Financing of a New Venture- Current Scenario

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Abstract

Start-ups are young companies founded to develop a unique product or service, bring it to market and make it irresistible and irreplaceable for customers. The government provides funding and financial assistance to start-ups through various schemes and programs. This helps start-ups to get the necessary resources to start and grow their businesses. By availing these benefits, start-ups can have a significant advantage over their competitors. The new ventures have been provided financial support also by Venture Capital Funds, Private Equity investors, Angel Investors, High Net worth Individuals (HNIs), incubators, accelerators, seed funds and by the government. There have been examples of Governments supporting early stage funding. The present research paper aims to discuss various financing schemes recently started by the government. It also examines the financing options for a new venture.

Keywords: Financing, New venture, Government

Introduction

A startup is an entrepreneurial venture which is usually a newly emerged, growing business that attempts to meet the market need by developing a viable business model around an innovative product, service, process or a platform. A startup begins with an idea which fills a gap, fulfils a pending need or creates a new service / product. This is how startups are usually distinguished from traditional business. Since most startups are internet based, the competition is very high as the internet nullifies geographical distances. It is essential for a successful startup that the idea is new, fresh, innovative, technically sound, free of legal issues, socially acceptable and has the potential to make profit. With the support from the government of India, there have been the emergence of a number of home grown unicorns across the country. One of the major contributors leading to this development has been the mega funding ploughed into most of these ventures in the past decade. This is in tune with the global trend.

Definition- Start-up, only for the purpose of Govt. Schemes

An entity Incorporated as a Private Limited Company (as defined in the Companies Act, 2013) or registered as a partnership firm (registered under section 59 of the Partnership Act, 1932) or a limited liability partnership (under the Limited Liability Partnership Act, 2008) in India is considered a 'Start-up' if

- its period of existence and operations should not be exceeding 10 years from the date of Incorporation;
- its turnover for any of the financial years since incorporation does not exceed INR 100 crore and
- it is working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property or if it is a scalable business model with high potential of employment generation or wealth creation. Further, the entity should not have been formed by splitting up or reconstruction of a business already in existence.

Eligibility for an Indian start-up

- For availing various benefits (except tax benefits) of the Start-up India Action Plan, an entity is required to be recognized as a Start-up by applying on Start-up India Mobile App/ Portal. Start-ups are required to submit Certificate of Incorporation/ Registration along with their application. The start-up needs to hold a certificate of 'eligible business' from the Inter-Ministerial Board of Certification to get various tax benefits
- The eligibility criteria for applying to Income Tax exemption under 80 IAC is that the entity should be a recognized start-up, only Private limited or a Limited Liability Partnership is eligible for Tax exemption and the Start-up should have been incorporated after 1st April, 2016. In order to obtain tax benefits under section 80 IAC of the Income Tax Act, start-up may apply for tax exemption. Post getting clearance for Tax exemption, the Start-up can avail tax holiday for 3 consecutive financial years out of its first ten years since incorporation.
- In order to get tax exemption under Section 56 of the Income Tax Act (Angel Tax), the start-up, afters getting recognition as a start-up may apply for Angel Tax Exemption. The eligibility criteria for tax exemption under Section 56 of the Income Tax Act is that the entity should be a Department for Promotion of Industry and Internal Trade (DPIIT) recognized start-up and aggregate amount of paid up share capital and share premium of the Start-up after the proposed issue of share, if any, does not exceed INR 25 Crore.

1. **Source : Department for Promotion of Industry and Internal Trade**

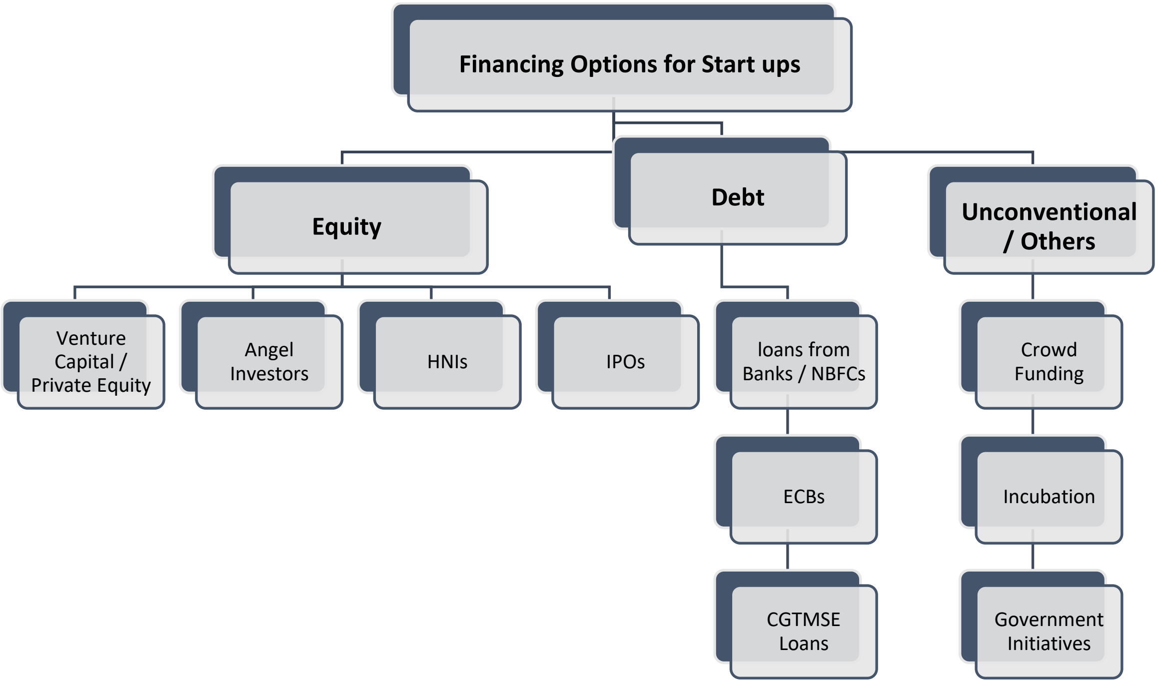
Guidance provided by Start-up India to individuals with innovative idea

DIPP has launched Learning Development module for budding entrepreneurs. The learning Program is a four weeks free program for early stage entrepreneurs across the country. This online program is aimed at teaching new and existing entrepreneurs on how to start a new business and how to scale an existing one. Incubators all across India provide guidance to budding start-ups and one can approach these.

Financing options for a New Venture

Globally, new ventures have been provided financial support by Venture Capital Funds, Private Equity investors, Angel Investors, High Net worth Individuals (HNIs), incubators, accelerators, seed funds and the government too. There have been examples of Governments supporting early stage funding. Government of India has recently taken number of initiatives of supporting early stage companies through number of funding schemes like Stand-Up India, Atal Innovation Mission (AIM) etc.

The best scenario for any new venture is that it is self-funded (bootstrapping). However, usually a new venture is the result of a novel idea brimming in the minds of its founders who may be very young graduates or at times even dropouts. In such a situation, appropriate and timely funding is essentially for the blooming of such an idea but the fact is that funds are always a challenge for such entities. For a first time entrepreneur, the world of funding is definitely complex and challenging. The funding provided by various sources can be categorised into three types (A) Equity based funding (B) Debt based and (C) unconventional. Besides these three sources, Government of respective countries also launch certain schemes / programmes to support and nurture talent. The various sources of funding under these categories are listed below and depicted in the chart too:



A. Equity based Funding Options: Start-ups are usually equity financed/ funded by way of angel investors, venture capital funds or private equity investors. Raising of funds via public issue popularly known as Initial public offering (IPO). It is another route though it is available only to mature organisations who have been in business for a while and have been making profits too.

(i) Venture Capitalist/ Private Equity: Venture capital (VC) and Private Equity (PE) are also known as risk capital primarily due to the amount of risk involved in such transactions. VC is often the first large and most suitable funding option for a start-up with large up-front capital requirement. Though funding is usually provided in return for equity stake, a part of it may be provided in the form of debt also. Both Venture Capitalists and private equity firms usually invest with a long term horizon in expectation of a capital gain of the equity stake in the venture. Another distinguishing feature of venture capital investment is their participation in the management of the company and timely guidance and support for growth of the organisation.

The entrepreneur must approach the venture capitalist with a detailed business plan complete with vital details such as description of the idea, market potential, expected competition and financial projections. Thereafter the venture capital fund (VCF) performs due diligence of the proposal satisfying themselves about the feasibility of the proposal. Once due diligence is observed to be satisfactory and VCF is assured of the feasibility of the idea, the legal documentation is done and funding process is finalised. The most preferred instruments used for funding by the venture capitalists are compulsory convertible preference shares and compulsory convertible debentures.

The various types of venture capital are classified as per their applications at various stages of a business. The three principal types of venture capital are early stage financing, expansion financing and acquisition/ buyout financing.

The main advantages of Venture Capital funding is that in addition to funding they provide a lot of wisdom and expertise to the organisation. In addition to capital, it provides guidance to make the venture successful by providing its expertise in marketing or technical assistance, managing resources as well as funds etc. On the other hand, since the VC owns an equity stake in the company leading to the founder losing his autonomy and control on the venture. Since members of the venture capital are part of the board of the company, there have been occasions where founders are forced to play a passive role and board takes the driver's seat.

The various exit options available for Venture Capital to cash out their investment are IPO, Promoter buyback, Mergers and Acquisitions and sale to other strategic investor.

Considering the high risk involved in the venture capital investments complimenting the high returns expected, one should do a thorough study of the project being considered, weighing the risk return ratio expected. One needs to do the homework both on the Venture Capital being targeted and on the business requirements.

The main difference between funding provided by VC and PE is that usually Private equity firms do control investing, where they acquire a majority stake or 100% of companies whereas VCs only acquire minority stakes. The PE firms tend to do larger deals than VC firms because they acquire higher percentages of companies and focus on bigger, more mature companies. PE firms usually acquire mature companies while VCs invest in early stage companies which have the potential to make it big quickly. Though proper due diligence is performed for all the investments made by VCs, it is expected that most of their portfolio companies will fail, but that if one company becomes the next Facebook, they can still earn great returns. PE firms can't afford to take such risks because a single failed company could doom the fund.

However, over the years the line between Private Equity and Venture Capital has thinned down. Many venture capital firms have moved up-market into growth equity and other later-stage investing and at the same time, many traditional private equity firms have moved down-market into growth equity (e.g., KKR, renowned PE firm has launched a 'Next Generation Technology Fund').

(ii) Angel Investors

Angel investors are usually individuals who may be retired entrepreneurs, industry executives or a group of industry professionals who are willing to fund the venture in return for an equity stake. Usually, the motivation behind their investment is not pure monetary considerations but also a desire to serve as mentors for the next generation of entrepreneurs. The most prominent angel investors in India are Ratan Tata, Mohandas Pai and Kunal Shah. When angels form a group to pool their resources and make bigger and better investments, they are termed as angel groups or networks. Usually, Angel investors provide funding at the seed stage, but they don't like to invest until the business owner has shown initiative by placing his or her own capital at risk.

Under the SEBI (Alternative Investment Funds) Regulations, 2012 which was subsequently amended in 2013, SEBI has made the following amendments applicable to angel funds investing in an Indian company:

"**Investment by Angel Funds** (1) Angel funds shall invest only in venture capital undertakings which: (a) have been incorporated during the preceding three years from the date of such investment; (b) have a turnover of less than twenty-five crore rupees; (c) are not promoted or sponsored by or related to an industrial group whose group turnover exceeds three hundred crore rupees; and (d) are not companies with family connection with any of the angel investors who are investing in the company

(2) Investment by an angel fund in any venture capital undertaking shall not be less than fifty lakh rupees and shall not exceed five crore rupees.

(3) Investment by an angel fund in the venture capital undertaking shall be locked-in for a period of three years.
(4) Angel funds shall not invest in associates.
(5) Angel funds shall not invest more than twenty-five per cent of the total investments under all its schemes in one venture capital undertaking: Provided that the compliance to this sub-regulation shall be ensured by the Angel Fund at the end of its tenure."
2. SOURCE: The Gazette of India Extraordinary Part– III – Section 4 Published by Authority New Delhi, September 16, 2013 Securities and Exchange Board of India Notification Mumbai, on (Alternative Investment Funds) (Amendment) Regulations, 2013

(iii) High Net Worth Individuals

High Net-worth individuals are those who have ample financial resources to sponsor a start-up. These individuals are having their existing business and are looking for opportunities to invest into the business. They mainly invest in those businesses which are having the highest calibre level to sustain in the market and generate good revenue streams in short span of time. The first advantage of this type of funding is that the new entrepreneur can design a custom investment based on the funds needed for the business. Also, the high net-worth individuals charge lower fees.

(iv) Initial Public Offering (IPO)

Once the start-ups achieve stable operations and revenue flows, it may consider IPO as an option to raise funds or increase the magnitude of the business operations. During the IPO, the company raises funds by offering and issuing equity shares to the public. An IPO allows a company to tap a wide pool of stock market investors to provide it with large volumes of capital for future growth. The existing shareholding will get diluted as a proportion of the company's shares. However, existing capital investment will make the existing shareholdings more valuable in absolute terms. Companies can also issue Global Depository Receipts (GDRs) to raise funds from international stock investors. The promoter has certain obligations such as (a) meeting minimum contribution requirements; and (b) is generally subject to a 3 year lock-in once the IPO is concluded. Various stakeholders such as investment bankers, underwriters and lawyers need to be engaged as part of procedure of IPO.

B. Debt Financing:

(i) Loan from Banks & NBFCs

Loans from banks and NBFCs help finance the purchase of inventory and equipment, besides securing operating capital and funds for expansion. More importantly, unlike a VC or angels, which have an equity stake, banks do not seek ownership in your venture. However, there are several drawbacks of such funding option. The entrepreneur pay interest on loan and that too on time. They require substantial collateral and a good track record, besides the fulfilment of other terms and conditions and a lot of documentation. There is no flexibility in this form of funding where repayment of the loan has to compulsory made as per schedule or else the loan is termed as Non-performing asset (NPA) and may invite attachment of the assets which have been provided as collateral and even blacklisting for further funding by banks.

(ii) External Commercial Borrowings

External Commercial Borrowings (ECB) in form of bank loans, buyers' credit, suppliers' credit, securitized instruments (e.g. non-convertible, optionally convertible or partially convertible preference shares, floating rate notes and fixed rate bonds) can also be availed from non-resident lenders to fund the business requirement of a company. ECB can be accessed under two routes, viz., (i) Automatic Route; and (ii) Approval Route depending upon the category of eligible borrower and recognized lender, amount of ECB availed, average maturity period and other applicable factor.

ECB raised has also certain end use restrictions such as that it cannot be used for (a) on lending or investment in capital market; (b) acquiring a company in India; (c) real estate sector etc. Under ECB also the borrower needs to create certain charge on immovable assets, movable assets, financial securities and issue of corporate and / or personal guarantees in favour of overseas lender / security trustee, to secure the ECB raised by the borrower, subject to compliance of certain conditions as prescribed under ECB guidelines framed by Reserve Bank of India. The documentation on similar lines as mentioned under bank loan section above must be executed.

(iii) Credit Guarantee Trust for Micro and Small Enterprises (CGTMSE)

The Credit Guarantee Trust for Micro and Small Enterprises (CGTMSE) scheme was launched by Ministry of Micro, Small & Medium Enterprises (MSME), Government of India to encourage entrepreneurs. Any new and existing micro and small enterprise can take the loan under the scheme from all scheduled commercial banks and specified Regional Rural Banks, National Small Industries Corporation (NSIC), North East Development Finance Corporation Ltd. (NEDFi), and Small Industrial Development Bank of India (SIDBI), which have signed an agreement with the Credit Guarantee Trust. This is discussed in detail under Unit 1.5 Government Initiatives for start-ups in India.

C. Unconventional Modes of Financing:

(i) Crowd Funding

This is recent phenomena being practiced for providing seed funding through small amounts collected from a large number of people (crowd), usually through the Internet. There are companies which specialize in providing ‘Crowd Funding’. The entrepreneur can get money for his venture by showcasing his idea before a large group of people and convince people of its success probability.

There are some websites where entrepreneur needs to put up on his profile and presentation, which should include the business idea, its impact, rewards and returns for the investors. It should be supported by suitable images and videos of the project.

(ii) Incubators: These set-ups precede the seed funding stage and help the entrepreneur develop a business idea or make a prototype by providing resources and services in exchange for an equity stake ranging from 2-10%. Incubators offer office space, administrative support, legal compliances, management training, mentoring and access to industry experts as well as to funding through angel investors or VCs. These are usually government-supported institutes like the IIMs or IITs, technical institutes or private business incubators run by industry veterans or companies. The incubation period may be 2-3 years and admission is rigorous. Some of the top options in India include IIM-Bangalore NSRCEL. It is IIM Bangalore’s flagship business incubator that is a non-profit institution purely focused on aiding creators and funding start-ups in their journey. Microsoft Accelerator and IIT-Kanpur SIIC. It is Start-up Incubation Innovation

Centre of IIT Kanpur and IIT Delhi amongst others. The Government of India has initiated a move to provide a range of benefits to start-ups originating in India so as to encourage people to become job providers rather than job seekers.

(iii) Government Initiatives for start-ups in India

The government is also providing incentives for the start-ups and to promote them. Government has launched many programmes such as the Bank of Ideas and Innovations to support the new product ideas besides providing funding from a dedicated corpus of Rs. 10,000 crores. There are also government programs wherein one does not require any collateral security against the loan borrowed for a start-up under the name of Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE). The government also started with MUDRA with an amount of Rs. 20,000 crores to sanction loans to start-up once it clears the laid out criteria. There are also institutions who take lower interest rates as compared to the market. The awareness is a parameter if one is applying for loan through the government programs.

- **Start-up India**

Launched on 16th January, 2016, the Start-up India Initiative has rolled out several programs with the objective of supporting entrepreneurs, building a robust start-up ecosystem and transforming India into a country of job creators instead of job seekers. These programs are managed by a dedicated Start-up India Team, which reports to the Department for Industrial Policy and Promotion (DPIIT). Under the Start-up India initiative, eligible companies can get recognised as Start-ups by DPIIT, in order to access a host of tax benefits, easier compliance, IPR fast-tracking & more. Over 96,000 start-ups are registered with the Department for Promotion of Industry and Internal Trade (DPIIT) till March 2023. The turnover of the entity for any of the financial years since incorporation/ registration has not exceeded one hundred crore rupees is the eligibility criteria among many.

- **Atal Innovation Mission**

In the budget session of 2016, the Indian government announced the Atal Innovation Mission (AIM) is a flagship initiative set up by the NITI Aayog. The name coming from Atal Bihari Vajpayee, the former Prime Minister of India. Atal Innovation Mission was established to create a promotional platform involving academicians and draw upon national and international experiences to foster a culture of innovation, research, and development. The government allocated around INR 150 crores in the year 2015 under AIM. AIM's goals include building 10,000 Atal Tinkering Labs (ATLs) and 101 Atal Incubation Centres (AICs), as well as sponsoring 200 businesses through the Atal New India Challenges until March 2023. The eligibility criteria for Academic Applicants is that the universities and colleges should be affiliated with UGC and with AICTE for Technical Diploma Colleges and it is. And for Non-Academic Applicants, it should be from organisations promoting science and technology.

- **Stand-Up India Scheme**

Stand-Up India was launched by the government of India on 5 April 2016 for financing SC/ST and/or women entrepreneurs. According to the scheme, bank loans between 10 lakhs to 1 crore can be borrowed by at least one Scheduled Cast (SC) or Scheduled Tribe (ST) borrower and at least one woman per bank brand to set up a greenfield enterprise. The Greenfield enterprise may be based out of manufacturing, services or the trading sector. In the case of non-individual enterprises, it is mandatory that an SC/ST or a woman entrepreneur holds at least 51% of the shareholding and controlling stakes. Achievements (as on March 21, 2023) Rs. 40,710 crore has been sanctioned under Stand-Up India Scheme to 180,636 accounts and 33,152 crore has been sanctioned to women under Stand-Up India Scheme. The eligibility for SC/ST and/or female entrepreneurs should be over the age of 18 among other conditions.

- **The Venture Capital Assistance (VCA) Scheme**

Small Farmer's Agri-Business Consortium (SFAC) has launched the Venture Capital Assistance (VCA) scheme for the welfare of farmer-entrepreneurs and to develop their agri-business. The scheme is approved by the banks and financial institutions regulated by the RBI. It intends to provide assistance in the form of term loans to farmers so that the latter can meet the capital requirements for their project's implementation. VCA promotes the training and nurturing of agri-entrepreneurs. The quantum of the loan will be 26% (40% for hilly regions) of the promoter's equity. The maximum amount of loan provided under this scheme will be INR 50 lakhs. For the North-East region, hill states (Uttarakhand, Jammu and Kashmir) in all these cases in any part of the country where the project is promoted by a registered farmer producer organisation, the quantum of venture capital are lower than 40% of the promoter's equity, Rs. 50.00 lakhs. In March 2023 Finance Minister Sitharaman launches a fund to encourage agri start-ups, increases the credit target to 20 Lakh Crores. In addition to the VCA scheme, there are several other government schemes for start-ups in India that aim to provide financial assistance, resources, and support to budding entrepreneurs. The scheme is for small farmers, Self Help Groups, Agripreneurs, Units in Agri export zones etc.

- **Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE)**

The Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) was set up by the government of India and had been put into effect from 1st January 2000 onwards to provide business loans to micro-level businesses, small-scale industries, and start-ups with zero collateral. It allows businesses to avail of loans at highly subsidized interest rates without requiring security. By working along with Small Industries Development Bank of India, the government provides a maximum amount of up to INR 100 lakhs under this scheme for boosting new enterprises as well as rehabilitating the existing ones. Primarily meant for manufacturing units, this loan can be availed in the form of working capital or a term loan. On March 30, 2023, the Credit Guarantee Fund Trust for Micro and Small Businesses (CGTMSE) corpus was injected with a value of Rs. 8,000 crores. The CGTMSE has announced recommendations for lowering the annual guarantee cost for loans up to Rs. 1 crore from a maximum of 2% per year to as low as 0.37% per year.

- **Start-up India Seed Fund**

On 16 January 2021, Prime Minister Narendra Modi announced the launch of the 'Start-up India Seed Fund' to help start-ups and support ideas from aspiring entrepreneurs. PM Modi said that the government is taking important measures to ensure that start-ups in India do not face any capital shortage. The Seed Fund will be disbursed to eligible start-ups through eligible incubators across India. An Experts Advisory Committee (EAC) has been constituted by Department for Promotion of Industry and Internal Trade (DPIIT), which will be responsible for the overall execution and monitoring of the Start-up India Seed Fund Scheme.

- **Coir Udyami Yojana**

It is another subsidy scheme launched by the government of India. It is offered for setting up of coir units with project cost up to Rs. 10 Lakhs plus one cycle of working capital, which shall not exceed 25% of the project cost. Any individuals, Self-Help Groups, Non-Governmental Organisations, institutions registered under Societies Registration Act 1860, Production Co-operative Societies, Joint Liabilities Group, and charitable trusts can apply for the scheme.

- **Udyogini Scheme**

Udyogini Scheme or Udyogini Yojana was implemented by the Women Development Corporation under the Government of India. The scheme aims at the welfare and development of Indian women entrepreneurs. It provides financial support to women for start-ups and existing businesses, thereby motivating entrepreneurship amongst poor women. Several banks offer this scheme to aspiring women entrepreneurs. The loan is offered at a competitive interest rate without any processing fee. Depending on the case, a loan is offered at a discounted interest rate or even without interest. The women entrepreneurs do not have to provide any collateral or guarantor. Only women entrepreneurs with an annual income of less than 1.5 Lakhs can apply for the scheme. However, there is no income limit for widowed or disabled women. The maximum loan amount that can be availed under the scheme is Rs 3 Lakhs, and the repayment tenure is typically 6 to 7 years. Apart from offering financial support, the scheme also offers skill development training programs for women.

Conclusion

The Government of India has been constantly motivating new entrepreneurs by introducing several credit schemes that can be availed easily at an affordable cost. If you are planning to avail of any of the schemes discussed above, make sure you prepare a detailed business plan with a summary of potential growth and financial returns expected. Submitting a clear plan with your application will create a strong impression and help you raise maximum funds for the venture.

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