

**Course on Entrepreneurship**  
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**Lecture 34**  
**Raising Finances and Developing Financial Strategy-Part 4**

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**Start-up IPOs - 1**

While some companies, even established ones, choose to remain private, for an overwhelming number of companies listing in the stock exchanges and accessing capital from the markets is the ultimate test of their maturity and strength.

The Initial Public Offering (IPO) is a major milestone in any corporate journey, followed by listing in other overseas exchanges like NYSE, Nasdaq, and LSE.

IPOs are not very common in the Indian start-up scene given that funding comes rather easily for good and proven ideas.

However, over the past five years, more start-ups have been exploring the listing option as they began turning profitable, an essential requirement for listing in the Indian stock exchanges. Some successful entrepreneurial firms with heady IPO debut are:

- Justdial (May 2013),
- Infibeam (March 2016),
- Quick Heal (February 2016),
- Yatra (December 2016),
- Tejas Networks (June 2017), and
- Matrimony.com (September 2017)



Many start-ups entered the market with rich valuations, and continued to build value amidst the inescapable stock market rollercoaster.



Then we also have start-up IPOs, one is to have a start-up demonstrate its product and go to specific investors and many start-ups also feel that having certain individual investor arrangements at times limits their freedom of action, freedom of thought, they are not able to think and act because they have the investors on their board and investor expectations are at times are quite different, a start-up may have a time horizon of 5 to 7 years, whereas an investor may have time horizon of 3 to 5 years.

In which case how do you really manage the evaluation game, and how do you provide the returns to the investor, in which case there would be undue pressure. Therefore, IPO Initial Public Offer, where the company directly goes to the market place and seek public holding is an extremely viable and appropriate way of doing, we already saw how Thyrocare has gone into the public and become quite a valued company.

There have been many other companies which were start-ups and became successful public companies. Just Dial 2013, infibeam in 2016, Quick Heal 2016, Yatra 2016 again, Tejas networks in 2017 and matrimony.com in 2017. These have been successful companies which made IPOs so that they could get the kind of funding they require for the growth of the firms and they become more diversified in the equity system. But all said and done IPOs are not

very common in the Indian start-up's scene given that funding comes rather easily for good proven ideas.

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**Start-up IPOs - 2**

Public listing on stock exchanges provides many advantages to start-ups:

- building brand image with all stakeholders, including investors, customers, employees, public and governments,
- providing measurable value to company's performance and potential,
- adding transparency and value to employee stock option schemes, and
- reducing the dependence on debt by bringing in more risk capital.

Successful start-up listing requires:

- high degree of corporate governance and regulatory compliance,
- high level of transparency, and
- strong leadership team with a qualified board of directors.

Typically, it takes several months for an internally focussed private start-up to prepare for public listing.

Ideally, start-ups must start integrating some of these features from the early days so that the transition from a private to public enterprise is smooth and seamless.

In the overall, the advantages of public listing would outweigh the disadvantages, if any.

Even the best technology companies of US namely, Microsoft, Apple, Google and Facebook have prospered with public listing



Now the regulators in India have been thinking how to support start-ups. Public listing on stock exchange certainly provides that advantages, one it builds brand image with all the stakeholders including investors, customers, employees, public and governments. Then provides measurable value to companies performance and potential because once you are listed on the public stock exchanges, you got certain corporate governance methodologies which you need to adopt.

And it adds transparency and value to the employee stock option schemes because although the start-ups provide lot of employee stock option schemes, they can only be cashed when the valuation happens or when the exits happen or at predetermined buyback situation, but on the other hand if a company is listed publicly, the company would be in a position to provide value to the stock options more readily.

Then, a public offering always reduces the dependence on debt by bringing in more risk capital. However, to be listed successfully, a start-up requires very good corporate governance and regulatory compliance, it requires high level of transparency and a strong leadership with a qualified board of directors.

This requires at least 6 to 12 months of preparation before a private start up can aim to become a successful publicly held start-up but it pays for start-up to integrate some of these

features early on from the very beginning so that the transition from the private enterprise closely held private enterprise to public enterprise is smooth and seamless. And overall the advantages of public listing will far outweigh the disadvantage of any.

Even the best technology companies of US, such as Microsoft, Apple, Google, Facebook, Twitter have all prospered with public listing but at the same time we also have seen very recent times that public listing has its risk if a company is not well managed or if this whole business model is based more on a bubbly valuation than on actual execution, we have seen that example also in recent times. Therefore, it is important that IPOs must be considered as one of the very viable ways of providing start-up financing.

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### Start-up IPOs – 3: About EmERGE ITP Platform



EMERGE's Institutional Trading Platform (ITP) is for Start-Ups and Small and Medium Enterprises which do not have their securities listed on any recognised stock exchange and which seek listing of their specified securities exclusively on the institutional trading platform for informed investors.

ITP is a credible platform for start-ups and growing companies to list and showcase their performance to their lenders and potential investors, with or without an IPO (Initial Public Offer).

India has witnessed a growing start-up ecosystem fuelled by a large entrepreneurial community. Many entrepreneurs are building excellent businesses but do not have access to the funding they need.

Simultaneously there is a growing Angel and Venture Capital industry providing much needed equity capital to these businesses, but they do not have access to diverse early stage opportunities.

Further, as these investments mature, it becomes essential for the initial investors to exit and look for new opportunities, and new investors to step in and fuel the next phase of growth. emerge\_itp will facilitate churn in the investment portfolios and create a more active market for channelizing funds to start-ups and small companies. 62

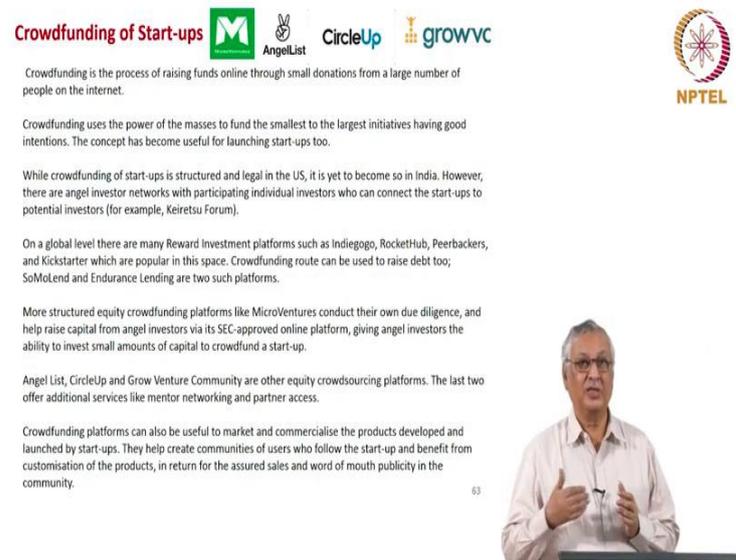


So we have seen the first steps, we have a platform called EMERGE platform, it is an integrated institutional trading platform for start-ups and small and medium enterprises which do not have their securities listed on any recognised stock exchange and which seek listing of the specified securities exclusively on the said platform for informed investors, it is the credible platform because it is supported by National Stock Exchange and it can be done with or without IPO.

Given that we have 20 thousand start-ups as we have seen, and I would think that there is significant potential to help this ITP platform gain more currency for the start-ups to accept. As we have many angel and venture capital people wanting to support start-ups, having this platform enables them to look at these ventures in a more cohesive and more time bound manner. And also it helps the investors move out after the investments mature, so it is a kind

of from a negotiated settlement stage, you move to a publicly benchmarked exit stage which is good for the start-up supporters as well as for the investors.

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**Crowdfunding of Start-ups** M AngelList CircleUp growvc

Crowdfunding is the process of raising funds online through small donations from a large number of people on the internet.

Crowdfunding uses the power of the masses to fund the smallest to the largest initiatives having good intentions. The concept has become useful for launching start-ups too.

While crowdfunding of start-ups is structured and legal in the US, it is yet to become so in India. However, there are angel investor networks with participating individual investors who can connect the start-ups to potential investors (for example, Keiretsu Forum).

On a global level there are many Reward Investment platforms such as Indiegogo, RocketHub, Peerbackers, and Kickstarter which are popular in this space. Crowdfunding route can be used to raise debt too; SoMoLend and Endurance Lending are two such platforms.

More structured equity crowdfunding platforms like MicroVentures conduct their own due diligence, and help raise capital from angel investors via its SEC-approved online platform, giving angel investors the ability to invest small amounts of capital to crowdfund a start-up.

Angel List, CircleUp and Grow Venture Community are other equity crowdsourcing platforms. The last two offer additional services like mentor networking and partner access.

Crowdfunding platforms can also be useful to market and commercialise the products developed and launched by start-ups. They help create communities of users who follow the start-up and benefit from customisation of the products, in return for the assured sales and word of mouth publicity in the community.

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Then we have another way of funding the start-ups which is crowd funding. Crowd funding is not legal in India as far as the start-ups or any other companies required but it is legal in certain countries, there are start-up crowd funding companies like micro ventures, we have got Angel list, Circle Up, growvc.

It brings the power of masses in full even to the smallest start-up venture and advantage is that even launch can be done through crowd funding of start-ups and in a way it is democratization of start-up movement, it helps start-ups move from relation based, a focus based working to get finances to a democratized way of getting finances from a wide spectrum of people. They also help in marketing of the products which are developed by the start-ups.

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### Need for Formal Crowdfunding Platforms

In India, as elsewhere, start-ups could succeed with investments ranging from a few thousands of rupees to a few lakhs of rupees, based on the product and scale

When angel investors and next stage investors add to the start-ups' financial mite in the second and third stages, start-ups blossom as full-fledged corporations.

The most difficult stage, however, are the initial stages of ideation and prototyping. There are more Theme-Thread-Passion platforms waiting to become start-ups than have actually become.

Several developed countries, including the United States, saw the establishment of formal laws and securities mechanisms in the 2000s to allow crowdfunding of equity investments for start-ups.

At the other end of the spectrum, a developing country such as Kenya has a vibrant crowdfunding ecosystem (Babandu and M-Changa are two popular crowdfunding platforms).



Under the JOBS Act in the US, crowdfunding up to USD 1 million can be raised by start-ups.

Crowdfunding enables more differentiated start-ups to come into being as organised financing typically tends to focus on successful domains.

Crowdfunding facilitates and encourages democratisation of entrepreneurship, something which India needs badly.

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So, as we have seen in India as well as elsewhere, start-ups could succeed with investments ranging from a few thousands of rupees to a few lakhs of rupees. So, crowd funding is an ideal situation for meeting small start-ups requirements for small scale of funds. Whereas, many time start-up's say when they knock at the doors, people will say that this is not my ticket size, this is not my ticket size, why do not you develop your product with your own savings and come to me after a particular ticket size of fundraising is required.

But when you look at crowd funding, none of such restrictions will matter it is quite possible that even small fundraising can be achieved and you can therefore have successful rounds of crowdfunding and that iterate yourself to your growth phase. In US we have got the jobs act, which provides crowd funding up to US dollar 1 million which can be raised by start-ups. I would suggest that we should look at something similar in nature for India, as well as and with lot of industry executives, retired personnel wanting to participate in the start-up systems but with a defined platform this could be another way to increase funding support to start-ups.

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**Idea Banking**

For a thriving start-up ecosystem, a proliferation of ideas is critical.

Incubators and accelerators have served to support ideas of entrepreneurship.

Even before reaching the incubator/accelerator stage, many ideas falter or wither away for want of mentoring or financing support. Two trends are encouraging, however:

- Graduates of premier institutes are developing creative ideas during their college educational stage itself and are prepared to forsake lucrative careers to pursue their ideas.
- Professors of such institutes are increasingly coming forward to share their ideas and co-nurture the ideas with students into start-ups.

Likewise, corporations should also be willing to give sabbatical to their executives to pursue their start-up ideas:

- Leaders should mentor start-up projects even when they are in active service and when they are able to provide positive influence.
- Given their knowledge, leaders can pick up niches from the value chains of their businesses which can be reinforced with start-up ideas.

When universities and professors, and corporations and leaders evaluate and choose ideas, and mentor start-ups with creative ideas, the ideas would become bankable.



Then how do you do ideas as bankable proposition? So, when we have scientist, then we have got professors, then we have got technicians who have brilliant ideas but which are not related to their nature of business and which cannot be supported, these ideas remain as ideas. However, when they decide along with their companies that I should be able to convert these ideas into action it's a kind of idea banking. Ideas themselves will be the currency which can be used for starting new start-ups.

In the Western University system, we have got University professors using their ideas, their laboratory products, their laboratory ideas into successful start-ups sharing the revenues with the Universities. It is quite possible for us also to replicate this methodology by which graduates of premier institutions, as well as professors of leading institutes are sharing their ideas with the start-up ecosystem or themselves setting up their own start-ups so that the ideas are not left in cold freeze, they are banked to start-up success.

This requires that corporations also participate in this, they can support these kinds of ventures by academicians and creative students, they can also help the executives within their own companies move into the space. For example, in today's automobile movement towards electric vehicles, it is quite possible for battery maker to energize their own staff to set up their idea banks and select those ideas which can be moved into this start up stage.

So internal start up idea bank generation, and then conversion of those ideas into successful start-ups is quite possible with corporate support. So, Universities, professors, creative

students, progressive corporations they can always and at all times make ideas as a pool of currency for generating new start-ups.

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### Financial Instruments - 1

Equity, convertible debt, and venture debt are three principal forms of raising finance for start-ups

The instruments are chosen based on the stage of the company, the business model, and the valuation levels.

Equity is typically obtained from angel investors or private equity funds, with issuance by the company to them. The options are:

- If the founders believe that the project has already proved itself they may issue direct equity, with the founders holding 100 percent of the equity pre-issue.
- If the founders believe that the project is proven but higher valuation is feasible in a few months, they can issue partially or fully convertible preference shares (which may be offered with some interest) that will convert into equity based on pre-determined valuations.

In cases where the start-ups do not wish to set a pre-determined valuation, the founders can issue convertible debt which can be converted into equity at a future point of time based on certain benchmarks.

The debt earns a coupon rate which is combined with the principal for conversion. Otherwise, the principal and interest are repaid in cash.



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So, we have considered so far, several ways of doing start up investments but basically there are three types of instruments by which this finance comes, one comes through equity, second comes through convertible debt and third comes through venture debt. When a founder believes that the project has proved itself the founder may issue direct equity, because at that point of time valuation can be high and the dilution the founder experience is low.

But on the other hand, if the founders believe that the all the investors also believe that the project is yet to be proved, you can look at a convertible debt which is fully convertible, partially convertible or non-convertible, so that the risk profile of the project is acceptable to the founders as well as for the investors. And in some cases, we can, as venture debt which is having a coupon rate.

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### Financial Instruments - 2

Start-ups have a few standard financial instruments to consider for inducing funding support from any of the above agencies and entities. These are: Equity, convertible debt, and venture debt

The instruments used are based on the stage of the company, the business model, and the valuation levels.

Equity is typically obtained from angel investors or private equity funds, with issuance by the company to them.

If the founders believe that the project has already proved itself they may issue direct equity, with the founders holding 100 percent of the equity pre-issue.

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### Financial Instruments - 3

Venture debt is a senior secured loan that sits on top of the funding pile, in terms of liquidation preference (repaid before all other debt or equity holders).

Venture debt is typically issued by more aggressive banks or venture debt investors. Such debt is usually secured by asset pledge.

All these instruments, typically, have a timeframe of 6 to 18 months for conversion or redemption.

The three instruments differ in terms of dilution to founder equity structure and influence or get influenced by valuations that are either pre-determined or determined at the time of conversion.

A revenue model is necessary to support the valuations in all the types of financing but is essential for the third route of debt.



Variations exist to each in terms of investor protection conditions, including first rights where equity issuance is involved.

An excellent summary of the financial instruments is available in a Forbes article "Comparing Equity, Debt and Convertibles for Startup Financings" (George Deep, March 19, 2014). <https://www.forbes.com/sites/georgedeep/2014/03/19/comparing-equity-vs-debt-vs-convertibles-for-startup-financings/#3cc6c08969ff>



So, this is the same as that. Venture debt is a senior secured loan that sits on top of the funding file and in terms of the liquidation preference, it has to be repaid before all other debt are equity holders. It is usually issued by aggressive banks and venture debt investors. So, the three investment instruments which we have discussed so far which is equity, the debt and the venture debt differ in terms of their criteria when they could be applied but at the core of all these things is a business plan.

A business plan determines what kind of equity instrument could be put, see if you let us say have a convertible debt instrument, the conversion will take place when the business plan is actually achieved in practice, so business plan becomes very important. On the other hand, if

somebody is putting in equity on the basis that there would be high revenue growth and therefore high valuation, again business plan becomes extremely important.

So, the rights of the investors, the protection as well as the risk that is taken depends on the business plan. So, the link below gives you an extremely good summary of the financial instruments that are available in terms of equity debt and convertibles for start-up financing.

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### Financial sufficiency for start-ups - 1

Entrepreneurial energy can take shape in terms of entities with highly variable scale and scope. From nano to mega, enterprises can be positioned and grown depending on the applicable product-market scope in each case.

As discussed in this chapter, India has as many as nine financing options with awesome financial power in the aggregate which can be made available to finance varied types of entrepreneurial ventures under different modes.

Profitable firms and successful investors can raise money by selling a small portion of their holdings periodically to set up and expand venture capital entities which will offer not only finance but also mentorship by the successful entrepreneurs and corporate leaders.

The Governments, Central and State, can also play catalytic roles in promoting such financial options for entrepreneurial ventures in different capacities.

Government e Marketplace (GeM) is an online procurement platform for government ministries and departments, and the most widely used channel for public procurement in India. MSMEs, SPVIT recognized startups and other private companies can register on GeM as sellers and sell their products and services directly to government entities.

GeM Startup Runway is a new initiative launched by GeM to allow startups to reach out to the universe of government buyers by offering innovative products that are unique in design, process and functionality.



We also have talked about financial sufficiency, how does financial sufficiency comes? Financial sufficiency comes not only from whatever support we are having through direct finance and direct investment but it also comes through marketplace support. We have discussed marketplace support through bootstrapping, that is very specific to a particular start-up at a particular phase of time but we must have a regular support system.

So, when government says that e-procurement should look at start-ups in a preferential manner or if we say that start-ups should not be allowed to have receivables in waiting or when we say that a government marketplace is created for online procurement for various government departments and ministries and MSMEs have a special channel in that area, then we have got a ecosystem which is available at all times to support start-ups and more such initiatives not only by the government and the public sector but also by the private sector would help have financials sufficiency for the start-ups.

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### Financial sufficiency for start-ups - 2

The financing models of not-for-profit and microfinance corporations have demonstrated how focus and reach can create a viable start-up network.

At the other points of spectrum, established venture capital funds and private equity players have to rework their models and become more entrepreneurial by themselves.

Indian mutual funds, pension funds and provident fund organisations as well as corporate groups have to set up India's own venture capital and private sector funds.

At the apex level the Government has to rediscover its role as a super venture capital investor, gaining additional financial capability from the envisaged PSU disinvestment programme.

Financial entrepreneurship has to be seen as the trigger for emergence of a full spectrum of nano, micro, small, medium, large and mega entrepreneurial entities in India.

**A 10,000 crore rupees fund** is set-up by the Government of India to provide funds to the startups as venture capital. The government is also giving guarantee to the lenders to encourage banks and other financial institutions for providing venture capital.

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Similarly, a fund of funds created by the government of India to support the start-ups that is also helpful and a private fund of funds with participation by the mutual funds, pension funds, provident fund organisations, corporate groups that also helps the start-ups have financial sufficiency.

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### Financial sufficiency for start-ups - 3

Entrepreneurial firms have a highly variable scale and scope. From nano to mega, enterprises can be positioned and grown depending on the applicable product-market scope in each case.

India has several financing options with awesome financial power in the aggregate which can be made available to finance varied types of entrepreneurial ventures under different modes.

Profitable firms and successful investors can raise money by selling a small portion of their holdings periodically to set up and expand venture capital entities which will offer due finance for start-ups.

The Governments, Central and State, can also play catalytic roles in promoting financial options for entrepreneurial ventures in different capacities. The Governments can be a super venture capital investor, gaining additional financial capability from the PSU disinvestment programme.

Even not-for-profit and microfinance corporations can create a viable start-up network.

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Indian mutual funds, pension funds and provident fund organisations as well as corporate groups have to set up India's own venture capital and private sector funds.

Financial entrepreneurship can trigger emergence of a full spectrum of nano, micro, small, medium, large and mega entrepreneurial entities in India.

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The third way to do is to ensure that we have more of smaller banks all across the nation support the start-up activity.

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### Indian Commercial Banks and Start-ups

Indian commercial banks and development institutions have been major drivers of India's industrial growth with their term lending and working capital funding

MSMEs owe their growth in the post-independence era, to a large extent, to the concessional lending support from the banks



Banks traditionally had funding lines for entrepreneurs but they were subject to traditional requirements of overall limits, collateral guarantees and margin stipulations, besides interest rates being high and initial moratorium periods being short

Under the Stand-up India Scheme, certain banks, notably public sector banks, began to open special funding windows for SMEs and self-employed professionals. Even these are limited to Rs 2 crore per start-up, and linked to collaterals but with an interest rate of 10 percent and moratorium period of 18 months. Unsecured loans entail a higher interest rate of 16 to 17 percent, which start-ups can ill-afford.

Technology-driven Start-ups which operate under uncertainty, however, have not received a special dispensation until recently; in other words, there are no tailored programmes of lending that recognise the uniqueness of each start-up situation

While leading banks have started deploying specific platforms for start-up needs (slides that follow) they are more in terms of counselling and support services rather than customised investment services

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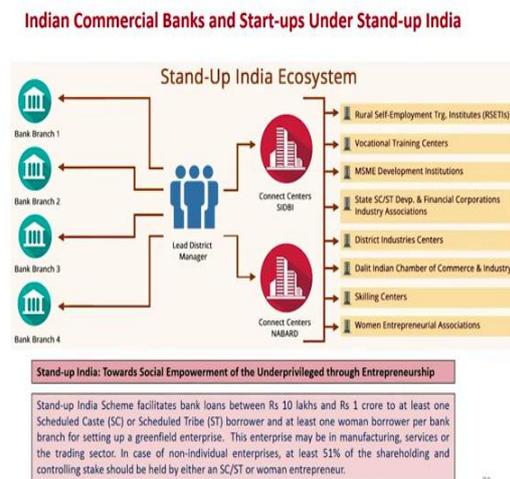
The problem with the commercial banking in start-up situation is that there are certain rules and procedures. Banks are custodians of public deposits, many people provide their lifetime savings in the banks on the basis that they will be paid whenever they are required, whether as savings bank account or fixed deposit account. Therefore, when they lend that money for other activities, banks have got certain responsibilities and regulations.

So, when banks do these activities, they got certain requirements, there are certain limits to which they can extend the loans, they have expectations of margins to be provided by the loan seeker. They have got certain collaterals that have to be pledged to the bank and interest rates naturally will be high because they have to have a spread between the deposit rate and the interest rate.

Therefore, banks have become the funding agents of choice when the business model is established and there is a viable operating cycle which they can fund and also in which they can participate as working capital lenders but as we have seen technology-driven start-ups work under completely different platforms where ideas have to be worked on for months and years before the first revenue happens, and even the first revenue may not be profitable and the particular level of scale is achieved.

So, the banking system, the way it is designed and which is in which it has to prudentially operate, does not lend itself readily to supporting start-up funding.

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Given this limitation, the government has been seeing, what can I do, so a stand up India ecosystem has been developed which is basically a methodology for social entrepreneurship, it has been developed for empowerment of underprivileged through entrepreneurship and it has got linkage between banks and indigent entrepreneurs.

And it provides bank loans between 10 lakhs and 1 crore rupees, for at least one in schedule caste or scheduled tribe borrower and at least one women borrower per bank branch for setting up a greenfield enterprise. And the enterprise can be in manufacturing, service or the trading sector. And in non-individual enterprises, 51 percent of the designated type of person should be a participant in the scheme.

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### Financial sufficiency for start-ups: Banking System

HDFC Bank, India's second largest private lender, launched its maiden start-up focussed, sector-agnostic fund that will initially have a corpus of USD 25 to 30 million. The Bank also proposes to provide legal and financial advice to its portfolio companies.

If other banks follow the example, the established banking system can create a large fund of at least USD 250 million, enough to provide additional reinforcement to the start-up ecosystem.

Interestingly, there has been an increasing trend of start-up firms specialising in financing of small and medium enterprises (SMEs). Given that most SMEs are entrepreneurial in nature, a start-up finance enterprise movement to support SMEs is indeed a welcome trend.

New age lending platforms like Capital Float, NeoGrowth, LendingKart, Kinara Capital and Indifi Technologies as well as a few others have themselves received funding to an extent of USD 200 million.



Lending to SMEs has its challenges due to low spreads and recovery risks tied to economic headwinds. That said, there is also potential for SME start-up finance sector to become a transformational force in the same manner as Non-banking Finance Companies (NBFCs) have been for transforming indigent rural and urban financing landscape.

Interestingly, NBFCs themselves have been adding medium, small, and micro enterprises to their portfolio. Apart from traditional industrial and consumer sectors, food processing and agro industries could benefit structurally from start-up finance in this sector.

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Apart from the commercial banks, a new age fintech companies are also coming in, where they take money from banks but they are able to deploy them in more efficient way for kick starting the start-up system. So, we have a Capital Float, NeoGrowth, Kinara Capital, Lendingkart, indifi which are into this new age financial empowerment for individuals as well as for start-ups.

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### Microfinance Corporation Support for Start-ups

The Grameen Bank was founded by Muhammad Yunus in 1983 in Bangladesh to provide tiny loans for the poor to enable self-employment.

The success of the Grameen Bank and the global recognition it secured is reflective of the potential of directed micro credit. Over a period of 26 years, the Bank created over 7.8 million active borrowers (cumulative) disbursing over USD 3.5 billion in tiny loans.

The pioneering work in employment generation touching the lives of the poorest of the poor fetched for Yunus and the Grameen Bank the Nobel Peace Prize in 2006.

Today the Grameen Bank has become more diversified in its product offerings, leading to greater generation of wealth for its customers.

In India, microfinance corporations (MFC) sector took root very quickly over the last two decades, and some of them even received small bank licenses under the new regulations of the Reserve Bank of India.

While MFCs played a stellar role in supporting social entrepreneurship and women self-help groups, upon conversion into small banks they shifted focus to high-cost business loans.

NBFC liquidity pressures need to be alleviated to ensure diversified start-up ecosystem, ground up



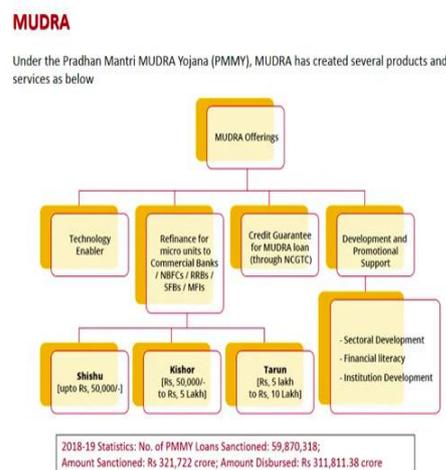
Then the big way is large finance corporations support, micro finance corporation support for start-ups. They are extending, normally urban systems are supported by the large banking corporation. And rural systems are supported by micro finance corporation and micro finance

corporation have been very instrumental in helping self-help groups but many micro finance corporation have also converted themselves into small finance banks and the moment they became small finance banks, they started operating as larger financial banks and the rules and regulations which pertain to banking system become applicable.

Therefore, their ability to support self-employment or entrepreneurship becomes limited. So, microfinance corporations still have got a significant role to play in motivating start-up movement and given that NBFC system today is in a kind of liquidity crunch, we got to wait and watch for the improvement and recovery in the NBFC system to support greater start-up support.

But their seller role cannot be denied and the one has to really expect future support from the Gramin bank has been the great example, and in India itself we have got many banks, Spandana Sphoorty and Ujjivan they are all been very successful in helping companies succeed in the start-up route through their support.

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So given this kind of NBFC requirement, government has formulated MUDRA which is Pradhanmantri Mudra Yojna to support start-up activities, we have got loans of different types up to 50 thousand, 50 thousand to 5 lakh, 5 lakh to 10 lakh with different roles and regions and the number of loans so far is staggering 6 million loans sanctioned in 2018-19 which is a very impressive and very recently loan within one hour kind of format has also been sanctioned.

But in all these things the start-ups also have to remember that the success of all this ventures which are very progressively and positively thought of is linked to the recovery being possible, which means that the operating models have to be proper and successful and they have to provide the funds back to the lending institutions.

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**Indian Banking Platforms for Start-ups - 1**

| Bank         | Initiative / Platform | Focus   |
|--------------|-----------------------|---|
| Axis Bank    | "Thought Factory"     | <ul style="list-style-type: none"> <li>Working from ideation stage with start-ups</li> <li>Looking for two-way benefit</li> <li>Focus on AI, blockchain, mobility and cloud</li> <li>Dedicated team to coordinate with start-ups</li> </ul>   |
| Federal Bank | "Launchpad"           | <ul style="list-style-type: none"> <li>Exclusive outlet for start-ups in Bangalore and Kochi</li> <li>Focus on digital financial services, biotechnology, hi-tech farming, healthcare, logistics, e-commerce etc.</li> <li>Counseling and customised banking solutions</li> <li>An exclusive corpus for investing in start-ups</li> </ul> |
| HDFC Bank    | "Smart Up"            | <ul style="list-style-type: none"> <li>In association with Zone Start-ups India (ZSI), a start-up initiative</li> <li>Offers a Smart-up current account and PayZapp for business payments</li> <li>Opportunity to showcase products on Smart Buy to 32 million HDFC bank customers</li> </ul>   |
| ICICI Bank   | "Startup Garage"      | <ul style="list-style-type: none"> <li>Advisory services for start-ups in digital, financial services, biotechnology, hi-tech farming, healthcare, logistics, e-commerce etc.</li> <li>Business networking and meets with leading VC's and PE players</li> <li>Connections with other service agencies</li> </ul>                         |





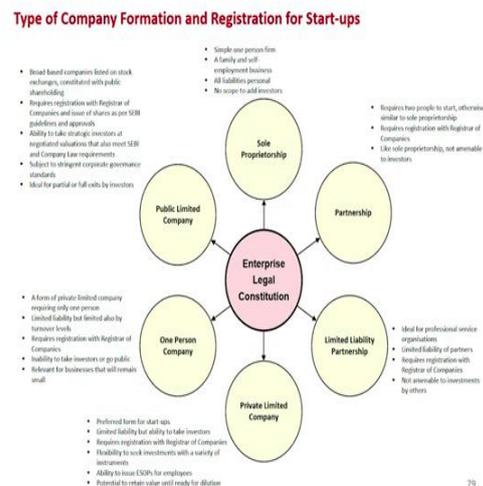




So, the public sector banks have been trying, given and also the private large corporate banks have been trying, various methodologies to participate and support the start-up system despite the limitations they have in terms of the normal banking lending regulations. So, Axis bank has thought about an initiative which is called Thought Factory, which starts with ideation stage and works with the start-ups it is a two way benefit, and the focus is on items which are required for the bank.

Similarly, Federal Bank has Launchpad, HDFC bank has got SmartUp, ICICI bank has got iStartup Garage, Kotak Mahindra Bank has got Kotak Business Boosters, Ratnakar Bank has got Start-Up club and State Bank of India has got IT-ISEP. So these are all the areas in which the banks are collaborating with the start-ups providing a healthy platform of not only idea exchange of ideas, but also ways and means in which they can participate with innovations that are useful for the fintech in general and also for newer areas like artificial intelligence and analytics, biometrics etc.

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So, we have considered the various aspects of financing and the canvas is very vast and it is indeed very difficult to trace them in a very sequential manner. So, what you have seen in a way is a potpourri of various financing options and it is a kind of pick and choose depending upon the start-up, but to be able to access any finance, an organised structure is required for this start-up.

And how does a start-up organise itself legally as an entity? So there again six options available, first option is sole proprietorship is not obviously great option for starting a growth-oriented start-up, it is very good for a nano enterprise and it helps keep the liabilities personal and it is ideal for family and self-employment opportunity. Then comes partnership like two people join together and this is probably this minimum required for starting registration with the registrar of companies.

Again, it is not amenable to investors because by law it is limited to two people starting the business and it could have more people but not really suited for investors of the kind which we have discussed. Then comes limited liability partnership very ideal for professionals to join hands together has limited liability but again is not limited for investments by other people investors.

So, if you are in the start-up game and you want to scale yourself up, it is very important to look at forms of company formation which can take investor interest inside, which is private limited company, a one person company or a public limited company. And in this private limited company is the mode of choice to start the start-up activity and then enable venture

capital firms or private equity firms to participate in this and then move on to become a public limited company, the pros and cons of different types of company formation are listed in this slide.

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### Valuation as a Lever of Financing - A Race to the Bottom?

An enigmatic feature of tech-based start-up system is if a start-up is able to achieve large user base and high market share even without any clear path to profit, such a start-up is able to achieve billion-dollar valuations

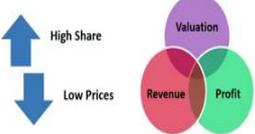
This has been supported by abundant availability of VC funding in the West; in 2005, VC funding was USD 20 million in the US and in 2018 it touched a peak of USD 99 billion. There is no evidence that the rise of unicorns or the spurt in valuations has led to start-up profitability

New technologies are enabling tech based start-ups, fuelled by generous VC funding to disrupt age-old ways of doing businesses, gain users and revenues at breakneck speed and create new behemoths; Uber, Spotify, WeWork, Flipkart, Ola, Oyo are a few representative examples. Some exceptions do exist (eg., TransferWise)

When such growth is achieved by low prices, discounts, incentives and offers, growth tends to be critically dependent on such margin-destroying measures; if the market has low tech barriers in addition, growth becomes virtually a race to the bottom

Techspace in its well-written paper in Medium (<https://blog.techspace.co/profit-vs-growth-part-1-unicorns-arent-real-23f0420e310d>) argues that most such unicorns are overvalued on paper for a variety of reasons including protection for VCs, which makes them vulnerable to tech bubbles that could burst in periods of recession

The advice is that start-ups should pursue business models that represent a prudent balance of revenues and profits, of pursuit of scale and focus on sustainability



But then there is also this question, is valuation a lever of financing or is a risk of financing? Is the chase for valuations, a race to the bottom. An enigmatic feature of the tech based start-up system as opposed to a physical operating model of a company is that if a start-up is able to achieve a large user base and high market share, even without any clear path to the profit, investors are willing to provide huge sums of their money to the start-ups. So, in west, there has been abundant availability of funding for such companies, and in 2005 VC funding was just 20 million dollars in the US.

And in 2018, it touched nearly hundred billion dollars. However, studies say that this has not necessarily been accompanied by either the rise of unicorn which are profitable or it has been accompanied by overall financial health and viability of the start-up. So, the rise in financing has had no correlation with the rise in profitability of start-up. And how does this high share get achieved? High share gets achieved with the lower prices or higher discounts.

So, we have a revenue, you have a profit and you have valuation parameter. So, in India as well, we have got examples where companies have been having high turnovers but losses also have been very high, so is no longer is a kind of profitability percentage is remaining investment enthusiasm, it is the market share and market presence which is driving this. There have been exceptions like TransferWise which had been prudently managed but overall

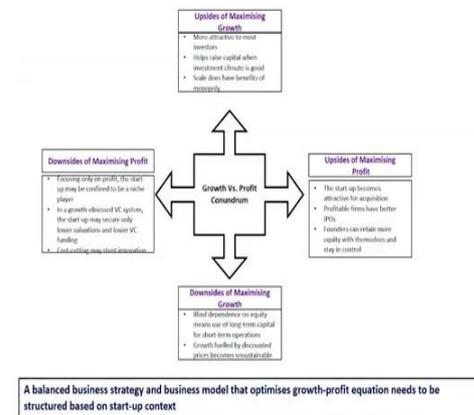
many companies which are very well fancied terms in start-up space have had still unviable operations.

So, these are margin destroying measures in one way, discounts, incentives, low prices, offers and once these are withdrawn for whatever reason, then the growth tends to falter. So, there is a paper written in Medium that, most such unicorns are overvalued on paper for variety of reasons including protection for VCs which makes them vulnerable to tech bubbles that could burst in periods of recession.

So, when India as a country, it is not really resource rich to be able to be profligate or extravagant in these kinds of investments, we need to really look at operating models which ensure not only revenue growth, but also profit growth. So, the more the start-ups pursue, business models that have prudent balance of revenues and profits, the better will be our start-up ecosystem and better will be our ability to attract funds indigenously as well as exogenously.

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**Pros and Cons of Pursuit of Growth Versus Pursuit of Profit**



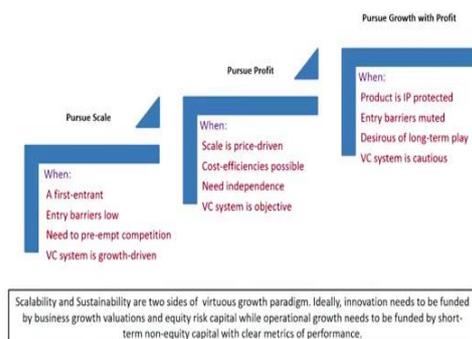
So, there are obviously pros and cons of perusing growth versus perusing profit. So, this graphic tells us what are the upsides of maximizing growth, what are the downsides of maximizing growth. Similarly, what was the upsides of maximizing profit versus the downsides of maximizing? So, when you maximize the growth, we become more attractive to the investors we raise capital when it is available, and it does have benefits of monopoly. On the downside, if such growth is dependent on just discounts, then we become vulnerable.

Similarly, the dependence on equity that comes with high growth, therefore high equity lead growth means that the start-up is vulnerable for external dependency and it has its own short term implications. The advantages of maximizing profit, the start-up becomes very attractive for acquisition, particularly by mainstreams firms, profitable firms have better IPOs and founders can retain more equity.

On the other hand, if you are so obsessed with profit, then we may end up being only niche player, we will not be able to grow and attract capital in a VC system which is unfortunately or fortunately growth obsessed. And if profits are achieved through cost cutting, probably that may not also be the best way to grow a business. Therefore, we require a balanced business strategy and a balanced business model, that optimises the growth profit equation based on the start-up context, that is also very important.

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### A Model of Scalability with Sustainability



So finally, we need to look at financing as part of overall business strategy, we should look at scalability, we should return we should look at sustainability. So, we should pursue scale when we are the first entrant when the entry barriers are low, when the need is to pre-empt competition and when the VC system is growth driven. So, if anybody can enter the market, it is important that we capture the marketplace very quickly, so therefore, growth is important.

Therefore, it makes sense if you are low price low margin player, but have a high market share but on the other hand, if your scale is price driven, you should start perusing profit. When cost efficiencies are possible, you should pursue profit. When we need independence

to pursue your own thoughts and your own product ideas, you need to look at peruse. And when the VC system is descending and differentiated to understand what is the discount led growth versus what is profit led growth, you should pursue profit.

And obviously you should pursue a combination of both, when you have got certain core competencies which are solid like your product is IP protected, your entry barriers are muted, when you are desirous of long-term play and when your VC system is cautious, then we should look at scalability along with sustainability. So, these are the two sides of virtual growth paradigm. Ideally innovation needs to be funded by business growth valuations because if your innovation is of that kind of disruptive innovation, eventually business will be valued highly. Therefore, it should be funded by equity risk capital.

Whereas, ones that innovation is brought into a product stage, that operational growth needs to be funded by more short term non-equity capital which will be like non-convertible debt or convertible debt with a mix of equity conversion as well as coupon rate and also linked to the clear matrix of performance.

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### Pitch Deck

A pitch deck is a vital vehicle for start-up founders to engage with all stakeholders, more specifically the investor community



A Pitch Deck must interest, engage, and inspire the stakeholders into positive commitment with the founders. When a pitch deck is narrated by the founders with passion, the value proposition becomes inspirational to all.



Then we will talk about pitch deck for a few minutes because start-up may have certain value propositions, start-up founders may have lot of passion but how do we really engage as start-up founders with the investors, be it the bank or be it the venture capital investors or the angel investor, for that pitch deck is important. A pitch deck is a vital vehicle for start-up founders to engage with all stakeholders, more specifically the investor community.

Given that there are many more start-ups than the funding streams available and typically a good VC has at least 10 meetings a day I believe and we have to capture the interest of the investor in a short period of time and to be able to do that, you should have a pitch deck which has certain ingredients. A pitch deck is a vital vehicle for start-up founders to engage all stakeholders because whatever the idea, whatever the passion the entrepreneur has, has to be conveyed to the investors in a very effective manner.

And pitch deck is something very unique to the start-up community because it is a combination of concise presentation with the expansive thoughts the start-up has got. It is skill and it is an art as well and that to be effectively translated into visible action, the pitch deck should have these four components.

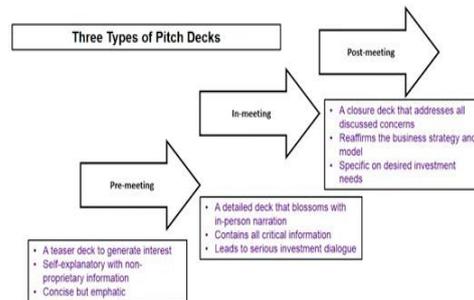
The first is the problem statement, what is the problem that the start-up has discovered and the solution of which would be very helpful for the society at large or for the business community or the customer base which it is going to serve in future. The second is the solution that is proposed to solve the problem, how elegant it is, how effective it is going to be and how technologically elegant it is.

The third one is the prototype built, in case the prototype has already been built, demonstration of the prototype and also the user feedback on the prototype. And the investor will also be keen to know the kind of business model that has been adopted by the company, whether it is an operations driven business model, customer driven business model, what kind of price mechanism are being adopted, what are the kinds of business to business relationships or business to consumer relationships that are being thought about that is the business model.

Now what is the intellectual property that is underpinning this entire idea and what is the team and what is the execution model. A pitch deck must interest, engage and inspire the stakeholders into positive commitment with the founders and they should stay engaged with the founders number 1, number 2 if the pitch deck is narrated by the founders with passion, there is even greater chance of the engagement reaching higher levels and the value proposition becoming inspirational not only to the founders as it always has been, but also to the investors. So, pitch deck is an extremely important constituent of the whole investment proposition.

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### Three Types of Pitch Decks



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There are basically three types of pitch decks, one is the pre-meeting pitch decks, second is an in-meeting pitch deck and third is a post-meeting pitch deck. The pre meeting pitch deck is typically a teaser document, it is short, concise but effective, helps in generating interest in the investor and is also self-explanatory with no proprietary information.

And in meeting teaser is a sufficiently detailed document, it will have all the eight components which I have discussed in the previous slide and it is always accompanied by in person narration. It contains all the critical information and leads to serious investment dialogue. And when the meeting concludes, there would obviously be certain questions and certain issues that are raised and certain propositions from both sides.

Typically, in meeting pitch deck is followed upon by a post meeting pitch deck, it is a closure deck, that addresses all the concerns, all the issues discussed reaffirms the business strategy and the execution model and it is very specific on the desired investment needs. So, these three pitch decks are an integral part of the investment transaction that is targeted and the start-up should have the necessary skills and capability to create the pitch decks and also narrate them when it is required to be narrated.



and in diverse industry settings, one was successful in confectionery, one was successful in moving goods from one location to other.

Another has been successful in making ready to eat food, and another has been successful in converting palm leaves into disposable items, one was a consultant, another has a milk and dairy products manufacturer and one took a very native dish, such as vada pav to a national level. So, it is possible for starting with low finance at times as low as 11 thousand rupees, and start a business and can make it grow to big scale.

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### Self-Financing Business Models with Innovation + Execution



But why does this happen, how does this happen? It happens because such start-up founders, of course had passion, they had diligence, they had the capability but they also deployed self-financing business models with innovation and execution. So, when you look at Asha Confectionery, the turning point was when it moved from small business to automated production, when we look at Agarwal Packers and Movers, the core success factor 100 percent safety guarantee to the customers. So significant customer orientation and choice of the team and choice of the vehicles for moment.

When we look at ID Fresh Food, which is specialist in batters for South Indian dishes and also for North Indian wheat based product. Technology to make food ingredients without the preservatives that has been a winning proposition, so that has helped the company. When we look at Wow momo category creation in unique snacks.



funding, provide more value in the hands of founders for longer period of time and then ensure that the start-up ecosystem is much more enterprising, much more viable and much more self-supporting.