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Start Up Financing in India – Avenues and Challenges

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ABSTRACT:

Sustainable entrepreneurship has enormous potential and is quickly becoming a key instrument for bringing about positive, long-term change through sustainability-oriented innovation. However, sustainability-oriented start-ups confront a number of unique issues that are not only connected to the creation of a new enterprise, but also to sustainability-related difficulties that necessitate the need for additional resources. Support for such endeavours Start-up accelerators is regarded as one of the most crucial support mechanisms for fledgling businesses. Creative initiatives, including start-ups focused on sustainability. Government through its flagship Startup India Project (w.e.f 2016) has been working to provide a favourable environment to encourage entrepreneurship and ignite the economic growth. It is also working to build an infrastructure for value added e-governance, investments and innovation via higher education. According to research, the development of the startup environment has mostly been concentrated in big cities. (Tier 1) cities and states having significant financial resources, particularly in IT-enabled industries such as ecommerce, transportation, and banking. Small firms outside of metro areas are not fully aware of, or incorporated into, programmes that give different government incentives and tax benefits to entrepreneurs. Inspite of all these, many of the startups face bottlenecks predominantly due to the unstructured and fragmented character of the market, lack of clarity on governmental initiatives and support and lack of infrastructure. Increasing awareness of government efforts and incentives, loan distribution to key industries, boosting outreach and network advantages and simplifying financing and tax concessions for international and domestic investors might all help startups in India.

INTRODUCTION

Startup is the most commonly used phrase in today's world. It has a significant influence on the country's economy. People with unique ideas are launching their businesses with limited resources. While starting a new business, skills are the only way to keep our economy strong. Entrepreneurs want assistance. These assistances are further subdivided into three categories: technical assistance, financial assistance, and managerial assistance. Institutions like as MPFC, SIDBI, and MSME are available to assist entrepreneurs, as are private investors such as Angle Investors and Venture Capitalists. On January 26, 2015, India's Hon'ble Prime Minister Shri Narendra Modi launched "Standup India-Startup India." Through this programme, the Government of India hopes to encourage entrepreneurs to form startups and to assist existing businesses.

Finance for entrepreneurial startups represents a shift in today's creative and imaginative minds. Although most meanings of the term "startup" are similar to what the US Small Business Administration defines as "a business that is often technology oriented and has strong growth potential."

Definition Of Startup

Features of a "startup" include its age, scope of its activity, and method of capital. It is often referred to a fledgling company that is just a few years old and has yet to launch a steady income stream. Such small-scale businesses, usually with a workable model or a paid pilot, but they have the capacity to grow and expand fast. In the initial stage of their business, they took help from friends and relatives, and they seek further funding aggressively in order to continue and expand as a firm.

The Startup India creativity of the Government of India defines a "startup" as a firm:

1. Based in India, having a history of no more than 10 years after incorporation or registration.
2. Having an annual revenue of less than INR 1 billion.

The Department of Industrial Planning and Promotion is in charge of the scheme's execution (DIPP). According to DIPP, a startup is one that is innovative and includes technology such as a website, mobile application, and so on. The goal of this project is to adopt an action plan based on three key pillars to provide financing assistance, simplify the process, and establish Academic-Industry Partnerships such as Incubation. Startup India Hub gives managerial and financial help to startups, whilst incubation centers provide technological and managerial support. For financial assistance, a corpus fund of Rs. 10,000 crores has been established. Capital gains tax exemption is waived for the first three years of operation.

Financial institutions assist entrepreneurs in overcoming financial obstacles and pursuing entrepreneurial goals. A better understanding of entrepreneurship and its drivers is critical to our economy's continued growth. Only by reading about new ventures and their founders can we learn about the motivation to start a business and the entrepreneurial process, as well as the funding of these ventures, the challenges that entrepreneurs face, and the policies and institutions that encourage better entrepreneurial activity.

This research is a descriptive study that will shed light on the Indian governments and private entities' financial policies that new entrepreneurs can utilise to establish their startup or firm, as well as impediments for both entrepreneurs and the government to construct a successful startup.

REVIEW OF LITERATURE

1. It is commonly acknowledged that appropriate finance is a critical component of any success.

Start up financing plays a vital role for a business to grow rapidly, to capitalize on physical and human capital, enabling new products and services and entering into global markets. (Dobbs & Hamilton, 2007) For funding, the high growth small and medium enterprises depend on debt _based financing more in comparison to equity financing. (Brown & Lee, 2019)

2. The theory of bank loan demand says that the start ups with highest quality possibly obtain bank business debt finance. (Cole & Sokolyk, 2018; Diamond, 1991). (Berger & Udell, 1998) Thus self-chosen new ventures choose to derive business bank loans from knowledgeable banks for establishing their credit history, indicate their significance and create reputations. (Cole & Sokolyk, 2016; Milde & Riley, 1988) Meanwhile well knowledgeable banks pick and fund only the startup firms with high quality. (Stiglitz & Weiss, 1981) Additionally, bank also observes the performance of such start ups to whom it has financed. (Robb & Robinson, 2014).

3. According to Maurya (2012), Bootstrapping and Lean Firms are complimentary approaches for developing low-burn startups by minimizing waste by maximizing current resources first before spending money on acquiring additional or external resources.

OBJECTIVES

- To Understand the Startup Scenario in India
- To study the various avenues of financing.
- To co-relate the financing options to the stages of the startup
- To Comprehend the Government initiative for startup financing
- To evaluate the challenges in startup financing

RESEARCH METHODOLOGY

The statistical data is collected completely from secondary sources such as e-reports, websites, reference books, research articles from newspapers etc.

RESULTS AND DISCUSSIONS

Startup Ecosystem

Nowadays, India has changed toward a startup-friendly culture and environment, enacting beneficial policies to combat unemployment, stimulate the young generation, and develop an entrepreneurial ecosystem capable of creating an increasing number of company chances. The Confederation of Indian Industry (CII) aspires to create a startup eco-system that assists companies through state and federal government. In comparison to other countries, finding prospects for a developing country is quite simple. Issues that develop on a daily basis necessitate solutions in which new company models emerge under affordable settings but owing to a lack of information about formal sources of funding.

The entrepreneur seeks funds from three avenues- family, friends and relatives. To improve this as a country it has to provide those circumstances in which a startup gets nourishment.

A startup ecosystem consists of an entrepreneur, a financial and technical support system, mentorship services, and an incubation centre. It also includes initiatives, government regulations, and research collaboration with universities.

The startup ecosystem dramatically emerged in India recently. In 1982, the National Science and Technology Entrepreneurship Development Board (NSTEDB) has introduced it and gradually and fortunately got so many opportunities after liberalization where IT professionals share their work with European and American counterparts who get benefited by their experience and expertise. This boasts India's confidence to trade high quality technological products easily which was a trigger point for techno startup in India.

Startup Financing in India

India startup financing Funding dependent on the age of the firm Friends and family VC/PE/Angel/Seed money Banks/VC/PE Public market/private equity in its early stages Stage of development Average A company's age (in years) 1 year with family and friends, 3 years with angle/seed funds/VC/PE, 5 years with VC/PE/Banks, and 8 years with the public market and PE.

Stages of Startup

Discovery- Locate a potentially large-scale product or service idea for a large target market. Validation -The product or service is released into the market in search of the first consumer willing to pay for it.

Maintenance Increasing profits while dealing with issues that arise as a result of the company's global expansion. Purchase or Renewal The option is to sell the startup to a large corporation or to gain massive resources that the brand will require to expand consistently.

Efficiency The entrepreneur starts to identify his company model and looks for ways to increase his client base. Scale Pushing the company's growth aggressively while increasing its capacity to nurture in a sustainable manner.

Sources of Financing

Boot Strapping: Bootstrapping means that the entrepreneur has certain earnings in the beginning, which is only likely if the start-up does not require a large investment and no financial investment is provided by third people.

Bank Loans: Loans from banks are the most conventional means to obtain financing, however owing to the complexity of the procedures and their lending criteria, which are based on the person's credit history and property. Startups are typically created by young individuals who are largely first-generation entrepreneurs; in many cases, they do not own any property, making it difficult to obtain financing.

Family and Friends: Before approaching external formal funding sources, entrepreneurs should make an attempt to obtain the initial funds from individuals who are close to them and well-known to them, such as friends and family. However, before going to larger and more powerful investors, the firm must secure seed funding. This demonstrates that the entrepreneur believes in his concept, as do his family, friends, and relations.

Seed Funds: Seed funds, also known as initial investments, assist startups in growing their businesses. Due to the quick change in technology, early financing assist new enterprises in their growth and development of their goods. Before starting any firm, entrepreneurs raise funds from friends and relatives in the initital stages. Seed funding covers all costs associated with product development, proof of concept, or market research, as well as administrative costs associated with launching a firm

Angel Investors: Business angels are investors who assist entrepreneurs in understanding their concepts. Furthermore, angels assist in sharing their knowledge, experience, and funding not just with startups but also with existing businesses that already have a set-up but are currently in financial distress. The greatest value of angels is so-called "smart funding," which involves supplying skills, expertise, and market contacts, although the most common motives for donating funds are profit, encouragement of entrepreneurship, trade activity, and creation of new worth.

Venture Capitalists: Persons, groups, corporations, or funds that invest in startups to help them grow are known as venture capitalists or risk capitalists. Venture capital investments differ from bank loans in that, following funding, Venture funds seek an equal share of ownership in the firm, whereas bank funds seek interest for a set length of time. For their investment, venture capital funds focus on high-risk, high-return initiatives. They give managerial, technical, and financial assistance to startups, as well as overseeing all managerial choices such as acquiring raw materials, negotiating with suppliers, and so on. Venture capitalists are always looking for fresh talent, as well as new and original concepts that may be turned into a business. Typically, it refers to funding a company's initial as well as growing stages of development.

Table 1: Top VC* investments in India (2019)

Company	Investors	Amount - USD Mn
Udaan	**GGV Capital, Lightspeed Ventures,Tencent, Altimeter Capital, DST Global, Others**	**586**
Ola Mobility	**Softbank Corp**	**250**
Grofers	**Tiger global, Softbank Corp, Squoia Capital, KTB Ventures**	**220**
Delhivery	**Carlyle, Fosun Group, Softbank Corp**	**413**
First Cry	**Softbank Corp**	**400**

*As of 24 December 2019, VC is defined as Seed to Series F investments in companies less than 10 years old (sinceregistration).
Note: PE investments are not included in this list. Source: Venture Intelligence.

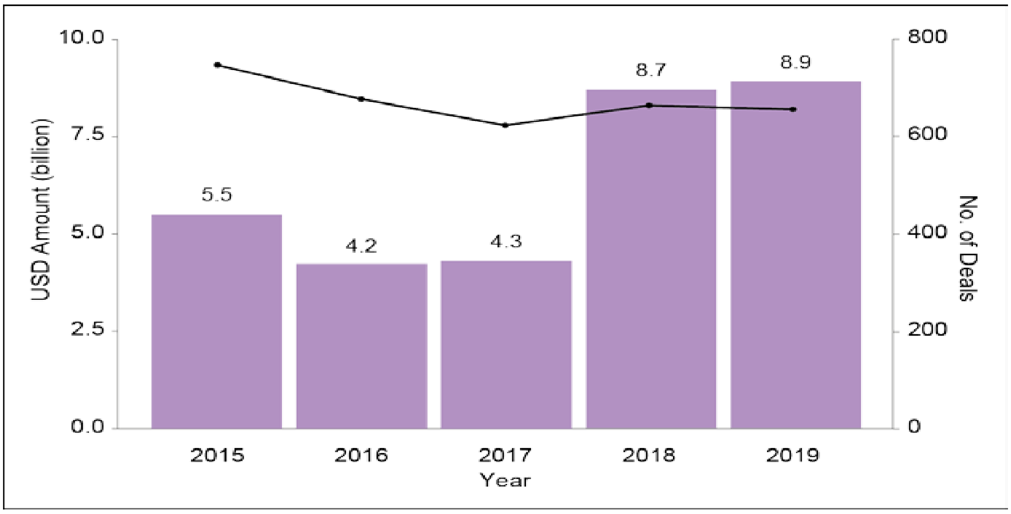
Table 2: TOP 10 VC in 2021 based on number of New fundings done

S No	VC Name	Number of Deals in 2021
1	Better	98
2	Sequoia	88
3	Accel Partners	74
4	First Cheque	72
5	Tiger Global	58
6	IOOX	51
7	314 Capital	51
8	Eight Roads	35
9	Elevation	35
10	Blume	31

Recent Developments in Investment in Indian Startups and Data Availability

Investment values surged at a compound annual growth rate (CAGR) of more than 75 percent between 2011 and 2015, while the number of transactions expanded at a CAGR of more than 80 percent. VC investments have grown rapidly since then, according to various estimates, peaking in 2019.

VC* Investments into Startups in India (2015–2019ytd)



*VC is defined as Seed to Series F investments in companies less than 10 years old.
Source: Plotted by authors based on data from Venture Intelligence | As of 24 December 2019.

Table 3: Funding Available for Startups at Each Stage of Their Development

Funding Type (Avg US$ Value in India)	**Startup Stage**	**Investor Type and Nature of Funds Raised**
Angel funding (10K-1M)	Early/idea stage: seek funding to construct a product/service prototype.	Individual/angel investors that give startups with coaching and early market access
Seed Funding (10K-1M)	Early/idea stage: test and refine the idea, which will need R&D financing (e.g., for patents)	Individual investors and venture capitalists mostly focused on initial funding to assist firms until they generate revenue.
Pre-Series A (10K -1M)	Early stage: seeking for individual-bridge round with some commercial traction.	Individual and institutional investors are connected through smaller cheques
Series A (1M-5M)		

	Early stage: has established traction and is poised to grow operations, with money used for capex, working capital, and expansion.	The first group of institutional investors will join existing individual investors, with a large contribution from the corporation's corporate venturing arm possible.
Series B (>3M)	Early stage: established with proven traction that requires scaling after establishing product-market fit	Institutional investors will lead the second round, which may include current individual investors as well as venture capital funds.
Series C, D (> 6M)	Expansion stage: established and effectively operating at scale, ready to expand through capex, organic, or acquisition growth.	Institutional investors, such as large/late-stage venture capitalists, private enterprises , hedge funds, and banks, enter and buy out early investors, often at a profit.
Series E, F, and beyond (>15M)	Growth stage: well-established and successfully operating at scale, maybe prepared for an IPO	Institutional investors, such as large/late-stage venture capital firms, private equity firms, hedge funds, and banks, fund extra expansion or raise value prior to the IPO.

In addition to Seed, VC, and PE funding, accelerators have assisted the development of the new startup ecosystem. Various throttle programmes – a type of booster sponsored by a profitable company in order to discover and evaluate new technologies and solutions by providing grants, paid pilots, or joint go-to-market options, while charging a flat fee or acquiring a 6–8% equity stake in the startups they help – have been a big trend in the last 3–5 years.

Accelerators and development programmes are available in the following forms:

• Corporate accelerator programmes sponsored by foreign firms like Google and Microsoft, as well as Indian conglomerates like Reliance and other public–private collaborations like T-Hub, T-Labs, Startup Village, and so on.•TBIs approved by the Department of Science and Technology, frequently housed in universities; college/university-based incubators in the country's top schools, such as IIMs and IITs; and industry-led incubator/accelerator programmes, such as NASSCOM 10,000 Startups.

• Private accelerator programmes, such as Axilor Ventures, Sequoia Capital's Surge, and others, led by venture capitalists
• Government-backed initiatives such as iStart Rajasthan and the Kerala Startup Mission

Ta Go Table 4: Government of India initiatives to create a conducive environment for emerging businesses and startups

Timeline	**Government Program**	**Aims and Target**
2009	Invest India	Establishment of an investment promotion and facilitation agency
2009	IndiaStack and UiD	To complement the Aadhaar – Universal Identification initiative, a digital push is being made for a cashless, paperless, consent-based scalable infrastructure.
2013	SEBI's Alternative Investment Fund	New guidelines for angel investors, who contribute early-stage capital to businesses.
2014	Make in India	The Government of India's (GoI) flagship effort aims to make the country a "global design and manufacturing" destination.
2015	Digital India	The Government of India's flagship programme focused at increasing e- government in order to promote inclusive growth and turn India into a "digitally empowered society and knowledge economy."
2015	Skill India initiative	A vocational training and certification initiative intended at providing 400 million young people with a better way of life by 2022.
2016	Startup India Initiative	The GoI's flagship programme to accelerate the startup culture and create an ecosystem for innovation and entrepreneurship.
2016	Startup India Online Portal	SIDBI FFS supported 367,171 registered startups, 26,374 recognised startups, 221 I tax exemptions, and 264 startups (as of 31 December 2019)

2016	Atal Incubation Centres (AICs) under Atal Innovation Mission (AIM)	31 AICs have been financed with INR 1.4 billion (about $20.39 million) and INR 576.8 million ($8.12 million) has been released.
2016	SIDBI "Fund of Funds for Startups (FFS)"	A corpus of INR 100 billion (about $1.4 billion) is contributing to the Alternate Investment Funds (AIFs) for startup investments.
2016	Bharat Interface for Money (BHIM) and United Payment Interface	The National Payments Corporation created a mobile payment app based on the United Payments Interface to enable for smooth and validated payments.
2019	Technology Incubation and development of Entrepreneurs (TIDE)	MeitY-sponsored programme to encourage socially responsible tech entrepreneurship through incubators that assist ICT firms that use emerging technologies (IoT, AI, blockchain, etc.)

Source: Compiled by authors from multiple sources including DPIIT Annual Report 2018–2019, Press Information Bureau
(2020), and NITI Aayog (2016).

Challenges

Startups in India Face Difficulties

The Indian startup ecosystem is still in its early stages, and scaling hurdles include:

1.While India as a market provides a big opportunity, but the spending discretion is limited among the Indian Middle class which according to NIAE, earn only INR 2.5 Lacs per year.
2.Startup revenue predictions can be distorted owing to irregularities in the Indian market, with VCs unable to generate outsized returns on their investment, but Asian investors, particularly Chinese and Japanese investors, remain bullish on India.
3.Higher rates of interest in comparison to those of developed nations is one of the bottle necks for rapid growth. Given the fact that the investment sizes are substantially smaller when compared to those done in foreign countries or the Silicon Valley, financing is still a problem for an emerging market like India.
4.The taxation structure adds to the woes on profitability though in recent years the taxation has been brought down from 33% to 22% and then to 14% in 2019. In addition to this the regulatory procedures for the startups to qualify for government incentives are too lengthy as a process and also gets rejected where the revenues cross INR 1 billion

5.Occasional Failure is a part and parcel of this entire startup ecosystem where globally the success rate is lower than 5%. In such a scenario, in other countries, the incubators and accelerators have proven effective by their guidance coupled with the simplified procedures from the government on incorporation, bankruptcy, other legal requirements and so on. India can as well look into this.
6.Most of the Indian Start ups fail on the ground of lack of basic global market intelligence and knowledge about the potential for its product or service. This is due to the acceptability challenges faced by the Indian startups in global market with an exception of Software services.

7.Patents sometimes hold the all-important key to success and India definitely lags way behind in this aspect behind countries like Japan and Korea. It has been almost a proven fact that lack of innovation leads to a most definite failure.
8.Insufficient trained labour, lack of formal mentoring and shortage of supply of specialized research manpower (PhD qualified) affect the prospects of the startup ecosystem.

CONCLUSION

Through reverse brain-drain, the government must now prioritize nurturing top-tier technological talent and global business capabilities, as well as to aggressively promote start ups in India. Extensive investment in R&D is required, benchmarking the same with what other nations do along with creating a network and liaison among businesses, academic institutions, entrepreneurs and the government. In terms of global innovation, India punches above its weight, but much more can be done to strengthen human resource, investments in infrastructure for professional courses, working and educating on intellectual property rights etc. Startups in India will also require assistance for entrepreneurs and inventors who are often just concerned with generating their own products and services and lack the experience and competence to expand via improved book keeping, marketing, and sales.

Empirical findings demonstrate that there is a direct correlation between financing avenues and start investments which suggest that credit from banks and other non banking financial companies and the process of enabling the companies to participate in government plans is critical to success.

The government would also need to develop exemptions or provide relief for startups when implementing macroeconomic policies such as demonetization and the implementation of GST, as well as specific legislation such as the "Angel Tax" and the benefits of the Insolvency and Bankruptcy Code. The government is presently using outreach activities to boost awareness of its projects, but it is critical to continue pushing innovation outside of Tier 1 cities. The contemporary technological know-how and venture capital process place a premium on number above quality, focusing on "unicorns" that disrupt and expand based on consumer demand. They tend to put shareholder profit ahead of shared wealth and rapid exits ahead of long-term development, necessitating alternative funding options. In order for first-time entrepreneurs to move beyond the currently dominant and popular verticals of e-commerce, Fin-Tech, edu-tech, and mobility and into the "third sector," which includes industries like media, education, healthcare, governance, sanitation, and alternate/clean energy, additional support will be required.

With the current technology, more data for analysis can be made available to analyse the success and failures of potential startups and other difficulties faced in establishing the same. A database can be developed in line with what Japan has done where it has accumulated SME data for 20 years which help their analysts to research on the SME characteristics. This will aid in financing the right and potentially successful startups.

It is also high time for the government to look into creating a bare minimal entry barrier to heavily funded foreign competition to enable a global start up to be created in India. While it will not be easy considering the liberalization policy, the government should look at means and ways to circumvent and create a conducive level playing field.

However, many of these ambitious businesses lack the vision and know-how required for global development, necessitating regulations to encourage their internationalisation. Singapore established International Enterprise; a government body formed to assist these enterprises in establishing a global footprint. Indian companies must go beyond just imitating successful global concepts and adapt them to the native setting, as well as create meta-level firms that solve fundamental challenges that can be scaled internationally.

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