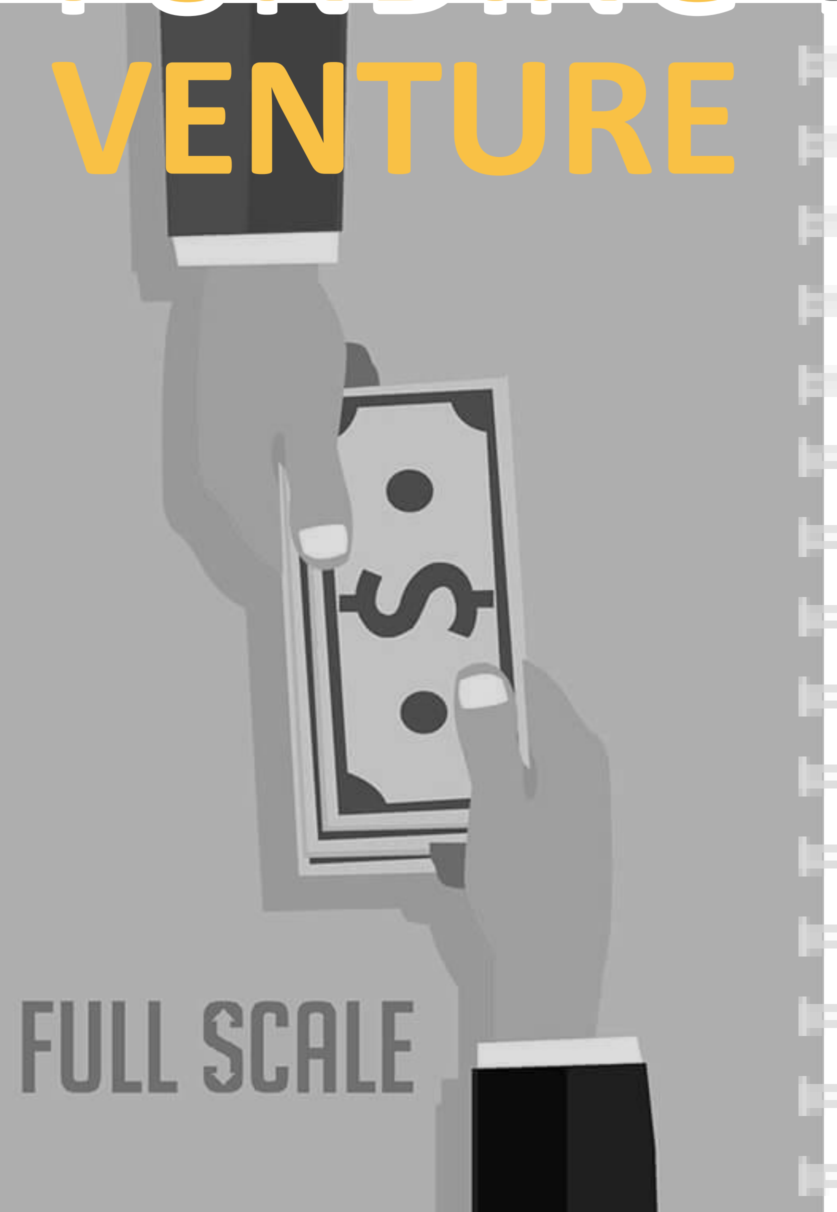
FUNDING YOUR VENTURE



How To Take Your Startup From Seed-Funding To Success

Vivhan Rekhi
The British School, New Delhi

ACKNOWLEDGEMENTS

I would like to thank the following people for making this guide possible:

- The teachers and administrators at The British School, who have supported my academic journey.
- My mentors in the Young Entrepreneurs Academy, Wharton Finance & Investment Summer Program, and Yale SIG Summer Course, who broke down the steps for developing a startup idea.
- My internship mentors at Magic Software, for giving me a taste of what it's like to work in the startup space.

INTRODUCTION

You have the idea. Let this guide help you get the financial support you need to make it a reality.

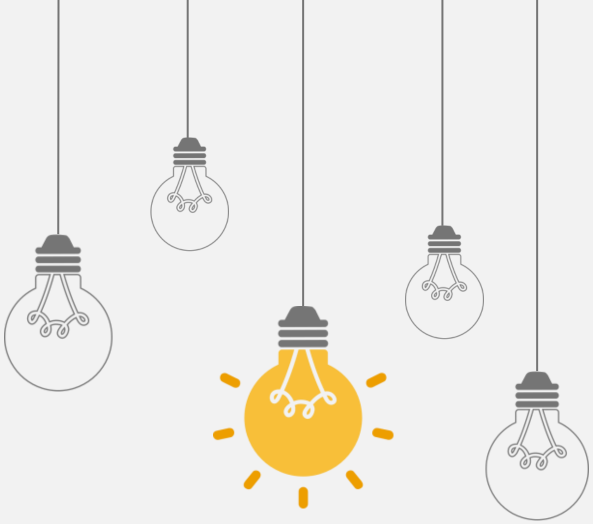
“Startup” and “Entrepreneur” are the buzzwords these days, and young people are finding the support for their ideas and innovations like never before.

In order to make these ideas a reality, however, they also need the funds to succeed.

This guide offers step-by-step instructions for how to finance your startup idea, including the types of finance that make sense for different company set-ups.

FINANCING A STARTUP

Let's say you have a Business Idea for the next great start-up. You've developed your business plan, done your market research, and found partners.



Now, the next step is to find financing…

There are *three key points* in a startup's growth when the company needs financing:

- Starting a business
- Expanding an existing business
- Managing business during difficult times

In each scenario, finance is needed for the following:

Starting a business	Expanding an existing business	Managing business during difficult times
• To buy fixed assets such as machinery, buildings, etc. • To buy current assets such as stock etc. • To meet expenses relating to formation of a company	• Additional fixed assets • Additional working capital • To finance “purchase consideration “ of any take over • Research and development of new products and production processes	• Buying advanced machineries to improve efficiency of a loss making business • Meeting short-term expenses for business with cash flow problems

Sources of Business Finance

- Finance sources can be classified into a few different types. They can be:
  - Internal (generated within the business)
  - External (generated outside the business)

- They can also take place over the short term (1-3 years), medium term (3-10 years) or long term (more than 10 years)

Internal Finance Sources

Retained Profit:

The accumulated profit retained in the business after the owners have taken their share of profit. This can be reinvested or ploughed back into business.

Advantages

- Need not be repaid back
- No interest has to be paid

Disadvantages

- No retained profit for new business
- Small firms have inadequate retained profit to finance expansion program
- More retained profit means less share of profit paid to owners/ shareholders as dividend

Internal Finance Sources

Sale of existing assets:

Selling off fixed assets such as non performing machineries, buildings or surplus vehicles, etc.

Advantages	Disadvantages
• Uses the capital tied up in the non- performing assets more profitably	• Time consuming to sell the fixed assets • Not available for new businesses

Internal Finance Sources

Running down/Sale of Stock of goods:

The cash tied up (blocked) in the excessive stock is released by selling at discounted prices to generate additional finance.

Advantages

- Reduces the opportunity cost of money tied up (i.e. losing interest)
- Reduces storage costs of high stock levels

Disadvantages

- The customer deliveries may be delayed or they may be disappointed if adequate stock are not available in the retail outlets

Internal Finance Sources

Owner's Savings:

For sole-trader and partnership businesses the owners can bring their own savings as additional capital investment.

Advantages	Disadvantages
• Available quickly	• Savings may be too low
• No interest is paid	• Owners' risk increases

To sum it up…

Internal Finance Sources are often lower risk for start-ups, as there is no interest and no need to pay back lenders.

However, many of the sources, such as sale of assets or goods are not an option for businesses that are just starting out.

External Finance Sources

Bank Loan:

A form of loan capital for a business. Banks set a fixed period for the loan, as well as terms of repayment and interest rate. They also typically require some form of security (collateral) offered up by the business.

Advantages	Disadvantages
• Usually quick to arrange	• Bank loan has to be repaid and with interest
• Available for different lengths of time	• Collateral of security is required to avail loan
• Low rate of interest for the large companies due to low risk	

Qualifying for Bank Loans

Banks will finance businesses if the following conditions are fulfilled:

- Financial information about the past and future in terms of profitability is provided.
- The forecast shows that the business is solvent, which indicates that it can repay back the loan with interest in time and in full.
- Past experience of the business in the same trade.
- The bank manager should be satisfied with the accuracy of the forecast figures of the business, without which the bank will not sanction the finance.

External Finance Sources

Crowdfunding:

Using small amounts of capital from a large number of individuals (both offline and online through social media networks) to finance a new venture.

Advantages	Disadvantages
• No interest to repay and no equity given in company • Very low risk to company	• Usually only a short-term financing solution. After the initial fundraiser, funds do not continue to trickle into business

Crowdfunding Platforms

KICKSTARTER

FUEL A DREAM
THE CROWDFUNDING PLATFORM

Ketto

Rang De

INDIEGOGO

ImpactGuru.com

External Finance Sources

Venture Capital:

Financing provided by investors provide who believe that a startup or small business has long-term growth potential. Investment is usually given in exchange for equity in a company.

Advantages	Disadvantages
• Available to startups that lack access to bank loans, capital markets, and other debt instruments	• Investors get equity in the company in exchange for their investment, and therefore also get a say in company decisions
• Funding terms are often easier to negotiate than with bank loans	

What's the Difference Between a Venture Capitalist vs. an Angel Investor?

Venture Capitalist

- Works with a company
- Can typically invest larger amounts
- Offer financial support as well as mentorship and strategic guidance
- Invest in companies that have shown potential for high growth

Angel Investor

- Works alone
- Usually invest smaller amounts
- Typically only offer financial support
- Invest in early stage businesses

Where to Find Angel Investors & Venture Capitalists

India's Most Active Angel Investors

Angel.co

Indian Angel Network®

India's Most Active Venture Capital Firms

External Finance Sources

Government Grants and Subsidies:

Non-refundable financial assistance given by the government to businesses to produce certain types of goods that have some social values, or that help reduce high areas of unemployment.

Advantages	Disadvantages
• Don’t need to be paid back	• Strings attached - terms and conditions may limit the business or profit making opportunity

Where to Find Government Grants for Start-ups

#startupindia

Top Business Grants 7

50+ Government Start-up Schemes

External Finance Sources

Issue of shares:

(By joint stock companies only). Shares are sold by Pvt Ltd. Companies privately to their friends, family members and relatives with the consent of all existing shareholders. Share capital is also called Equity Finance.

Advantages	Disadvantages
• Permanent source of finance which need not to be paid back	• Dividends will be expected by the shareholder
• No interest is to be paid	• The ownership of the business could change

Shares are sold by PLC's to general public in a different ways to raise finances:

- Public issue- Selling shares to general public through advertisement
- Rights issue – Selling shares to existing shareholders at a lower price
- Private placement – Selling shares to merchant bankers who sell the shares to general public

External Finance Sources

Selling Debentures:

These are long term certificates issued by limited companies to general public, which commits fixed rate of interest and predetermined maturity period as to redemption.

Advantages	Disadvantages
• Usually used to raise long term finances such as for 25 years	• Like bank loan has to be repaid and with interest

External Finance Sources

Factoring of Debts:

"Debt Factors" are the agencies to whom businesses sell their bids/debts at a discount (say 95% of the debt) for immediate cash. These factors collect the full payment afterwards from the debtors of the business and the excess they receive is their income.

Advantages

- Immediate cash is available
- The risk of collecting debt is shifted to the "debt factor"

Disadvantages

- The business needs to pay a fee to "debt factor" by way of discounting the debt

To sum it up…

External Financing sources are often more available to start-ups.

Some of them, including fundraising, venture capital, and grants/subsidies offer attractive terms, but you must make a successful pitch and show your business’ potential for long-term, sustainable growth.

How to Craft a Successful Pitch for Funding

- Show the investor how big your potential market is
  - If you’re targeting an existing market, show how your offerings are different from the other players
  - If it’s an emerging market, show how big the market is expected to grow in the next few years and the growth drivers
- Demonstrate the strength and expertise of your team
- Have real data to support your claims for market growth, or demand for your product
- Research the potential investor beforehand, and make sure his or her area of expertise/investment is in line with your company’s

In order to calculate your "ask" amount, you need to estimate your business expenses

Business expenses to consider include:

Capital Expenditure

- Expenditures made on buying fixed assets and/or to increase the productive capacity of the business, the benefits from which are derived over a period of more than one year.

Example: Buying new machineries, buildings, land etc.

Revenue Expenditure

- Expenditures made to meet the day to day expenses such as fixed costs and variable costs, the benefits of which are derived within a period of one year.

Example: Buying stock, paying for rent and wages etc.

Other Sources of Short-Medium Term Finance

Overdraft

A flexible short term source of finance which is readily available and allows the business to overdraw by issuing a cheque above the bank to certain limit. The overdrawn amount needs to be repaid with interest in short notice.

Trade Credit/Creditors

An arrangement by which the business buys the goods and/or raw materials from the suppliers on credit (called creditors) within a certain credit payment period.

Hire Purchase

A business buys fixed assets by paying small amounts as a down payment and monthly installments with interest over a long period. The ownership of the fixed asset gets transferred to the business after full and final payment of hire purchase.

Leasing

A financial arrangement through which a business does not buy the asset but uses the fixed assets by paying monthly leasing rentals to the leasing company. The business might buy back the asset at the end of the lease period.

What Type of Finance makes most sense for your startup?

Factors to Consider:

1. Purpose and time period

The time period of source of finance should match the length of time your company will need financing.

- Long term finances are required to finance fixed assets or meet company expansion expenses
- Short term finances are required to finance working capital requirements, to pay creditors, to buy components or to meet unforeseen orders

What Type of Finance makes most sense for your startup?

Factors to Consider:

2. Size of finance (amount needed)

- Large sums are usually financed by long term finances
- Size and status of the business organization
  - Large organizations such as PLC usually rely on a wide variety of sources, including issue of shares and debentures to reduce costs of finance

What Type of Finance makes most sense for your startup?

Factors to Consider:

3. Control

If the business raises finances by selling more shares, then the existing shareholders might lose control of the business

4. Risk and Gearing

A business is said to be highly geared if large proportion of the "total capital employed" is raised by way of long term liabilities. The higher the gearing means higher the risk to invest into such businesses, because only a small proportion of the capital is contributed by shareholders

Further Reading on Entrepreneurial Financing

1. New Players in Entrepreneurial Finance, Joern H. Block, Massimo G. Colombo, Douglas J.
2. Cumming, Silvio Vismara
3. Should You Even Raise Money?, Harvard Innovation Labs
4. Funding Strategies to Go the Distance, Harvard Innovation Labs
5. SAFE, and the SAFE Primer; Y-Combinator
6. Raising Seed Capital? Here's My Guide on How To Do It Successfully, Purul Singh
7. Time Value of Money, Khan Academy
8. Using the Time Value of Money to Make Financial Decisions, Lynda.com
9. Discounted Cash Flow Model, Corporate Finance Institute
10. An Analysis of Criteria for Investment and Financing Decisions under Certainty , D. Teichroew, A. Robichek, M. Montalbano

Thank you!