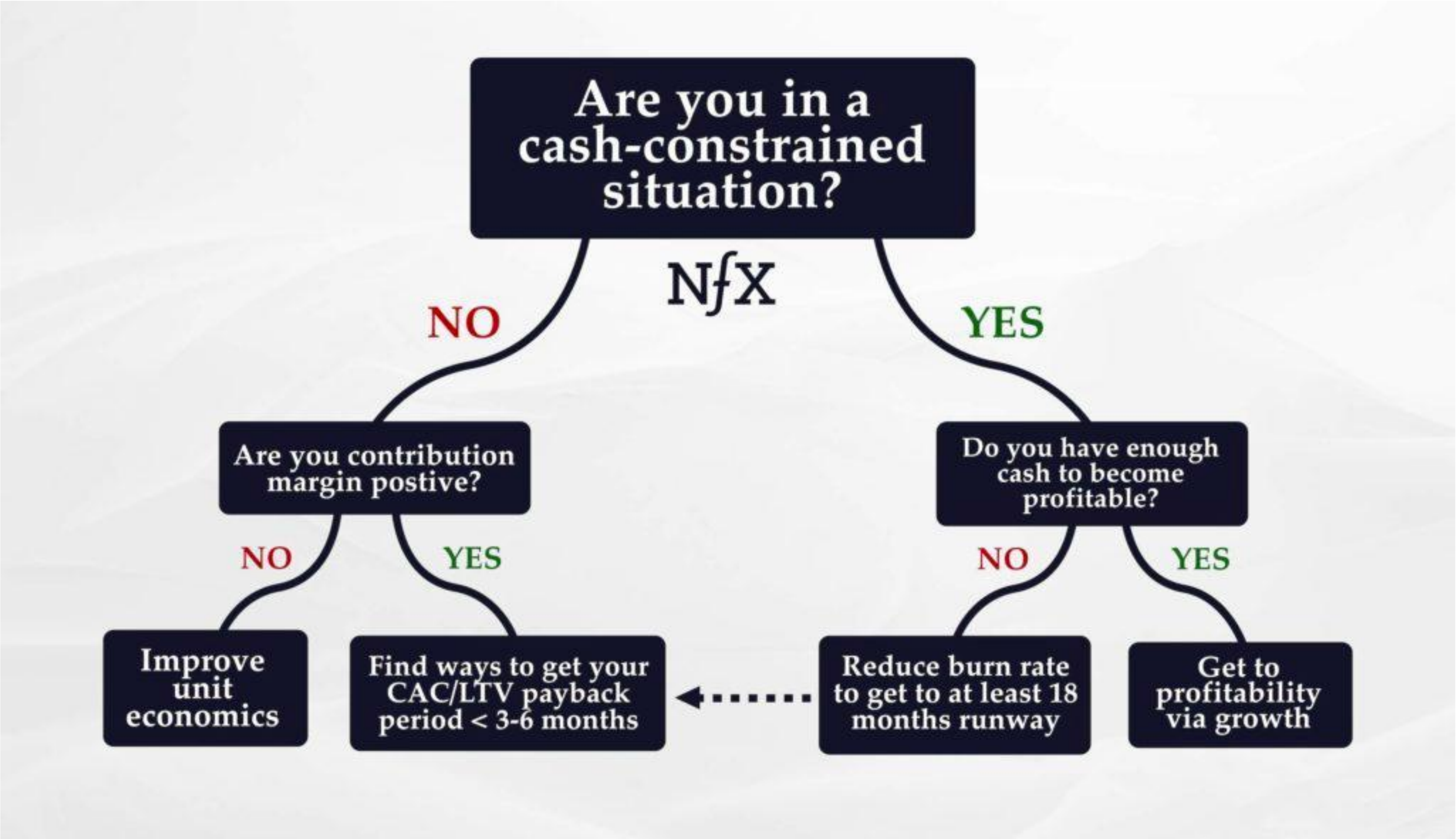
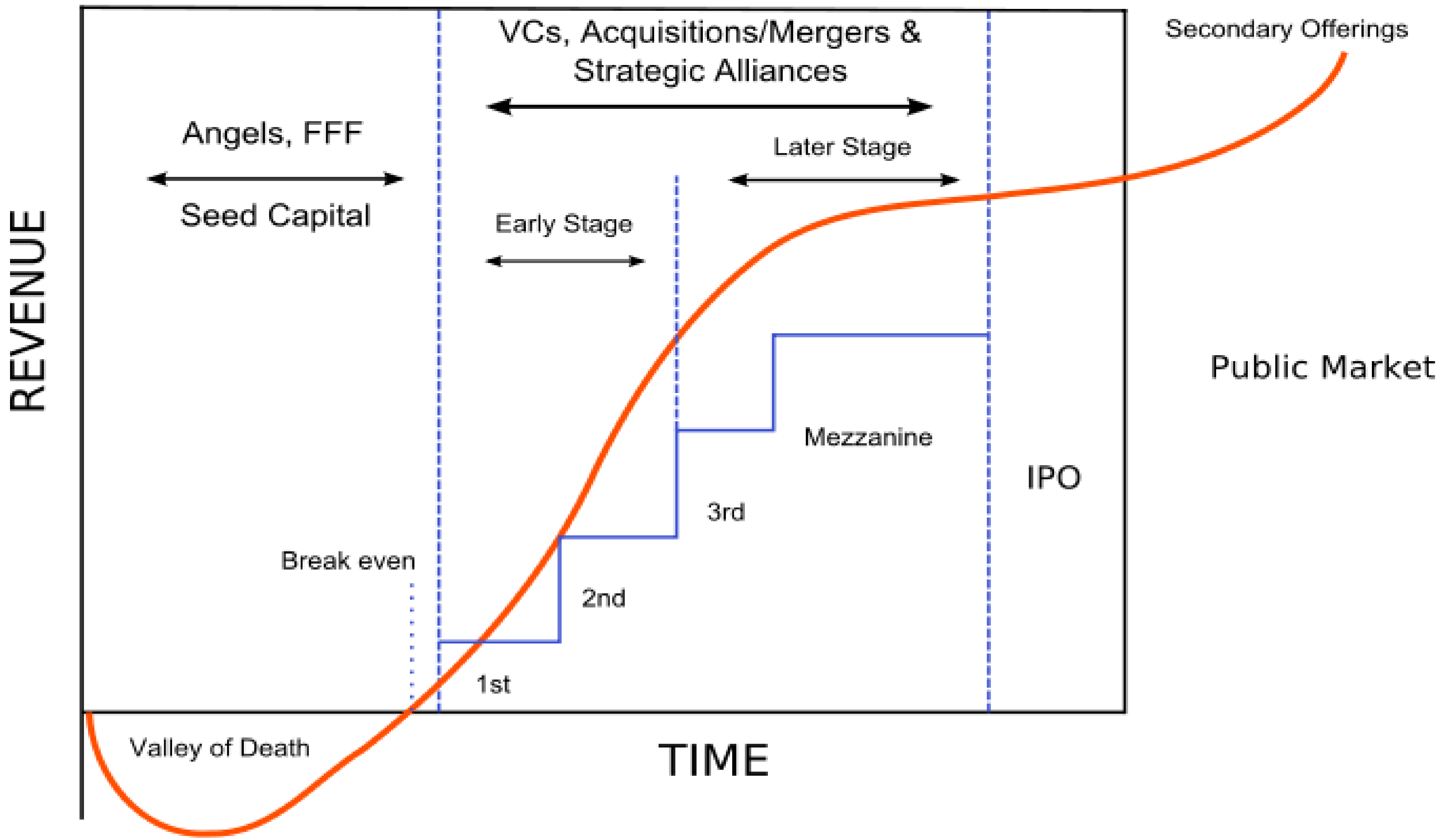

Are you in a cash-constrained situation?
NfX
NO
YES
Are you contribution margin postive?
Do you have enough cash to become profitable?
NO
YES
NO
YES
Improve unit economics
Find ways to get your CAC/LTV payback period < 3-6 months
Reduce burn rate to get to at least 18 months runway
Get to profitability via growth

Venture Capitalists and Valuation

Startup Financing Cycle



The Venture Capital method

Venture capital ("VC"): Financial resources given to early-stage companies.

given to startups by VC firms (by group or collective investment vehicles)

VC firm gets % of profits or equity (stock), Board seats / veto, right to fire founder, liquidation preference , tag along , ratchet options

stages of VC financing:

seed funding:	initial minimal funds; often given by angels
start-up:	early funds from VC firm for marketing/dev
growth ("**series A**"):	large investment ($1-2M) for preferred stock
second round:	company is successful, but not profiting
expansion ("**mezzanine**"):	$ given to a newly profitable company
exit/bridge:	VC firm sells stock once company matures

Is Your Company “Fundable” by a VC?

- Strong management team
- Large and growing market
- Viable model
- Competitive advantage/ barriers
- Realistic exit opportunities

Principles of Valuation

- Valuation: how much the company is “worth”
  - Pre-money valuation
  - Post-money valuation
- Valuation is the #1 issue in the negotiation between the founder and the investor
- Valuation influenced by market conditions and competition for the deal, amongst other factors

Startup Company Valuation Model
Example – Incorporation

- Founders A and B each purchase 2,000,000 shares of common stock at a purchase price of $0.001 per share

Person	*# Shares*	*% of Shares*	*Value*
A	2,000,000	50%	$2,000
B	2,000,000	50%	$2,000
Total	4,000,000	100%	$4,000

Two class stock structure

- Preferred and common stock
  - Common stock is generally used for compensatory purposes (i.e., as a form of payment to employees, board members, consultants, advisors and other service providers) and issued to founders at incorporation
  - Preferred stock is generally used for investment purposes and has many more rights, preferences and privileges than common stock
  - Common stock is typically "priced" at a lower price than preferred stock (i.e., for option granting purposes)

Liquidation Preference

- Investors get a “Liquidation Preference” in the event of a liquidity event of the company
- “Liquidity events” include M&A transactions
- A typical liquidation preference would provide the investors their money back before any other stockholders receive any proceeds
  - A “participating” liquidation preference entitles investors to their money back, plus the right to participate in the remaining amounts
  - Caps are often negotiated

Startup Company Valuation Model
Example – Initial Financing Round

- The company completes a $4,000,000 venture capital financing round of Series A Preferred Stock at a purchase price of $1.00 per share, representing a $6,000,000 pre-money valuation. Option pool is increased to reflect 20% of the fully diluted capitalization.

Person	# Shares	% of Shares	Value
A	2,000,000	20%	$2,000,000
B	2,000,000	20%	$2,000,000
Option plan	2,000,000	20%	$2,000,000
Series A	4,000,000	40%	$4,000,000
Total	10,000,000	100%	$10,000,000

Pre Money Valuation : Us$ 6m
4X Liq Pref Investment : Us$ 4m
VC : 40%
Post Money Valuation : Us$10m
Post 3 yrs - Valuation : US 40m say

Exit Math :

F Value	*L P*	*Remain*	*Val / Proceeds*
8 m	-	4.8 m	4.8 m
8 m	-	4.8 m	4.8 m
8 m	-	4.8 m	4.8 m
16 m	16 m	8.6 m	24.6m
40 m	16 m	24 m	40.0m

Types of Business Entities, Funding, and IPO Journey

A comprehensive overview

Types of Business Entities

- Sole Proprietorship
- Partnership Firm
- Limited Liability Partnership (LLP)
- Companies:

  Private, Public, and One Person Companies (OPC)

Types of Securities

- Equity Shares
- Preference Shares
- Compulsory Convertible Preference Shares (CCPS)

Comparison

Criteria	Equity Shares	Preference Shares	CCPS (Compulsorily Convertible Preference Shares)
Ownership	Represents ownership in the company.	Represents partial ownership but with fixed dividend preference.	Represents partial ownership, converts to equity after a period.
Voting Rights	Full voting rights.	Typically no voting rights (unless specified otherwise).	Voting rights are usually deferred until conversion to equity or Voting rights as per the Shareholders Agreement.
Dividend Priority	Dividends are paid after preference shareholders.	Fixed dividends are paid before equity shareholders.	Priority in dividends similar to preference shares until conversion.
Dividend Rate	Varies, depending on company's profitability.	Fixed rate, stated at the time of issuance.	Fixed rate before conversion; behaves like equity after conversion.
Risk Level	Higher, as returns depend on company performance.	Lower, due to fixed dividend rate.	Medium, provides fixed returns initially, then equity risk post-conversion.
Capital Appreciation	High potential for capital appreciation.	Limited capital appreciation.	Converts into equity shares, offering potential capital appreciation.
Liquidation Preference	Lowest priority in case of liquidation.	Higher priority than equity but lower than debt holders.	Higher priority like preference shares until converted to equity.
Convertible Feature	Non-convertible.	Optionally convertible, based on terms.	Mandatory conversion into equity shares after a specified period or event.
Redemption	Non-redeemable.	Redeemable.	Not redeemable, as they convert into equity shares.
Issuance Purpose	Used to raise long-term capital.	Issued to attract conservative investors seeking fixed returns.	Often used by startups to raise funds while delaying equity dilution.

Fundraising

- Face Value vs Premium: Difference in share pricing
- Private Placements: Quick mode of raising funds
- FDI: Automatic vs Approval RBI routes

Valuation and Its Importance

- How valuation is performed: Methods and experts involved
- Role in attracting investors during funding rounds
- Impact on company's growth and ownership during different funding stages

Employee Stock Option Plans (ESOPs)

- Explanation: Granting, vesting, and exercising options
- Benefits for employees: Ownership stake, financial incentives
- Promotes an ownership culture within the company

Cap Table/ Shareholding Pattern

- Pre and Post Cap Tables: Shareholding patterns before and after investment

- Concept of Fully Diluted Basis: Effects on ownership and EPS

Example of Cap Table changes across funding rounds

SHAREHOLDING PATTERN OF THE COMPANY				
PART A – AS ON THE EXECUTION DATE				
Name of Shareholder	Equity	Shareholding %		
Promoter A	50,000	50		
Promoter B	50,000	50		
Total	1,00,000	100		
PART B – AS ON THE FIRST CLOSING DATE				
Name of Shareholder	Equity	CCPS	Total Equity Securities (on Fully Diluted Basis)	Shareholding %
Promoter A	50,000	-	50,000	33.33
Promoter B	50,000	-	50,000	33.33
Investor A	-	50,000	50,000	33.33
Total	1,00,000	50,000	1,50,000	100.00
PART C – AS ON THE SECOND CLOSING DATE				
Name of Shareholder	Equity	CCPS	Total Equity Securities (on Fully Diluted Basis)	Shareholding %
Promoter A	50,000	-	50,000	12.50
Promoter B	50,000	-	50,000	12.50
Investor A		50,000	50,000	12.50
Investor B		2,00,000	2,00,000	50.00
ESOP	25000	-	25000	6.25
Advisory Pool	25000	-	25000	6.25
Total	1,50,000	2,50,000	4,00,000	100.00

Journey - From an Idea to IPO

- Key stages:
  - Idea generation
  - company formation
  - funding rounds
  - Growth
  - Scaling operations and refining the business model
  - Late-stage growth: Preparing for IPO, compliance, and governance.

The IPO Process

- Roadshow: Presenting the company to institutional investors
- Underwriters: Selecting and working with merchant bankers
- Setting share price and regulatory requirements

Thank You