Transcription

Funding Overview

Seeking External Funding

We really didn't have any money. We were 12 of us who were shifting – had shifted in to a 2-BKH apartment in Powai. I still remember eating only Vada-pavs for lunch but I think not having any money made us want to run even faster, right. So, I remember 20-20 hours just working on helping the Tech team build the product, right and the moment we build the product we very quickly understood how we could get traction. We launched on the 7th June 2012 and that is around the time when a lot of people are graduating from colleges, a lot of people are taking up their first job and looking are looking for houses for the first time in their life and we were able to reach out to them because of our network, right and so we got some quick traction and we went ahead to raise an angel round of funding but the first 4 months we were completely bootstrapped and I think we use that as a positive when we let that make us run even faster towards going ahead and achieving a few milestones wish we could then use to go ahead and raise an angel round of funding. So, I remember we had only one white board in the house which we would split into 12 people and try to brainstorm on that. So, I think those core values need to stay even though 3 years down the line you might eventually end up raising 150 million dollars in funding but we still work like that.

It was very interesting to hear Advitiya talk about the initial days at housing and how it was a big struggle. I think in an early stage startup the first round of funding comes from the founders themselves when they dip into their savings. It shows people that they believe in their business and are willing to put their own money behind it. Now it's going to be interesting to understand from Tarun Davda, partner at matrix capital – one of the leading investors in the country about how one should think about funding and how to go about approaching various sources of funds.

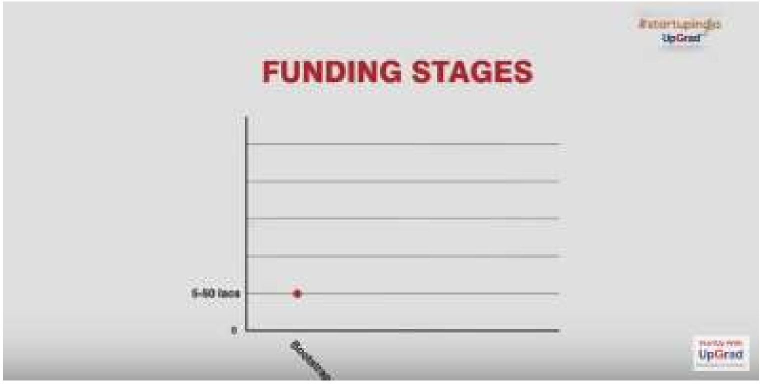
So I think firstly you are thinking about raising funding, you remember you need to have at least 6 months before you really need the money because if you are starting anything less than that I think you are cutting it too close so you should start thinking about raising money at least 6 months before you really need the money.

Now the money could be used for different things, you could be raising money to set up a new business, you could be raising money for you know just working capital needs to sustain the business or you could be raising money to you know taking the business to the next phase of growth. I think before each of this though i think the more macro point that you should keep in mind is what is the end outcome of this business? What are you driving this business towards, why should the investors invest in you, what sort of return profile do they have? Everything is driven of what is the end outcome of this business, right. So let's assume that you think that you are operating in a large business, it's a scalable business, you can drive sort of returns, and it's a right business for the venture capital investor to come in. If it's a business where you are trying to get it more for you know working capital needs you better go to financial institution and raise debt from there. I think the nature of the business, the nature of the eventual end state vision of your business will determine who you speak to, how do you approach them and when do you approach them.

Funding Stages

I think day 0 of your business are literally the day you have sort of dreamt about this idea, there is a particular problem that you have set out to solve

I think that's the first stage where typically I think you know may be you have a co-founder or maybe you don't and if you don't have one I think the first thing you should focus on is do I need to bring on a cofounder on board you know who is going to take care of my technology, who is going to take care of marketing, so I think all the key skills should ideally be the part of the founding team. So if you don't have that I would start with that. But the reality is you will still need some sustenance money you know to pay office rent, to pay bills, to get computers on board you know whatever else you may need. Typically at this stage it is either dipping in your own savings if you have been working previously may be borrowing money from friends or family or parents you know, other people you know from sort of your network.



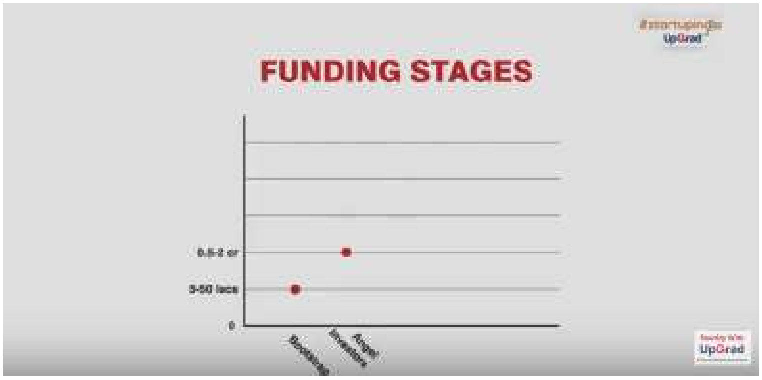
Generally this amount is very small; this amount is just literally starting out money. So it could be anywhere from 5 lakhs to 50 lakhs depending on what you felt you will need from 6-12 months.

Okay, when we started the company, we did not even think that we were VC-fundable. So let me put it that way. We in fact chose to build a helpdesk because that's something that I know where we can actually build a product and start charging money from customers from day 1 unlike many businesses which probably worry about monetisation later.

Monetization for us was a day 1 priority because we didn't have a lot of money. So, we bootstrapped with my savings. Whatever I had earned or ten years of working. We took that savings. The understanding between me and my co-founder was, okay, we have probably an 18-24 month runway to have a small team and try out working and also our initial team members took big pay cuts. Most of them were earning like 30-40% of what they made before joining Freshdesk. And I and my co-founder were not taking any salaries at all. Our total burn was like 5K USD per month including everything. So, we thought "Okay, let's try and run for some time and if it doesn't work out we'll probably lose some money but that's OK, we'll go back". And I think that's probably the biggest advice I would give any entrepreneur is ,if you try and fail, if the worst thing that happens to you is lose some money, I don't think it is such a bad thing because you gain a lot of experience.

Girish makes a very important point. At the initial stages when the startup does not have any external funding, founders just dip into their own savings to run the business. It shows the world and also the employees that the founders are behind this idea and believe in it and it also helps the team to push very hard to think if the product or service would ever monetize and when they would get their money back. So let us listen to Tarun Davda of matrix partners telling us when a company should think about reaching out to external investors and how they should do so.

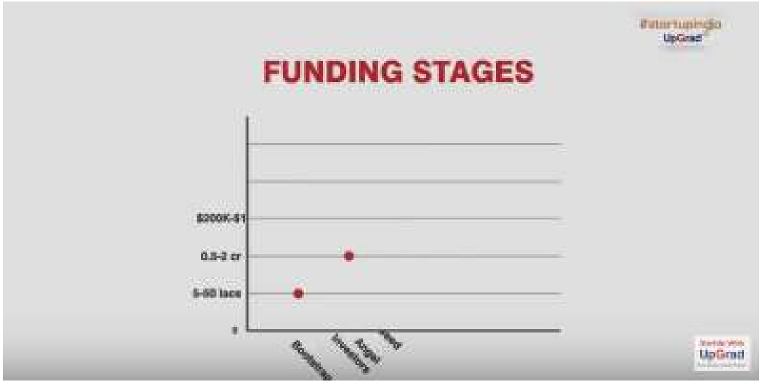
So I think once you have basically shown that you can bring a core team together I think the next stage is building what you know typically we refer to as minimum viable product which is a minimum viable product, it is a basic product which you can take out to the market if it is a B2C business to your end users, if it's a B2B business to your you know customers. What is it is something that they will see value in. It need not have all the features but it is something that is solving very basic problem for them.



Typically over here that's where think the initial sort of seat funding comes in, could be anything from 50 lakhs to a crore sometimes even 2 crores and the right people to approach at this stage is high network individuals, it could be individual angels like Rajanandan, Sharat Sharma, some of the more successful internet companies, their founders, SnapDeal founders, Flipkart founders are doing lot of angel investments these days. Approaching such people that you know you may know or you may know somebody who can get you in touch with them, that's the right stage where you are saying you know what I have got basic team in place, I have a minimum viable product and I need to raise money to build a minimum viable product.

Tarun talks about reaching out to angel or seed investors to get funding for your MVP or Minimum Viable Product. Let us take an example to understand this further. Say you have a mobile tech product and you want to raise funds for some initial traction. Once the product has a few customers and a core team working on solving the problem, you can then reach out to angel investors or even micro VCs to scale up operations further. Once you get that initial traction, you can then reach out to various sources of funding that now Tarun will talk about.

I think phase 3 is basically now you got the team in place, you have the minimum viable product ready and you are looking to sort of now take in the business to what we call as the early Product market fit. Early product market fit is A : do you have a product, do you have particular solution that is meeting a need of a particular set of customers, it could be a very small set of customers but is it solving a real problem for those customers. So if it's a B2C business, it's have I learnt something, do I have basic product where I can make users to come sign up on my website, may be do a couple of transactions, some of them come back, have repeat users, it's great. If it's B2B business you know have I got at least a couple of clients who are willing to pay me for the product that I have launched?

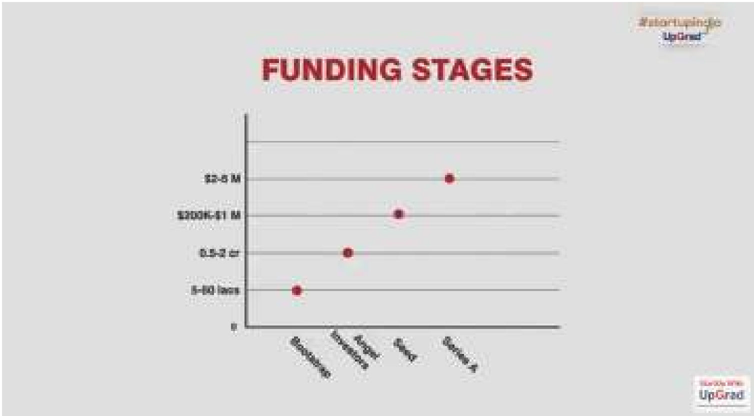


I think this is the right stage where people start thinking about seed, what is formally known as seed round of funding, cheque sizes here are typically in the range anywhere from 200,000 dollars to million dollars and frankly the profile of the investors you approach is very different.

It could be sort of very high network, he could be a sort of very network individual who really believes in the vision, he could be writing you the cheque or group of people could come together and write you the cheque. It could be early stage seed funds whether it's a k capital or whether it is India quotient or you know other similar such funds that are sort of that's their sweet spot, that's the kind of stage at which they like to enter or it could be in venture capital funds like us at Matrix partners we have written a bunch of seed cheques in last 12-18 months and so I think the nature of investors is fairly varied but typically the size of funding would be 200,000 to million dollars and typical dilution just so that you are prepared, the typical dilution at this stage is anywhere from 20% to 35% depending on cheque size, depending on sort of conviction investor has on your business, depending on how much you are willing to dilute, how much money you have put in earlier in the business prior to bringing in an external investor you know variety of factors determine that.

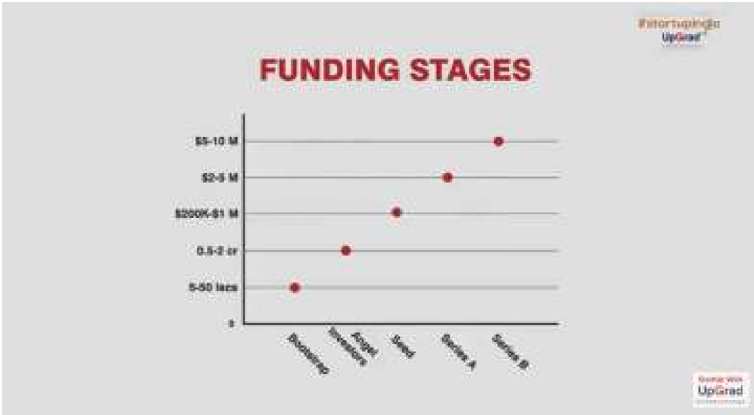
Tarun emphasizes on three key sources of funding – HNIs, seed funds and VCs. We understood what are the typical cheque sizes that are involved in the seed funding round and what kind of dilution is accompanied with it. This is something that is very important for us to understand because it helps steer the startup in the early days in the right direction. Now I think it's going to be very important for us as entrepreneurs to understand how series A funding works.

So think the next phase is once you have established the team is in place, you have a minimum viable product, you have shown some early product market fit, I think you need to demonstrate that that product market fit is scalable. I think that's typically where you will go for series A round of funding.



Series A round of funding I think typical standards in India today anywhere from 2-5 million is sort of is the standard cheque size, dilution is again in the 20-30% range and that's really where you are saying what I think this business has potential, there is a large market opportunity ahead of us, the typical milestone could be " hey you know what I am going to do thousand orders a day with this money you give me" It's basically taking that initial you know may be you are doing 5, 10, 15, 20, 50 orders a day but you are saying now with this series A money i am going to demonstrate the business can scale to thousand or few thousand order a day even.

I think that's really where you have demonstrated that the product market fit or the early product market fit that you have got is scalable I think the next stage is various stages of growth of the business and typically in venture capital terms we call it as series B round, series C round, series D round and so on which basically at each stage essentially what you are saying is listen I am expanding the market opportunity, I have launched may be in one city but now I need growth funds and I have demonstrated the models in a particular city or a particular the customer demographic and I want to grow that into areas, it could be either cities, it could be other products, it could be other customer demographics.



But essentially you are saying that I am going to raise series B round of funding, series B cheques are generally 5-10 million dollar range. Again you are looking to dilute somewhere between 15-20% at that stage. Series C, series D I think at each stage you are basically you know saying that okay I need additional growth capital to take the business to plan in the next level.

I have heard multiple times, founders talk about using a certain round of funding to propel the next phase of growth. For example, if there is a Flipkart it has not only seen series A or series B funding, but it has gone up to series H. And they talk about using their funding for expanding to different cities or in certain cases different geographies. And it does not just limit at venture capital funds, but people also raise funds from private equities. So, I think it's going to be important for us to understand when a private equity party comes into picture and how it really works.

So I think typically I would say series A, series B, may be even series C sometimes is largely venture capital investors because I think the lot of risks the venture capital investors take still exists in the business. I would say series D and beyond is really where private equity investor would be comfortable coming in because they see that a lot of the early risk in the business has been taken out. It could be team risk. It could be product adoption risk, it could be product development risk more often. They are looking at more predictability, they are looking at stability, they are not looking at capital loss situation because when you are writing a larger cheque you know the last thing you want is that the business could actually shut down so you are coming at that stage where things are fairly stabilise, the team has been able to demonstrate execution in building the product and now they want additional growth funds to scale the company to next level.

So I will just quickly talk stage by stage. I think typically when it comes to early friends and family round, my experience is generally it is more of convertible note because friends and family is not sort of sophisticated investor by definition. So typically they listen I don't know how to ascribe value to your business today but why don't you take this money and we will just convert it at some discount to the next round pricing when you actually bring in sort of formal investor and that discount could be anywhere from 15% to 30%, generally 20% of the discount to next round is fairly standard. So that's the first round of funding. I would say seed round of funding cheque size is I would say anywhere from 200,000 to million dollars, dilution over there is anywhere from 20% to 30-35% sometimes. Series A round of funding is 2-5 million cheque size; you are looking to dilute anywhere from again 20-30% and sometimes by the way these rounds merge. I could raise fairly large series A and just skip the seed round altogether. Series B round of financing I think the sort of market norm would be 6 million dollar to 10-12 million dollar of financing looking to dilute anywhere between 15-255 in this stage and then series C and beyond the cheque size just become larger depending on the scale of business, the market opportunity, dilution would keep reducing but like I said it's may be 5-7% lower at each round.

Qualities to Look for in Investors

It's very important to ensure that the investor is aligned with the long term vision that you want to build out. Ola has been very lucky to have a wonderful set of investors who understand the internet space globally, who are very long term focused and were great partner to the entrepreneur and the management team. We have great investors in Tiger Global and Softbank and Sequoia, Matrix and all of these people have really helped us to leverage the learnings and also been great partners in the eventual vision. So most important for me is ensuring that the fund and the specific partner of the fund understands our long term vision and actually believes in that.

The role of an investor in any startup is extremely crucial. Once you get funding from a particular investor, you are looking at a relationship which lasts 5, 10, 15 years and hence it is critical to find the right kind of investors for your company. It is not just about the money or the dilution but there are other critical factors that need to be considered like their domain expertise, what kind of operational knowledge they bring to the table in order to help your startup grow. Do they help you with hiring and in fact do they help you, in certain cases, get more customers. So all of these factors need to be evaluated very carefully before you go ahead and choose an investor for your company.

What to look in an investor is I would say is one of the things that lot of early founder you know because of lack of experience in previously raising funding I think lot of people don't give as much importance to this as much as they should. The reality is the way you should be thinking about this is that here is somebody I will be working very closely with over the next 5-10 years at least this person is going to be on my board, this person is going to influence the direction that my company tackles, this person is going to be guiding me, this person is going to be helping me build the team, so it's very important to understand the eventual objective and the end state vision.

Firstly are you aligned on that end state vision? I think number 1 very very critical, you don't want to be in a position where you are running the company this way, this person has a very different sort of objective function that they are trying to optimize in terms of end state vision, I think that alignment is very important. So that's your first thing. I think second thing is you need to understand that A what is the capacity of this particular investor to invest in future rounds of fund raising, very important again to have that expectation set early because you otherwise you could be in for a surprise.

Third thing is the individual from that particular fund who is going to be on your board because at the end of the day you are going to work with that individual literally on a weekly basis, they will be guiding you on product strategy, they will be guiding you on market strategy, they will be guiding you on helping you build out your sort of core team making sure that you are able to get along with that person you know have a cup of coffee with this person, enjoy speaking with this person I think is very critical. I think the last thing understands the nature of engagement that you can expect from this investor.

Some investors are you know extremely involved on a day to day basis in understanding what's going on in the business. Other investors are completely hands off and say i will only meet you at the board meeting. Now the reality is you need to know what's right for you and at every stage that changes. At early stage you might want a more frequent interaction, you might want weekly phone call to sort of just level set on what's happening. At a later stage when the business is scaling you might say, let's move that to once a month or once in a quarter interaction. So I think understanding all these things and what is right for you at which stage I think is very important.

Approaching Investors

In the previous segments we discussed in detail about the various phases in the funding journey and we also critically analysed what are the various factors that an entrepreneur needs to keep in mind before selecting the right investor. Now it is also going to important for us to think about how to approach an investor. Do you send him an email with the pitch deck? Do you land up at their office and try and demonstrate your product? I think it would be great for any entrepreneur to understand what is the right way to approach an investor.

So I think today the world firstly become a lot more open and connected but the reality is that's also a problem because you know investors like me sometimes we receive a few 100 sort of incoming email pictures you know or LinkedIn pictures every week. So does become very hard for us to respond to every single one of them. While we try it doesn't always happen. I think the sure short way of actually getting an introduction of getting the attention of investor is by going through a warm introduction. Now the warm introduction could be through a portfolio company that I have already funded so there is some level of trust that okay my own portfolio is sending it to me it means that there is some level of you know sort of filtering that has already happened. Second it could be with somebody that I have helped hire at one portfolio company and again I trust that person, I hired that person, he came to the company, he is recommending that I speak to you is very important. Third is I think PR, very often you know people sort of underestimate the power of PR, getting a story out on a tech blog whether it's your story or next big or tech circle or any of the main stream daily, if at all you can get that we do tend to read a lot as investors and we like to you know cover businesses, we like to reach out to businesses rather being covered which means that they are doing something right, they are able to go and share their story out and if it sounds interesting we proactively reach out to them.

Summary - Funding Overview

This was a great session where we got to understand the funding landscape in India. We started with understanding the various phases in the funding journey. Starting from bootstrapping where an entrepreneur puts his own money or capital to start the business. Then you move on to angel or seed rounds of funding after which you move on to big ticket funding rounds like series A and Series B where you are looking at funding in the range of $10 million and finally it can go on to as much as series H where the subsequent rounds of funding are significantly higher than the earlier ones.

Then we also looked at the critical factors that you need to consider while choosing the right investor for you. One is the Alignment on vision. And the second is your comfort and ease of working with him.

We also saw that it is going to be critical once you do all of this analysis to kick start your fundraising campaign by reaching out to investors through the right channels and the right means. It was great meeting you for this session and I look forward to seeing you soon.