Fund Raise: Debt & Equity

NEW VENTURE CREATION

Learnings from Interview exercise

- Reach out
  - Linkedin, email id from Linkedin and then email,
  - Multiple ways
  - Friends, Seniors
  - If they give you their handset number, you are a part of their network
- Soliciting a meeting
  - Iterative process
  - Not competing with people of your credentials when chasing a stranger
- Relationships are best made in college

Why is Business Plan an important document

- Group Case assignment: 20% weightage
- Final submission of your 'PITCH DECK' on or before Sunday, Oct 23rd
- Presentation in class over three days
- Wherever you get stuck: you can meet me on Tuesday/ Friday (over zoom or in person – room 509)
- I request you to share the categories (for which the 'Pitch' will be made) by Wed, Sep 14

Interviews: My views

- OUTSTANDING WORK BY ALL OF YOU
- Blog were right, well written (some were long) but well posted

- Words are a great asset for respecting others (public sycophancy)
- Linkedin is the best social platform for corporate lead generation
- Now you have atleast one well-wisher in the entrepreneurial space
- There is more traction in making someone else a hero (PR is best done by someone else)
- Tagging other people is a way of impressing your mentor (how many of us tagged IITD)

After the business plan….finance

A Hypothetical Example to Illustrate CLV Calculations

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Number of Customers	100	90	80	72	60	48	34	23	12	6	2
Revenue per Customer		100	110	120	125	130	135	140	142	143	145
Variable Cost per Customer		70	72	75	76	78	79	80	81	82	83
Margin per Customer		30	38	45	49	52	56	60	61	61	62
Acquisition Cost per Customer	40										
Total Cost or Profit	–4,000	2,700	3,040	3,240	2,940	2,496	1,904	1,380	732	366	124
Present Value	–4,000	2,454.55	2,512.40	2,434.26	2,008.06	1,549.82	1,074.76	708.16	341.48	155.22	47.81

Cash burn

(Source: Kotler)

After the business plan

There are three types of fund raise

1. Debt
2. Equity
3. Mixed: options/ convertibles/ bonds/ debentures

What is Debt

This is the money raised by you or your company in the form of borrowed capital, on which an interest needs to be paid

- Represents the money you/ your company 'owes'
- Commitment to make fixed payments in the future
- The fixed payments are tax deductible
- Failure to make the payments can lead to either default or loss of control of the firm to the party to whom payments are due.

Cheapest form of capital

Who is raising the Debt

- When you raise it PERSONAL LOAN
- When your company raises it CORPORATE LOAN
- When you take a loan to put money in the company
  - Your loan is PERSONAL
  - You can either loan or put in ‘seed capital’ (equity)

What all is debt?

- Any interest-bearing liability, whether short term or long term.
- Any lease obligation, whether operating or capital.
- Any money that you owe to anyone for which there is a contract standing

Benefits of debt

- Tax Benefits
- Adds discipline to management
    - Equity is a cushion; Debt is a sword;
    - The management of firms which have high cashflows left over each year are more likely to be complacent and inefficient.

Costs/ Risks of debt

- Bankruptcy Cost
- Agency Costs
- Loss of Future Flexibility
    - All debt finance by your company keeps adding to the total

Any/ All Debt needs a collateral

- Equity:
  - Your cash raised by you or your investors which can be pledged
- Fixed assets
  - The property you are buying for your factory
- Other assets
  - Machines, Cars, Computers etc. you need for business operations
- Future Sales CONTRACT
  - Sales contract with great clients which the financer is willing to consider
- Any debt without a collateral is ‘unsecured debt’….FFF… else only a theoretical concept

What is Equity

- It refers to the 'net worth' of the company
- It is the source of permanent capital
- Total funds contributed by all the owners of the business (founders, co-founders, investors) but not the debt-givers

- Networth/ total number of shares = share value

Playing with Equity

- You put money into my company, and I will give you shares of the company (investor)
- Please don't take salary from me, I will give you shares of the company (stocks)
- Please don't take money for advertising my business, I will give you shares (sweat equity)
- Usually, equity is not given – option to purchase stock (SOP) is given
  - Vesting time: when the option come to you.
  - Exercise period: when you can buy the stock at the agreed price.
  - Liquidation event: when you can sell the stocks that you own.

Debt convertible into equity: Bonds

- It pays fixed-income interest payments but can be converted into a predetermined number of common stock shares.
- The conversion from the bond to stock happens at specific times during the bond's life and is usually at the discretion of the bondholder.
- A convertible bond offers investors a type of hybrid security that has features of a bond, such as interest payments, while also having the option to own the underlying stock.
- Bond's conversion ratio determines how many shares of stock you can get from converting one bond. For example, a 5:1 ratio means that one bond would convert to five shares of common stock.
- Who’s got the option determines (debt -> equity) or (equity -> debt)

Also Note

Critical Stakes

- Less than 10%: you are a nobody, but you can trade shares
- 10.01% - 25%: you can ask questions through board member
- 25.01% - 49.99%: You can demand a board membership
- 50%: You are qual
- 50.01-75%: You have operational control
- 75%+: You have financial and operational control

When encashing equity, remember the MULTIPLER

		Valuation		
		(products)	(tech Prod)	(services)
Revenues:	x	5x-7x	7x-15x	3x-5x
Or				
Profits	y	15y-20y	15y-20y ~	

- 5/7/3 : Multipliers
  - Used more with revenues, especially for loss making startups
  - Function of what the hypotheses is
  - Your startup in someone else's hand can change the

When to get in an investor

	revenue	pre-value	Investor pays	Post Value	Investor gets
Year 1	40 lakh	2 cr	1 cr	3 cr	1/3 = 33%
Year 2	80 lakh	4 cr	1 cr	5 cr	1/5 = 20%
Year 3	100 L	5 cr	1 cr	6 cr	1/6 = 18%

Later you get, more equity you save

Fund raise after fund raise

	revenue	Pre-Value	Investor pays	Post Value	Equity gone
Year 1	40 lakh	2 cr.	1 cr. (A)	3 cr.	(1/3) = 33%
Year 2, exit	80 lakh	4 cr.	2.33 cr. (B)	5 cr.	(1/5) = 20 % + 33%
Year 2, no exit	80 lakh	4 cr.	2 cr. (B)	6 cr.	(2/6) = 33 % + 33%

EXIT

- Investor A: sold his 1 cr. to B at 1.6 cr. = made 60% ……you get nothing
- Investor B in year 2 is 53% owner i.e., majority….you are now minority

NO EXIT

- Investor A and Investor B own 33% each

BOLSTER your finance understanding BEFORE speaking to investors

Thank you