CHAPTER 15

STARTUP FINANCE

LEARNING OUTCOMES

After going through the chapter student shall be able to understand:

- Introduction including Pitch Presentation
- Concept of Unicorn
- Startup Initiative of GOI
- Sources of Funding
- Succession planning in Business

1. THE BASICS OF STARTUP FINANCING

Startup financing means some initial infusion of money needed to turn an idea (by starting a business) into reality. Traditional lenders like banks etc. are not interested in a startup business. The reason is that when you are just starting out, you're not at the point yet where a conservative lender or investor can rely on security of your assets or be able to forecast cashflows to secure their investments or estimate your repayment capacity with certainty. So that leaves one with the option of selling some assets, borrowing against one's home, asking loved ones i.e. family and friends for loans etc. But that involves a lot of risk, including the risk of bankruptcy and strained relationships with friends and family.

So, the pertinent question is how to keep loans from family and friends strictly business like. This is the hard part behind starting a business -- putting so much at risk but doing so is essential. It's what sets entrepreneurs apart from people who collect regular salaries as employees.

A good way to get success in the field of entrepreneurship is to speed up initial operations as quickly as possible to get to the point where outside investors can see and feel the business venture, as well as understand that a person has taken some risk reaching to that level.

Some businesses can also be bootstrapped (start and build a company from personal finances or from the operating revenues of the new company).They can be set up and grown quickly enough to make money without any help from investors who might otherwise come in and start dictating the terms.

In order to successfully launch a business and get it to a level where large investors are interested in putting their money, requires a strong business plan. It also requires seeking advice from experienced entrepreneurs and experts -- people who might invest in the business sometime in the future.

2. SOME OF THE INNOVATIVE WAYS TO FINANCE A STARTUP

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

Here are some of the sources for funding a startup:

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

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

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

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

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

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

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

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

(ix) Factoring accounts receivables: In this method, a facility is given to the seller who has sold the good on credit to fund his receivables till the amount is fully received. So, when the goods are sold on credit, and the credit period (i.e. the date upto which payment shall be made) is for example 6 months, the factoring company will pay most (say 80-90%) of the outstanding amount upfront. The balance amount will be paid on due date once the factoring company has received the full amount from customer after deducting it's interest charges. In this way, a startup can raise funds to pay it's day-to-day expenses.

3. PITCH PRESENTATION

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

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

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

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

For instance, when Facebook was launched in 2004, it added some new features which made it stand out in comparison to Orkut which was there for some time. Customers have no privacy while using Orkut. However, in Facebook, you can view a person's profile only if he adds you to his list. This simple yet effective advantage that Facebook has over Orkut made it an extremely popular social networking site. It enabled Facebook to become an instant hit.

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

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

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

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

- **Income statement:** This estimate how much money the business will generate by projecting income and expenses. It will show:
  - ❖ How much revenue did the business generate?

- ❖ How much did it cost to generate and support that revenue?
- ❖ How much did the business pay its employees?
- ❖ How much did it pay towards rent?

For your first year in business, you'll want to create a monthly income statement. For the second year, quarterly statements will suffice. For the following years, you'll just need an annual income statement.

- **Cash flow statement:** A projected cash flow statement will depict how much cash will be coming into the business and how much cash will be utilized. At the end of each period (e.g. monthly, quarterly, annually), one can tally it all up to show either the cash burn or the cash generated during the period and the cash balance remaining at the end of the period.
- **Balance sheet:** The balance sheet shows the business's overall finances including assets, liabilities and equity. Typically, one will create an annual balance sheet for one's financial projections. It shows:
  - ❖ How much cash is in the bank?
  - ❖ How much money does the company owe to suppliers?
  - ❖ How much money has been invested in the company?

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

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

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

A business model can be illustrated with the help of an example. There are two companies – company A and company B. Both the companies are engaged in the business of renting movies. Prior to the advent of internet both the companies rent movies physically. Both the companies made ₹ 5 crore as revenues. Cost of goods sold was ₹ 4 crore. So, the companies made ₹ 1 crore as gross profit. After the introduction of internet, company A started to offer movies online instead of renting or selling it physically. This change affected the business model of company A positively. Revenue is still ₹ 5 crore but the significant part is that cost of goods sold is now ₹ 2 crore only.

This is because online sales lead to significant reduction of storage and distribution costs. So, the gross profit margin increases from 20% to 60%.

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

Every investor wants to get his money back, so it's important to tell them in a pitch presentation as to how the startup is planning to generate revenue. It is better to show the investors a list of the various revenue streams for a business model and the timeline for each of them. Further, the pitch should clarify how the startup in planning to price the product and how does it compare to what the competitors charge for the same or similar product. It is also beneficial to discuss the cost of acquisition, lifetime value of the customer and what strategy the startup is planning to use to retain the customer.

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

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

4. CONCEPT OF UNICORN

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

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

(i) A privately held start-up.

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

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

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

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

In September 2011, InMobi, an ad-tech startup, became the first Unicorn of India. SoftBank invested US$ 200 million in InMobi valuing the mobile advertising company at over US$ 1 billion, making it India's first unicorn. InMobi was founded in 2007 and took four years to achieve the Unicorn status in 2011 In 2018, Udaan, a B2B e-commerce marketplace, became the fastest growing startup by becoming a Unicorn in just over two years' time.

The names of various startups that became Unicorn during last decade is as follows:

Year of becoming Unicorn	Unicorn Name
2011	• Inmobi
2012	• Flipkart
2013	• Mu Sigma
2014	• Ola • Snapdeal
2015	• Paytm • Quikr • Zomato
2016	• Shopclues • Hike
2017	• ReNew
2018	• BillDesk • Byju's • Freshworks • Oyo • Paytm mall • PhonePe • Policy bazaar • Rivigo • Swiggy • Udaan
2019	• Bigbasket • Delhivery • Druva • Dream 11

	• Icertis • Lenskart • Ola Electric
2020	• Cars 24 • Firstery • Glance • Nykaa • Pine Labs • POSTMAN • Razorpay • Unacademy • Dailyhunt • Zenoti • Zerodha
2021	• Acko • Apna • BharatPe • Blackbuck • Blinkit • BrowserStack • CarDekho • Chargebee • CoinDCX • Coinswitch • Cred • Cult fit • Digit • Droom • EaseMyTrip • ERUDITIS • GlobalBees • The Good Glamm Group • Groww • Gupshup

	• Infra.Market • Innovaccer • Licious • Mamaearth • MapMyIndia • Meesho • MENSA • Mindtickle • MobiKwik • MPL • Moglix • NoBroker • Of business • PharmEasy • Pristyn Care • Rebel Foods • ShareChat • Slice • Spinny • UpGrad • Urban Company • Vedantu • Zeta • Zetwerk
2022	• Amagi • CredAvenue • Darwinbox • DealShare • Elasticrun • Fractal • Games24×7 • Hasura • Lead • Leadsquared

	• Livspace • One Card • Open • Oxyzo • Physicswallah • Purplle • Shiprocket • Tata 1mg • Uniphore • Xpressbees • 5ire

India has now emerged as the 3rd largest ecosystem for startups globally, after US and China, with over 59,000 DPIIT-recognized startups. As per data available on InvestIndia.gov.in, as of 7th September 2022, India had 107 unicorns with a combined valuation of US$ 340.79 billion. The next milestone for a Unicorn to achieve is to become a Decacorn, i.e., a company which has attained a valuation of more than US$ 10 billion. There should be no doubt that within a few years the Unicorns would be a thing of the past and we would be talking about the Decacorns of India.

5. MODES OF FINANCING FOR STARTUPS

5.1 Sources of financing

5.1.1 Bootstrapping

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

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

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

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

Communication skills are important here. The financial plan has to be shown. The owner or the financial officer has to be explained about the business and the need to get the first order on credit in order to launch the venture. It will also help to get reference of someone known to the supplier who can confirm your credentials, integrity and if possible professional competence. The owner or financial officer may give half the order on credit and balance on delivery. The trick here is to get the goods shipped and sell them before paying to them. One can also borrow to pay for the good sold but there is interest cost also. So, trade credit is one of the most important way to reduce the amount of working capital one needs. This is especially true in retail operations.

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

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

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

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

Further, if you are able to shop around and get the best kind of leasing arrangement when you're starting up a new business, it's much better to lease. It's better, for example, to lease a photocopier say at ₹ 5,000 per month, rather than pay ₹ 1,00,000 or more for it; or lease your automobile or van to avoid paying out ₹ 5,00,000 or more.

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

5.1.2 Angel Investors

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

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

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

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

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

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

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

5.1.3 Venture Capital Fund

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

5.1.3.1 Venture Capitalists generally

- Finance new and rapidly growing companies
- Purchase equity securities

- Assist in the development of new products or services.
- Add value to the company through active participation.

5.1.3.2 Characteristics of Venture Capital Financing

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

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

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

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

5.1.3.3 Advantages of bringing VC in the company

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

5.1.3.4 Stages of funding for VC

1. **Seed Money**: Low level financing needed to prove a new idea.
2. **Start-up**: Early-stage firms that need funding for expenses associated with marketing and product development.
3. **First-Round**: Early sales and manufacturing funds.

4. **Second-Round**: Working capital for early stage companies that are selling product, but not yet turning in a profit.

5. **Third Round**: Also called Mezzanine financing, this is expansion money for a newly profitable company.

6. **Fourth-Round**: Also called bridge financing, it is intended to finance the "going public" process.

Risk in each stage is different. An indicative Risk matrix is given below:

Financial Stage	Period (Funds locked in years)	Risk Perception	Activity to be financed
Seed Money	7-10	Extreme	For supporting a concept or idea or R&D for product development and involves low level of financing.
Start Up	5-9	Very High	Initializing prototypes operations or developing products and its marketing.
First Stage	3-7	High	Started commercial production and marketing.
Second Stage	3-5	Sufficiently high	Expanding market and growing working capital needs though not earning profit.
Third Stage	1-3	Medium	Market expansion, acquisition & product development for a profit making company. Also called Mezzanine Financing.
Fourth Stage	1-3	Low	Facilitating public issue i.e. going public. Also called Bridge Financing.

5.2 VC Investment Process

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

1. **Deal Origination**: VC operates directly or through intermediaries. Mainly practicing Chartered Accountants work as intermediaries and through them VC gets the deal.

Before sourcing the deal, the VC would inform the intermediary or its employees about the following so that the sourcing entity does not waste time:

- Sector focus
- Stages of business focus
- Promoter focus
- Turn over focus

Here the company would give a detailed business plan which consists of business model, financial plan and exit plan. All these aspects are covered in a document which is called Investment Memorandum (IM). A tentative valuation is also carried out in the IM.

2. **Screening**: Once the deal is sourced the same would be sent for screening by the VC. The screening is generally carried out by a committee consisting of senior level people of the VC. Once the screening happens, it would select the company for further processing.

3. **Due Diligence**: The screening decision would take place based on the information provided by the company. Once the decision is taken to proceed further, the VC would now carry out due diligence. This is mainly the process by which the VC tries to verify the veracity of the documents taken. This is generally handled by external bodies, mainly renowned consultants. The fees of due diligence is generally paid by the VC. However, in many cases, this can be shared between the investor (VC) and Investee (the company) depending on the veracity of the document agreement.

4. **Deal Structuring**: Once the case passes through the due diligence it would now go through the deal structuring. The deal is structured in such a way that both parties win. In many cases, the convertible structure is brought in to ensure that the promoter retains the right to buy back the share. Besides, in many structures to facilitate the exit, the VC may put a condition that promoter must sell a part of his/ her stake along with the VC. Such a clause is called tag-along clause.

5. **Post Investment Activity**: In this section, the VC nominates its nominee in the board of the company. The company must adhere to certain guidelines like strong MIS, strong budgeting system, strong corporate governance and other covenants of the VC and periodically keep the VC updated about certain milestones. If any milestone has not been met, the company has to give explanation to the VC. Besides, VC would also ensure that professional management is set up in the company.

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

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

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

6. VENTURE CAPITAL FUNDS IN INDIA

6.1 Evolution

Venture Capital in India stated in the decade of 1970, when the Government of India appointed a committee to tackle the issue of inadequate funding to entrepreneurs and start-ups. However, it is only after ten years that the first all India venture capital funding was started by IDBI, ICICI and IFCI.

With the institutionalization of the industry in November 1988, the government announced its guidelines in the "CCI" (Controller of Capital Issues). These focused on a very narrow description of Venture Capital and proved to be extremely restrictive and encumbering, requiring investment in innovative technologies started by first generation entrepreneurs. This made investment in VC highly risky and unattractive.

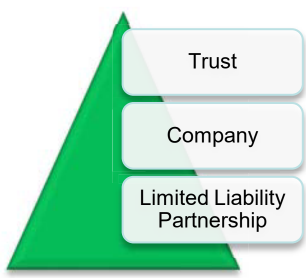
At about the same time, the World Bank organized a VC awareness seminar, giving birth to players like: TDICICI, GVFL, Canbank and Pathfinder. Along with the other reforms the government decided to liberalize the VC Industry and abolish the "CCI", while in 1995 Foreign Finance companies were allowed to invest in the country.

Nevertheless, the liberalization was short spanned, with new calls for regulation being made in 1996. The new guidelines' loopholes created an unequal playing ground that favoured the foreign players and gave no incentives to domestic high net worth individuals to invest in this industry.

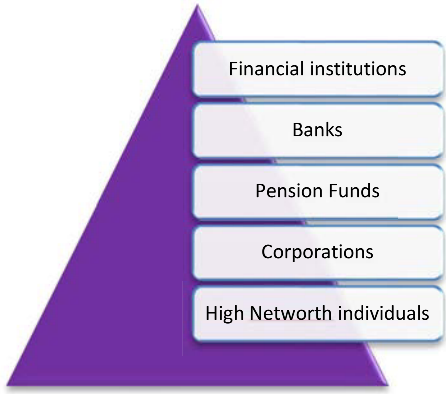
VC investing got considerably boosted by the IT revolution in 1997, as the venture capitalists became prominent founders of the growing IT and telecom industry.

Many of these investors later floundered during the dotcom bust and most of the surviving ones shifted their attention to later stage financing, leaving the risky seed and start-up financing to a few daring funds.

Formation of venture capital has been depicted in the diagram below:



Investors in venture capital funds are shown in the following diagram:



6.2 Structure of Venture Capital Fund in India

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

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

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

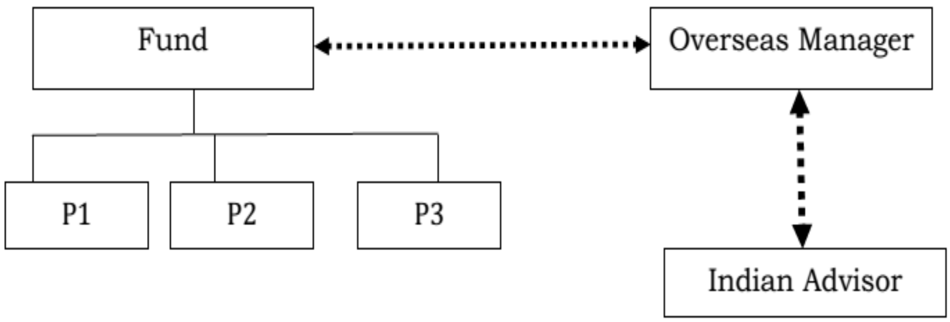
ii) a separate investment adviser that carries those duties of asset manager.

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

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

Offshore structure

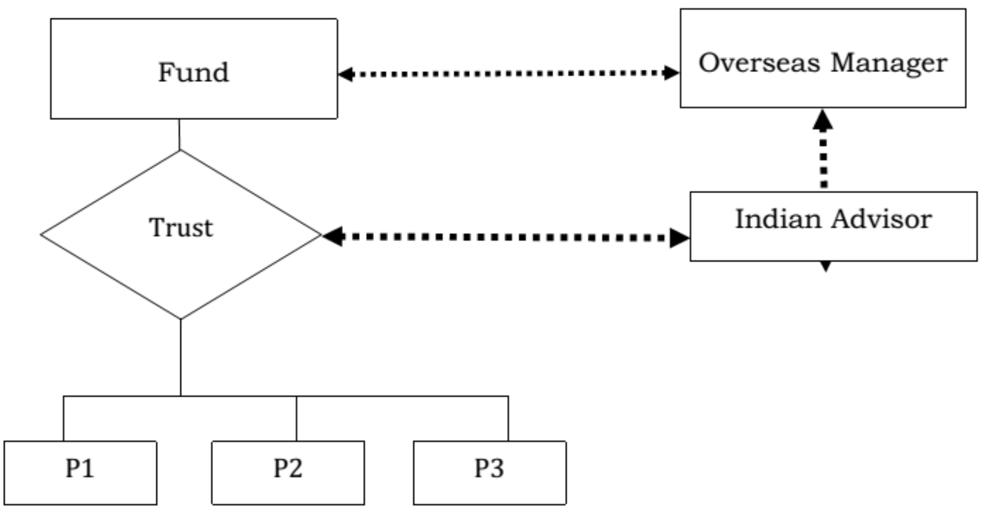
Under this structure, an investment vehicle (an LLC or an LP organized in a jurisdiction outside India) makes investments directly into Indian portfolio companies. Typically, the assets are managed by an offshore manager, while the investment advisor in India carries out the due diligence and identifies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



Off shore structure

Unified Structure

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



Unified Structure

7. STARTUP INDIA INITIATIVE

Startup India scheme was initiated by the Government of India on 16th of January, 2016. As per GSR Notification 127 (E) dated 19th February 2019, an entity shall be considered as a Startup:

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

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

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

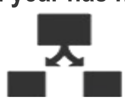
Provided that an entity formed by splitting up or reconstruction of an existing business shall not be considered a 'Startup'.

What is a Startup to avail government schemes?

Up to 10 years from its date of incorporation / registration

Incorporated as either a Private Limited Company or a Registered Partnership Firm or a Limited Liability Partnership in India

Turnover for any fiscal year has not exceeded INR 100 crore



Entity should not have been formed by splitting up or reconstructing a business already in existence

Working towards innovation, development, deployment or commercialization of new product, processes or services driven by technology or intellectual property

Source: http://www.startupindia.gov.in/

The start-ups story of India got a major boost with the launch of Startup India and StandUp India programs in year 2016. It helped in creating widespread awareness in general public about start-ups and gave a boost to the entrepreneurial mindset. By setting up a SIDBI-run Electronic Development Fund (EDF), the Indian Government became a Limited Partner (LP) in a fund for the first time ever. Easy finance options such as Mudra Scheme, tax benefits such as 100% tax holiday under section 80-IAC and exemption from angel taxation also provided the much-needed push to the young Indian start-ups.

In January 2021, the Department for Promotion of Industry and Internal Trade (DPIIT) created the Startup India Seed Fund Scheme (SISFS) with an outlay of INR 945 Crore to provide financial assistance to start-ups for Proof of Concept, prototype development, product trials, market entry, and commercialization. It will support an estimated 3,600 entrepreneurs through 300 incubators in the next 4 years. A start-up, recognized by DPIIT, incorporated not more than 2 years ago at the time of application and having a business idea to develop a product or a service with a market fit, viable commercialization, and scope of scaling, can apply for SISFS. A start-up can get seed fund of as much as INR 50 Lakh under SISFS. The priority sectors for SISFS are social impact, waste management, water management, financial inclusion, education, agriculture, food processing, biotechnology, healthcare, energy, mobility, defence, space, railways, oil and gas, and textiles.

Apart from the support from government, there are quite a few other reasons why India became such a sustainable environment for start-ups to thrive in. Some of the major reasons are:

(i) The Pool of Talent - Our country has a big pool of talent. There are millions of students graduating from colleges and B-schools every year. Many of these students use their knowledge and skills to begin their own ventures, and that has contributed to the startup growth in India. In the past, much of this talent was attracted to only the big companies, but now that is slowly changing.

(ii) Cost Effective Workforce - India is a young country with over 10 million people joining the workforce every year. The workforce is also cost effective. So, compared to some other countries, the cost of setting up and running a business is comparatively lower.

(iii) Increasing use of the Internet - India has the world's second-highest population, and after the introduction of affordable telecom services, the usage of internet has increased significantly. It has even reached the rural areas. India has the second-largest internet user base after China, and companies as well as start-ups are leveraging this easy access to the internet.

(iv) Technology - Technology has made the various processes of business very quick, simple and efficient. There have been major developments in software and hardware systems due to which data storage and recording has become an easy task. Indian startups are now increasingly working in areas of artificial intelligence and blockchain technologies which is adding to the growth of businesses.

(v) Variety of Funding Options Available - Earlier there were only some very traditional methods available for acquiring funds for a new business model, which included borrowing from the bank or borrowing from family and friends. However, this concept has now changed. There are numerous options and opportunities available. Start-up owners can approach angel investors, venture capitalists, seed funding stage investors, etc. The easing of Foreign Direct Investment norms and opening up of majority of sectors to 100% automatic route has also opened the floodgates for foreign funding in the Indian start-up ecosystem.

8. SUCCESSION PLANNING IN BUSINESS

8.1 Meaning of Succession Planning

Succession planning is the process of identifying the critical positions within an organization and developing action plans for individuals to assume those positions. A succession plan identifies future need of people with the skills and potential to perform leadership roles. Succession planning is an important priority for family owned businesses as most of them are managed by a non-family leader even though the ownership lies with the family. Taking a holistic view of current and future goals, this type of preparation ensures that the right people are available for the right jobs today and in the years to come. It can also provide a liquidity event, which enables the transfer of ownership in a going concern to rising employees. Succession planning is a good way for companies to ensure that businesses are fully prepared to promote and advance all employees—not just those who are at the management or executive levels.

8.2 Why is there a need for succession planning?

- **Risk mitigation** – If existing leader quits, then searches can take six-nine months for suitable candidate to close. Keeping an organization without leader can invite disruption, uncertainty, conflict and endangers future competitiveness.
- **Cause removal** – If the existing leader is culpable of gross negligence, fraud, willful misconduct, or material breach while discharging duties and has been barred from undertaking further activities by court, arbitral tribunal, management, stakeholders or any other agency.
- **Talent pipeline** – Succession planning keep employees motivated and determined as it can help them obtaining more visibility around career paths expected, which would help in retaining the knowledge bank created by company over a period of time and leverage upon the same.
- **Conflict Resolution Mechanism** – This planning is very helpful in promoting open and transparent communication and settlement of conflicts.
- **Aligning** – In family owned business succession planning helps to align with the culture, vision, direction and values of the business.

8.3 Business succession strategy

Step 1 – Evaluate key leadership positions: - To evaluate which roles are critical, risk or impact assessment can be performed. Generally, these are such positions which would bring transformation to the entire business or create strategic direction for the organization.

Step 2 – Map competencies required for above positions: - In this step, one needs to identify qualifications, behavioral and technical competencies required to perform the role successfully.

Step 3 – Identify competencies of current workforce: - Identifying what are possible internal options that can deliver results as expected in Step-2, and also if there is a need for training and development of certain skills required. The organization should also place weight on whether is there a need to search outside the organization.

Step 4 – Bridge Leader: - In family owned business appointment of an outsider as 'bridge leaders' will help to develop the business and prepare young family members for leadership role.

8.4 Challenges

In context of Start-up following challenges are faced in implementing Succession Planning.

(1) Founder mindset might be different than the corporate mindset – The way founder's brains are wired is different from the way that a traditional corporate manager thinks, and this puts off seasoned corporate leaders from joining even matured start-ups.

(2) Premature for startups to implement business succession - Certain startups are at early growth stage and too much of processes would lead to growth slow-down and hence they are not in a current stage for implementing business succession planning.

(3) Founders are the face of startups – One cannot imagine a startup without a founder who initiated the idea and executed it and in his/ her absence succession planning can become difficult.

TEST YOUR KNOWLEDGE

Theoretical Questions

1. Explain some of the innovative sources for funding a start-up.

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

ANSWERS/ SOLUTIONS

Answers to Theoretical Questions

1. Please refer paragraph 2.
2. Please refer paragraph 3.