

Theory Chapter

classmate

Date
Page

Startup Finance

→ Methods to Finance Startup

- Personal financing
- Personal credit lines
- Family and friends
- Peer to peer lending
- Crowdfunding
- Micro loans
- Vendor financing
- Purchase order financing Company
- Factoring Accounts Receivables

→ Steps for Pitch presentation

- > Introduction
- > Team
- > Problems
- > Solution
- > Marketing / Sales
- > Milestone Projections
 - Income Statement
 - Cashflow statement
 - Balance sheet

- > Competition
- > Business model
- > Financing

→ Modes of Financing of Startups

> Bootstrapping

- Trade Credit
- Factoring
- Leasing

→ Don't beg, rent to keep cashflows stable

> Angel investors

- Informal investors → generally connections
- Invest in entrepreneurs, rather than business
- Use their own money
- Not interest in equity, rather helping out business
- Professional angel investors have defined exit strategy like IPO, acquisition etc.

> Venture Capital Funds

- Funds for smaller businesses and start ups
- Look for exceptional growth
- Objective is to earn capital gains
- Purchase equity securities
- Active participation and assist in development

• Characteristics

- (i) Long term investors
- (ii) Lack of liquidity [for VC]
- (iii) High Risk
- (iv) Equity Participation

• Advantages

- (i) Long term financing
- (ii) Sharing risk and rewards
- (iii) Network of contacts

- (v) Practical advice & guidance
- (vi) Additional rounds may be available
- (vii) Help prepare company for IPO
- (viii) Facilitate trade sale

• Stages of Funding

Level of
Risk

(i) Seed money → for proving idea

Extreme

(ii) Start-up → marketing & development

V. High

(iii) First round → early sales & manufacturing

High

(iv) Second round → working capital

→ Sufficiently high

(v) Third round → Mezzanine financing

Medium

↳ Expansion when profitable

(vi) Fourth round

↳ Bridge financing

Low

↳ When going public

→ VC Investment Process

① Deal Origination



Directly / through intermediaries (including CAs)



Investment memorandum [IM] entailing all details from funding till exit is made
This document includes a tentative valuation

② Screening



Deal scrutinized by committee of senior members of VC
Companies selected here.

③ Due diligence

④ Deal Structuring



→ Both parties win

→ Right to buy back, exit clause,

tag-along clause [promoter to sale stake with VC]

⑤ Post investment activity



→ Board Nominee

→ MIS and monitoring

→ Milestones to be met & explanations to VC

⑥ Exit Plan



- IPO / stake sale to 3rd parties
- Buy back commitment, promoter buy back

Venture Capital Funds in India

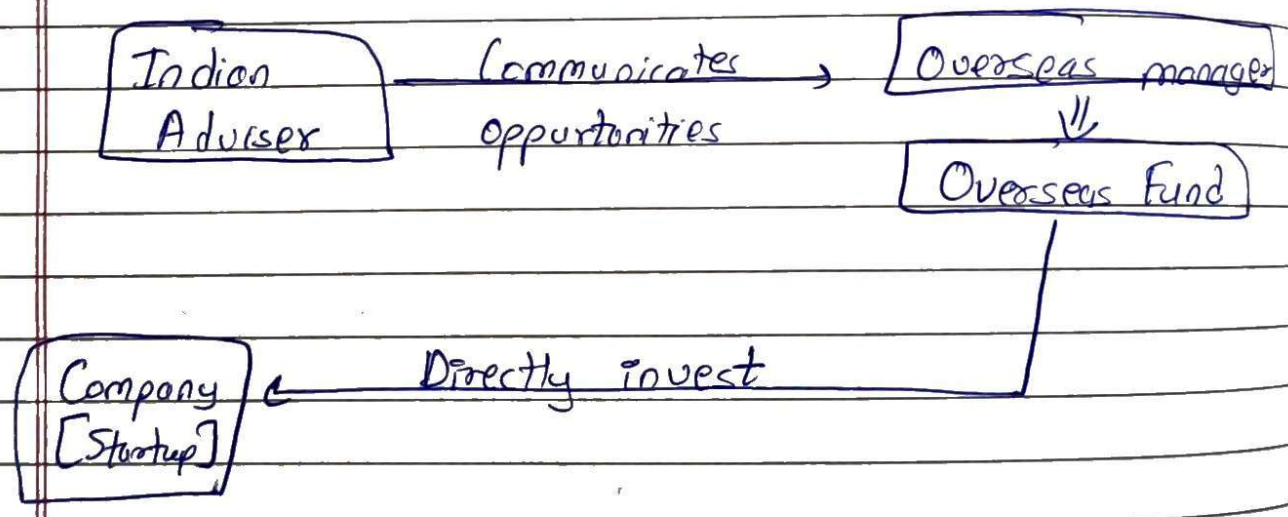
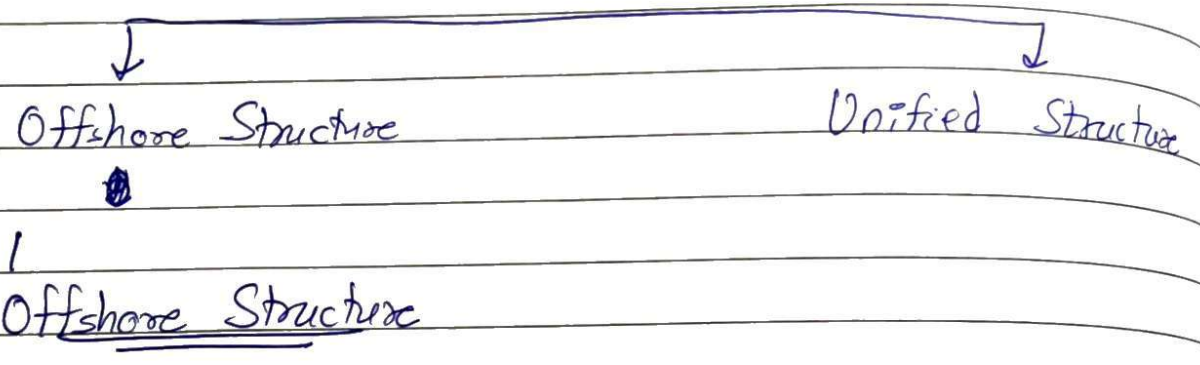
→ Structure:

a) Domestic Funds

- Domestic Vehicle to pool investor's money
- Seperate investment adviser

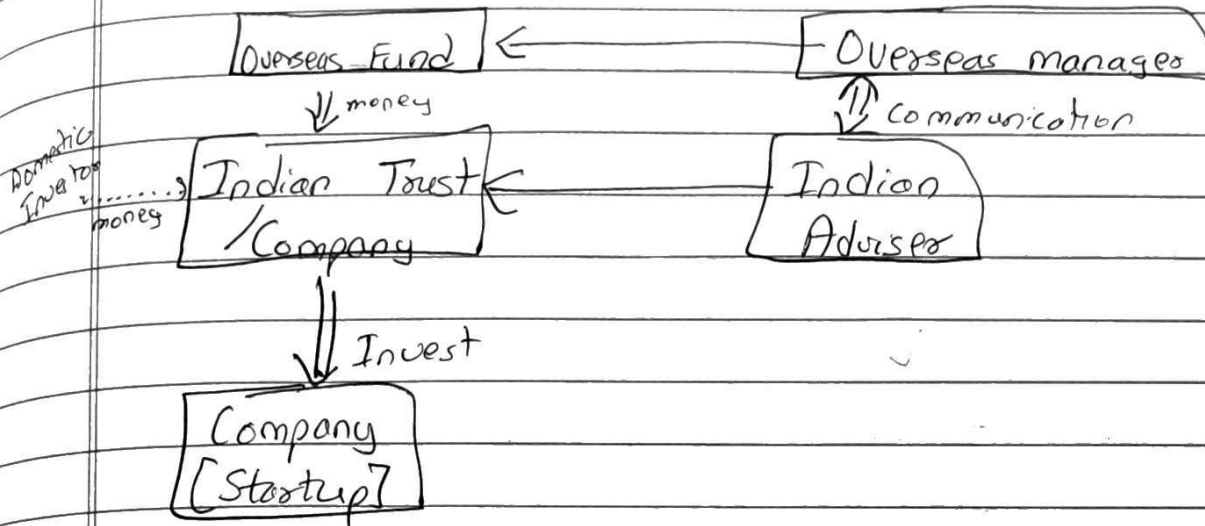
→ In India, can be either Trust or Company, not LLP

b) Offshore Funds



Unified Structure

- Used when domestic investor pooling expected
- Local domestic entity created and investments made under that name.



Startup India Initiative

Startup:

Conditions:

i] Structure $\left\{ \begin{array}{l} \rightarrow \text{Private Company} \\ \rightarrow \text{Registered Partnership} \\ \rightarrow \text{LLP} \end{array} \right.$

ii] T/o in any year since incorporation ≤ 500 crores
 \hookrightarrow not exceed

iii] Innovation / Scalable business model



Then for 30 years since incorporation, it will be a start-up

Government Support:

(a) SIDBI-run Electronic Development Fund [EDF]

\rightarrow Upto 50 lakhs seed funding

\rightarrow For proof of concept, product development, product trials, market entry etc

\rightarrow startup, incorporated less than 2 years ago may apply.

(b) Section 80-IC tax holiday

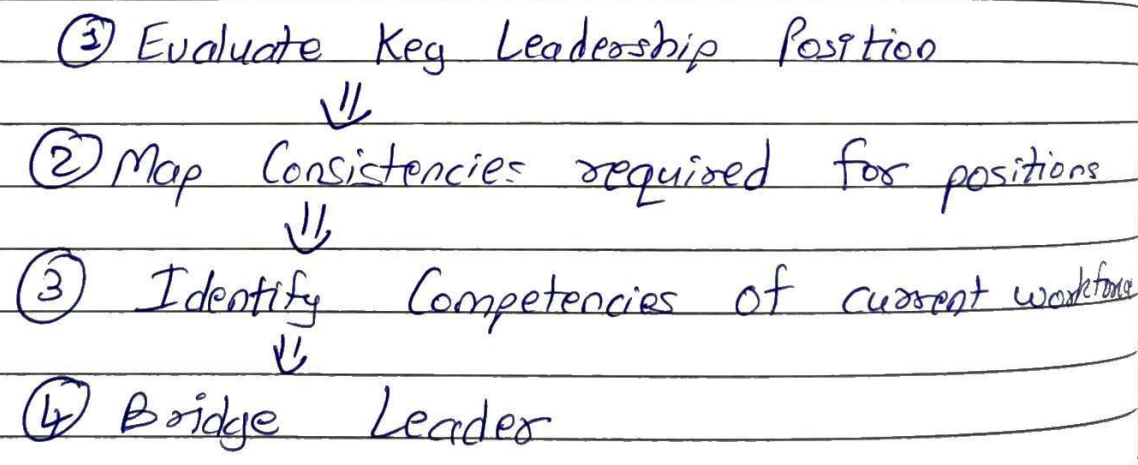
① Sustainable environment for startups : [Reasons]

- Pool of talent
- Cost effective workforce
- Increasing use of internet
- Technology
- Variety of funding options.

Succession Planning

- Identify critical positions in business and develop action plan for people to assume those positions
- Important for family owned businesses run by personnel or family
- Identify future personnel needs.
- Need of Succession planning:
 - Risk mitigation:
 - Cause removal
 - Talent Pipeline
 - Conflict resolution mechanism
 - Aligning

→ Business Succession Strategy



→ Challenges:

- (i) Founder mindset v/s Corporate mindset
- (ii) Premature for Startups to implement business succession
- (iii) Founders → Face of startups

Financial Policy & Corporate Strategy

→ Strategic Financial Management combines



Backward looking, report - focused discipline of AC
⊕ with
dynamic, forward-looking subject of financial management

→ Financial Decisions to involve:

- > Search for best investment opportunities
- > Selection of best " "
- > Optimum mix of funds
- > Internal control systems
- > Analysis of results

→ Decisions falling within scope of financial management



Financing



Investing



Dividend



Portfolio

Different Levels Strategy

Corporate level

- > Selection of business
- > Co-ordination & development of portfolio

- Sustainability
- Feasibility
- Acceptability

Business Unit Level

> Strategic Business Unit

Operates separately from other profit centres

Deals with:

- > Practical Co-ordination
- > Competitive Advantage of goods/services

Functional level strategy

> Operating level issues

> Business Process and value chain

Provide inputs to other levels

Conversion of Strategies to discrete action plans

Financial Planning

=

Financial Resources + Financial Tools
+ Financial Goals

⇒ Topic not in these notes → pg 3.6 → Topic 5
→ Interface of Financial Policy and Strategic management

⇒ Financially Sustainability

- More than one source of income
- More than one way of generating income
- Do strategic, action and planning regularly
- Adequate financial systems
- Good public image
- Clear about it's values
- Financial autonomy

⇒ Sustainable growth rate

$$= ROE \times [1 - \text{dividend ratio}]$$

⇒ Sustainable growth model assumes:

- target structure to be achieved w/o equity
- target dividend payout ratio exists
- sales increase as much as market allows

Concept:

$$RoE = \frac{NP}{Sales} \times \frac{Sales}{Assets} \times \frac{Assets}{Equity}$$

↓

so only way ← Assumed constant
of raising

equity = retaining earnings [+ any debt]

→ No restriction on growth rate if entity open to issuing shares

→ Growth Strategy } Cornerstones for achieving
→ Growth Capability } Sustainable growth

Sustainability

↓

Weak idea

↓

Overall capital assets
should remain constant

↓

Preserve critical resources
for long-term

↓

Strong idea

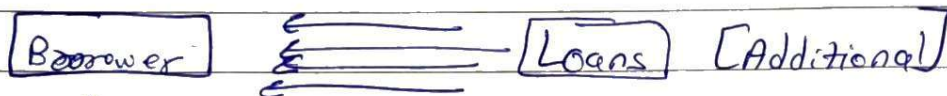
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Preserve critical resources
under primacy of
ecosystem functioning

What makes organization sustainable?

Symbol	Point
→	Clear direction
🔍	Scan environment for opportunities
👤	Attract, manage & retain competent staff
Road → SS	Admin and financial infrastructure
Lever →	Demonstrate effectiveness & leverage resources
RRRRR	Community Support

→ Sustainable growth model useful when



↓
model makes borrower either

- issue equity } to reduce financial leverage and
- reduce expansion } comply with growth model

In mature firms

Actual growth rate < Sustainable rate

↓
Find productive use of excess cashflows

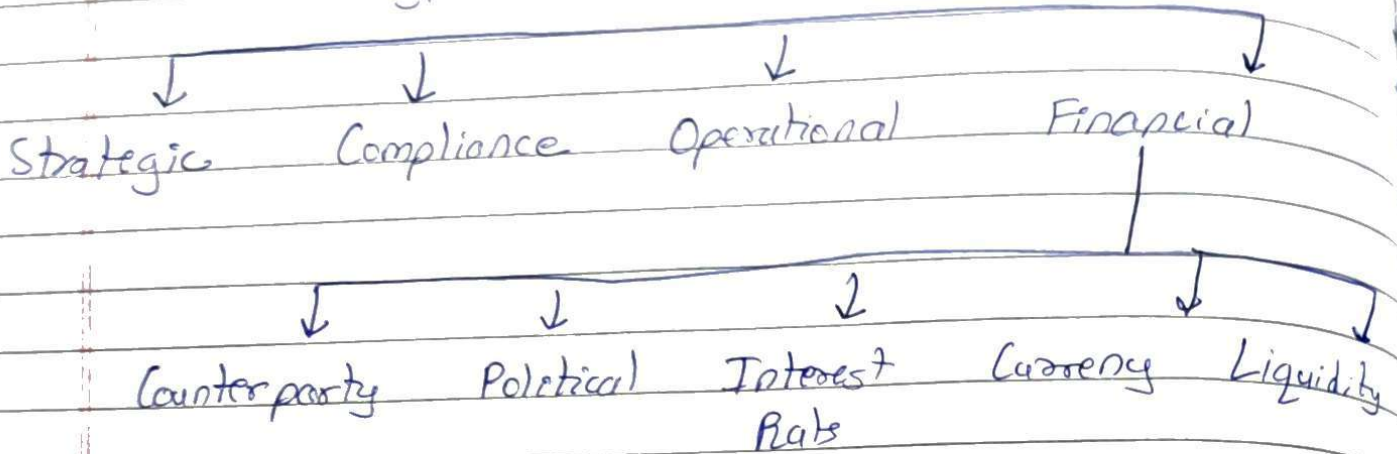
↓
Enhance rate by acquisition

↓
Includes dividend, stock repurchase, reducing debts etc

→ Now read → pg 3.30 → Mitsubishi Corporation

Risk Management

Types of Risk



[Book has given some standard ways to identify and mitigate above FINANCIAL Risks
~~Part~~ [read on last day]]

Value at Risk

Eg

Portfolio Value

100,000

VAR

12,500 @5% significance for 1 day

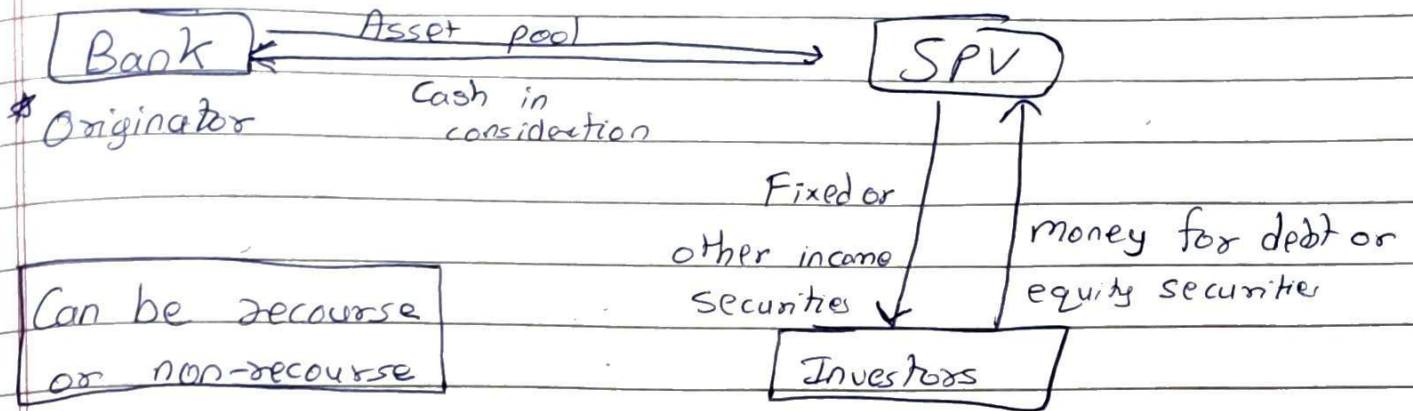
Interpretation:

With 95% confidence, we can say that max loss is
 ₹12,500 in a day

⇓

Only 5% chance that loss above ₹12,500 will be
 made in a day

Securitization



- SPV takes the timing difference risk and pays bank immediately
- Loans/assets of SPV are generally secured by charge on assets of borrower and hence investors are safe
- Secondary participants:
 - > Obligees - Borrowers who will repay loan to SPV
 - > Rating agencies
 - > Receiving & Payment agent
 - ↳ EMI of borrowers paid to investor
 - > Trustee
 - ↳ Safeguards interest of investor
 - > Credit enhancer
 - ↳ Originator/other person who guarantees investors
 - > Structurer.
 - ↳ Normally investment banker

Benefits of Securitization



Originator

Investors

- ⊙ Off BS financing
 - ⊙ Specialization in main business
 - ⊙ Helps improving financial ratios
 - ⊙ Reduced Borrowing cost
- Diversification of Risk
 - Regulatory Requirement
 - Protection against default

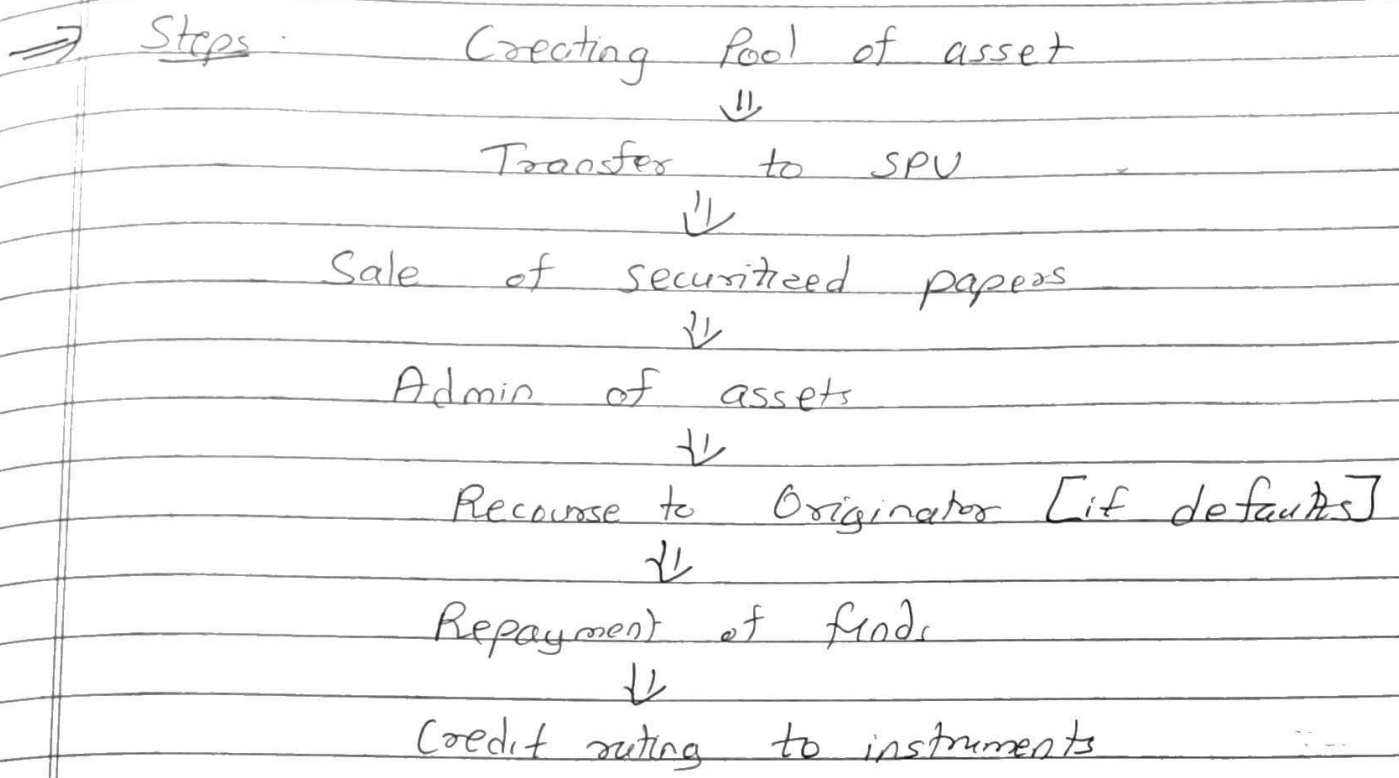
⇒ Features of Securitization

- Creation of financial instrument
- Bundling & unbundling
- Tool of risk management
- structured finance
- Tranching
- Homogeneity

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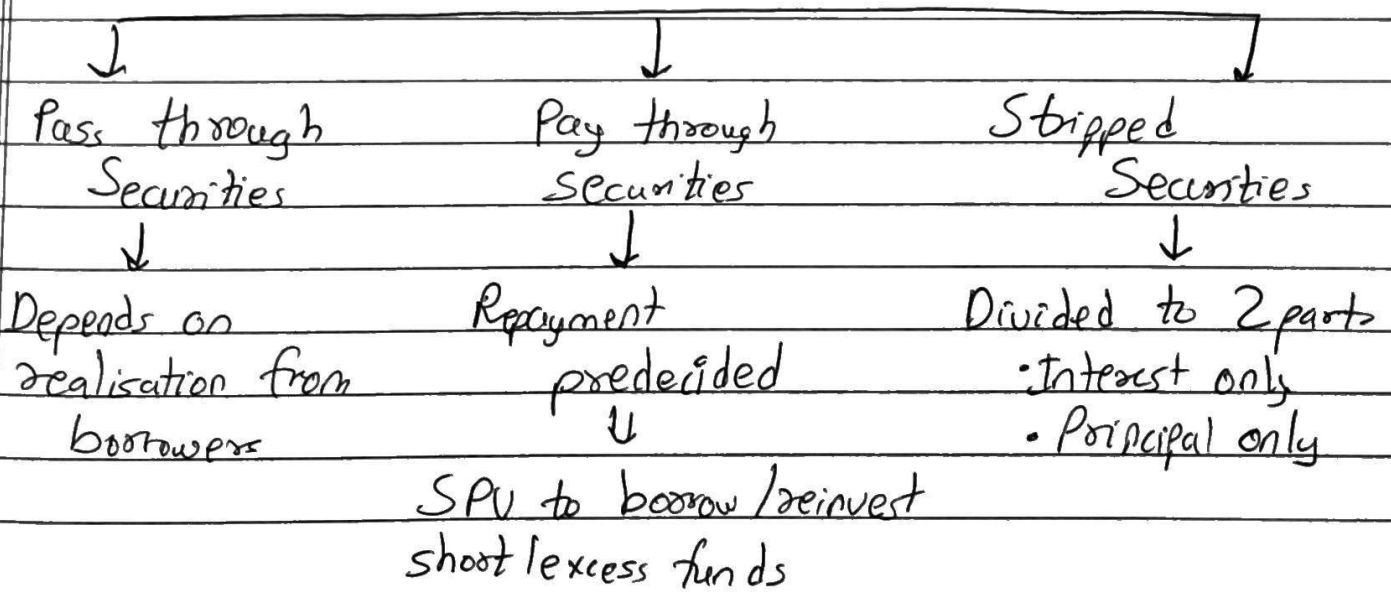


FaceBook Test Main.



- ⇒ Problems faced in India :
- Stamp duty
 - Accounting
 - Taxation
 - Lack of Standardization
 - Inadequate debt mt
 - Ineffective foreclosure laws

Categories



Pricing process

↓
Originator
⇓
Discount at
appropriate rate
such that
rate also includes
SPV profits

↓
Investor
⇓
Discounting at
YTM

⇒ Securitization in India

- Citi Bank led concept
- SARFAESI Act launched
- 70,000 crores in 2016 as per CRISIL
- SEBI allows FPI to invest in securitized debt of unlisted companies.