Comparative Study of Sources of Finance for Startups in Metro Cities

Sheetal Kalbande
Department of Business Management, Viday Vikas Arts, Commerce & Science College,RTMNU, Nagpur(MS.),India
E-mail: shitu205@gmail.com

Rajvilas Karmore
Professor, Business Management Viday Vikas Arts, Commerce & Science College, RTMNU, Nagpur(MS.),India
E-mail: rajvilaskarmore@gmail.com

ABSTRACT

For the past few years, start-ups and budding entrepreneurs can be seen as flourishing in India due to the rise of digital technologies. India is now home to the third-largest startup ecosystem in the world with an increasing number of young entrepreneurs. Highly educated graduates coming from lesser known institutions usually fall short of meeting employers' expectations, thereby being compelled to either take up jobs for which they are overqualified or being pushed into unsuccessful entrepreneurial pursuits The employability factor is inadequate to accommodate all skilled graduates; therefore, the Indian youth is motivated towards self-employment instead of relying on others. Rather, they start to take the initiatives to look for new challenges and innovations which encourage and promote a self-employment environment to create startup systems in India. The Indian Government initiated many new schemes by the Central and State Governments to foster and assist many innovative ideas into incubation. Due to the current pandemic, most start-ups face financial issues to grow their business. Some of them are doing the best in their business and some are struggling to find the milestones due to some problems. According to a recent study, over 94% of startups fail during the first year of operation and more than 50% of startups fail in their first 5 years out of which an estimated 38% of startups fail because they run out of cash and fail to raise new, necessary capital.

The long painstaking yet exciting journey from the idea to revenue-generating business needs a fuel named capital. This paper aims to understand the sources of finance for startup companies and identify various options available to startups for appropriate funding.

Keywords: Startups, finance, funding.

1. INTRODUCTION

Due to the startup revolutionization in India, India is now being ranked as one of the fastest-growing economies in the world. With the surge in digitisation, the Indian government has increased its focus on the technology industry. A favorable regulatory environment, coupled with strategic government initiatives such as Digital India, Make in India, and Production Linked Incentive (PLI) schemes, has paved the way for unprecedented growth. As investments play a crucial role in the economic development of any nation, there is a need to analyze the behavior of investors in start-up companies. Unfortunately, maintaining this enthusiasm and momentum is challenging – especially if you don't have access to funding. Finding sources of finance can be tricky and, at times, elusive. After all, traditional business loans require at least a year in business (or more). Start-up companies need proper guidance for handling the investment for their profit. The surge in the number of folios was an encouraging sign as many investors, irrespective of their age, saw the potential of growing and creating wealth through equities. The government also needs to plan the design of investment policies to sustain its business. This investment may help them to decide whether to increase their profit or use it to improve their business.

1.1 Startups/start-up

A start-up is an entrepreneurial venture which is usually a newly emerged, fast-growing business that aims to satisfy a marketplace need by developing a viable business model around an innovative product, service, process or platform. A start-up is typically a corporation designed to effectively develop and validate a scalable business model. Start-up companies can be of varied forms and sizes. Some of the crucial steps in the initial stages of a start-up are to build a co-founder team to secure key skills, know how to manage financial resources and other elements, and conduct research on the target market to analyze the needs and gaps present in the market. Typically, a start-up will begin by building a primary minimum viable product (MVP), a prototype, to validate, assess and develop new ideas or business concepts. Start-up investing is the act of making an investment in an early-stage company (the start-up company). Beyond founders' own contributions, some start-ups raise additional investment at some or several stages of their growth. However, not all start-ups trying to raise investments are successful in their fundraising.

1.2 Business plans for Start-ups Company

a business plan conveys your business goals, the strategies you'll use to meet them, the potential issues that you may face and ways to solve them, the organizational structure of your business (including titles and responsibilities), and finally, the amount of capital required to keep it going. **Financial section** that contains income and cash flow statement, balance sheet and other financial ratios, such as break-even analysis.

The start-ups can work out their investment plans based on the profit earned. At the subsequent stages of their growth, the start-ups can initiate fundraising rounds beyond their founders' own contributions. Various factors, including market size, company potential, current revenues, and management determine valuations of these startups. Depending upon the style of revenue generation or revenue sharing the ownership of the company can invest their profit into different savings or ROI plans. Start-up companies need to check for untested business models with a high degree of uncertainty. Different types of people involved in start-ups are Incubators, Accelerators, and TBEDs. The Indian government aims to build an ecosystem that promotes entrepreneurship at the start-up level and has taken a number of initiatives to ensure that start-up businesses get appropriate support. Different start-ups have different affecting parameters such as Mentorship/Guidance, Market structure, Consumer behavior, and Location. Despite having raised good investments, start-ups struggle to survive the competition. Effective cash management is an important factor to achieve objectives both short term and long term.

1.3 Cash flow and different plans of saving or investment

A small business needs the proper flow of cash management. But many think of speedy scalability with an increase in profit as the main objective. Before analyzing the different types of positive and negative cash flows from investing activities, it's important to review where a company's investment activity falls within its financial statements. Revenue generation is a vital entity for any start-up because usually, it takes more time for sales and towards initial setup years. Forecasting plays an important role in better financial control. The monthly forecasts act as a budget for general, administrative, and sales expenses and help to assess the effect of quarterly tax payments on cash flow.

Cash flow is often utilized using different saving schemes like Fixed deposit, ELSS, Shares, Venture Capitalists or mutual funds. Cash flow gives two options: savings and investments. Fixed deposits help for keeping the cash within the account with the security to withdraw at any moment of your time. Investors are advised to consult their tax mentors in sight of the individual nature of tax benefits. Experts suggest that the simplest way to save taxes is by investing in Equity Linked Savings Schemes (ELSSs). But don't think that just putting the specified amount in an ELSS fund assures your well-being. Mutual funds channel the investments of retail investors into the stock exchange while mitigating the danger. Venture Capitalists create a fund using other people’s money.

1.4 Startups company from metro cities

Metro cities are most entitled to investing in different investment or saving schemes due to the fluctuation of money. Tier II and III cities now offer improved infrastructure at lower costs compared to Tier I cities. The remote-first approach along with the rise of managed office and co-working spaces have led to the mushrooming of startups in sectors such as healthcare, agritech, socialtech, and ruraltech. Most startup companies handle their service from urban/two-tier cities. Cities like Mumbai and Nagpur are metropolitan cities with all the facilities for handling money transactions. Most founders believe that they need to migrate from a Tier 2/3 city to a Tier 1 city to effectively raise funds. Different saving or investment schemes for startup companies may help to make decisions for taking risks or for getting benefits. A startup company requires guidance to handle their income to use in the downstream situation. Similarly, this money can be helpful for them to invest in increasing their business. As a growth-seeking investor, it is required to achieve a good overall return on investment while avoiding the most speculative areas of the market.

Today most of the incubators are built up with financial support from various grants by Govt. of India. Many states are having incubators ready at their educational premises. These incubators provide mentoring, financial support and administrative support to many small ranges to medium-range start-ups. They may support their investment with various financial resources.

2. REVIEW OF LITERATURE

The review of related literature is carried out to investigate the past efforts taken within the subject of choice. Furthermore, to know the methodologies adopted to perform the studies and to find out the research gap. The review of the literature is as follows-

According to Aidin and Kesim (2015) start-ups are newly born companies struggling for their existence. They came up with brilliant ideas and put the effort in growing.

Suominen et al., (2017) address whether software start-ups differ if the company has early-stage investments and what's this relationship with the company being active later [6]. They have carried out a survey of over 1,000 Finnish companies founded during 2010–2013 and the results show that investment companies are different from non-invested companies, but revenues are higher for the latter.

Bertoni et al., (2015) study the investment patterns of various sorts of investments. that covers 1663 first VC investments made by 846 investors in 737 young high-tech entrepreneurial ventures in seven European countries. Study findings indicate that in terms of investment patterns, governmental VC investors appear to be the most distinct sort of VC investor.

Innovation within the biotechnology sector depends on the expensive infrastructure universities or large pharmaceutical companies provide. Grohn et al., (2015) examine the biotechnology start-up and review strategies that the founding team has successfully employed to determine a reasonable laboratory and reduce research expenses. Corporate structuring strategies to scale back risk and give stability are also discussed.

Fleming (2015) described that several recent trends in early-stage venture capital funding are influenced by regulatory and reimbursement policies. Policymakers can foster renewed private investment into critically needed early-stage products by increasing Small Business Innovation Research (SBIR) funding and public support for clinical trials in targeted areas of interest; creating regulatory pathways to enable early testing of experimental compounds in limited populations, and offering economic incentives for investors and developers in designated therapeutic areas.

According to Rosenberg and Marron (2015) the tax system requires varying tax rates on investments in several activities, favors debt over equity and favors pass-throughs over corporations. Targeted tax incentives can lower the price of capital for small businesses, start-ups, and people that invest in intellectual property.

In developing countries, Women entrepreneurs can make a big impact on economic and social development globally. But the challenges entrepreneurial women face are unique and multiple, pressing the necessity for research and policies to maximize impact. Kuschel et al., (2017) discussed the challenges women start-up founders face to secure funding within the technology industry. There are two factors that affect women entrepreneurs in raising capital and in facing the subsequent challenges: first, working in a non-traditional field for women, because it is the technology industry, and second assuming a leadership role as start-up founders. The findings show that women entrepreneurs, but also men, seeking start-up financing and alternatives are a viable source of employment and economic sustainability.

The research paper focuses on the problem faced by software start-ups during their early progress phases. The problems were intended to be judged on the assumption that the lack of software quality assurance practices is the reason for several hurdles in the way to the progress of the start-ups with limited sources, rush to the market, and other subjective situations (Saadullah Aleem et al.,2021).

The research offers the chance to start dispatching the role of curriculum and business incubator, which should not only be limited to its incubation phase but also pre and post-incubation (Tri Anggoro Wiradinata et al.,2019).

The research results show that business skills, entrepreneurial environment, and individual norms either directly or indirectly affect the business motivation and entrepreneurial intention of university students. Thus, it is suggested that universities and other educational institutions should provide more activities and teach courses that help scholars acquire the information and skills necessary for entrepreneurship (Do Thi Minh Hue et al.,2022).

3. RESEARCH PERSPECTIVE

From the research point of view, such a study will help in developing and expanding knowledge of investment in urban cities. This behavioral analysis will help the government of Maharashtra to develop new plans specifically designed for startup companies for their income investment plans.

In order to examine the issues raised above, the following will be the objectives of the study:

a. To study the influencing factors for investment policies for startups

b. To identify and relate information or knowledge used by start-ups to select investment policies.

c. To perform statistical analysis on behavioral features to select appropriate investment policies by start-ups in metro cities

Apart from deciding the precise entity for registering your startup and going through the unwieldy procedure of following the numerous regulatory compliances, getting your startup sponsored is a key aspect that needs noteworthy time and effort. Since the mid-2000s, start-ups have progressively become the powerful force of new jobs and development engines for advanced countries, and developing nations are endeavoring to vitalize start-ups through active government support policies. However, approximately 30% of start-ups shut down within a few years of their foundation. Accordingly, this study determines the factors affecting a selection of appropriate investment policies of start-ups as based on available government support and provides suggestions to increase the effectiveness of government-supported projects. This study conducted a survey of around 75 start-ups in Mumbai and Nagpur and empirically analyzed the best suitable investment policies for start-ups. Start-ups choose the following options: Friends and Family, Banks and Government Agencies, Angel Investors and Networks, Accelerator Incubators, and Venture Capital Firms for the funding.

3.1 Research methodology

The research methodology includes the research design and the specific procedures used in conducting the study. This includes information regarding research design, sample selection, research instrument and its development, data collection method, and methods of data analysis.

The following are the methods used for performing research:

a. Research Design: Research revolves around startup companies; hence the literature survey focuses on the business policies of startup companies. Hence descriptive research design will be used in study because it will help to cover all the aspects included in the title and objectives of the study. In addition to this, survey methodology will be used to collect the data.

b. Sample: This study attempts to study the behavioral pattern of start-ups towards important investment avenues. Therefore, it would be conducted over an extended period having both ups and downs in the environment of the market with a sample size of 75 from the urban city Mumbai (50) and Nagpur (25) only.

c. Snowball sampling Method: Snowball sampling (or chain sampling, chain-referral sampling, referral sampling) is a nonprobability sampling technique where existing study subjects recruit future subjects from among their acquaintances. It doesn't have the probability involved, with say, simple random sampling. Snowball sampling consists of two steps as specified:

    1. Identify potential subjects in the population. Often, only one or two subjects can be found initially.
    2. Ask those subjects to recruit other people (and then ask those people to recruit. Participants should be made aware that they do not have to provide any other names.

d. Data Collection: The study is a blend of both primary and secondary data. Secondary data will be collected from web sites of respective investment schemes. The primary data required for the study will be collected using a detailed interview schedule/questionnaire from investors respectively.

Data analysis & interpretation: Data analysis will be done using various software such as MS Excel, SPSS etc The collected data will be analyzed by using various statistical techniques which include Percentage Method, Rank correlation, Z-test, and SWOC analysis (Strength, weakness, opportunities, and challenges)

Fundraising is a long and tiring experience everywhere and Mumbai and Nagpur are no exception.

1. Venture Capital finance is biased towards software endeavors because of larger business models, exit as well as growth opportunities. Financing in other sectors is not tracked in the same manner. From a Big investment point of view, venture capital is just an alternative investment asset class and the 'show me the money law applies. Investors want profits. Possible extra-large growth leading to 4–10x returns in 4–10 years era is what drives most investing decisions. Venture capital is 'growth financing' i.e. cash to scale and raise an already verified business that has happy paying customers. No traction means no growing money. Angel and Venture capital are two different investors with diverse dimensions and investment objectives. Timing matters. VC finance is recurrent. VCs raise capital from rich people who make money in market events.
2. Most start-ups raise money from friends and family. But the best way to get funding is to find a market where you can recapitulate ideas economically and build a customer base. Identifying the right sector is important. Once you have a substantial number of satisfied repeat customers, paying a customer base smart money will find you.
3. People with the right testimonials and connections can nurture millions based on just a vision but that will not work for the rest 95% of first-time founders. You need something far more real.
4. Investment is negotiation. Devote time to realize your needs, your opportunities and that of another side. With precise reasons, investment raising can be at all or any phase of endeavors. Each phase has its own entrance and departure benchmarks. Understand what phase your venture is and what financiers expect from that phase. We have fewer VC deals because people investing in Mumbai and Nagpur start-ups are not able to exit from their

past investments. What the ecosystem needs is exits and smart money (the founder who made big and now investing).

4. Survey Summary

During the pandemic period from June 2019 to Dec 2020, we conducted an online survey for 75 small and medium size startups in Mumbai and Nagpur. The following sections show the analysis with questions asked, responses received, and analysis.

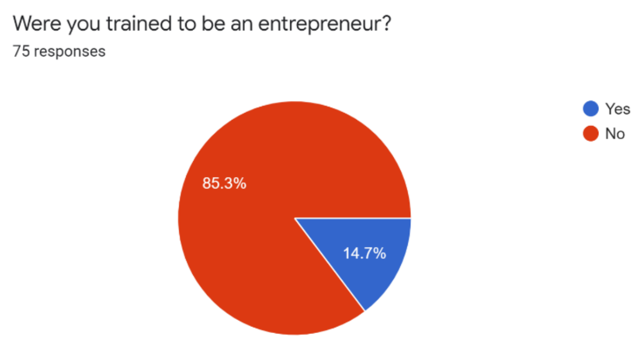

Fig. 1. Were you trained to be an entrepreneur?

1. When asked whether any training was given to be an entrepreneur, 64/75 people responded No. It depicts that there is a high chance that people might be unaware of efficient financial planning with the help of different funding available in the market.

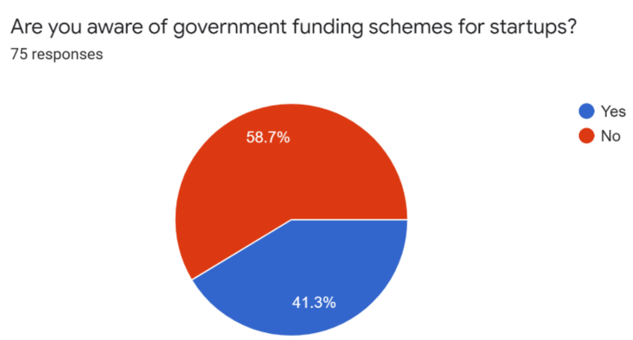

Fig. 2. Are you aware of government funding schemes for Startups?

Further, when asked about the awareness of the availability of government funding schemes for start-ups, 37 responded “No” and 26 responded “Yes”. This shows that many people are not yet fully aware of such schemes, and this calls for an efficient system to promote the existing beneficial schemes in the market, as well as to design and plan out new schemes.

Following are some of the funding schemes identified by the survey:

a. NIDHI SSS (Seed Support System)
b. STP (Software Technology Park) Scheme
c. PMMY (Pradhan Mantri MUDRA Yojana)
d. DST (Department of Science & Technology) Schemes
e. NIDHI PRAYAS (PRomoting and Accelerating Young and ASpiring technology entrepreneurs)
f. NIDHI EIR (Entrepreneur-in-Residence)
g. MSME (Ministry of Micro, Small & Medium Enterprises) Schemes
h. NSTEDB (National Science & Technology Entrepreneurship Development Board) Schemes
i. Startup India
j. MSInS (Maharashtra State Innovation Society) Schemes
k. NSIC (National Small Industries Corporation) Single Point Registration Scheme
l. CRG (Core Research Grant)
m. EMR (Extra Mural Research Funding)
n. CBI (Central Bank of India) Cent Kalyani
o. Venture Capital Scheme

2. *The problems faced by the start-ups:*

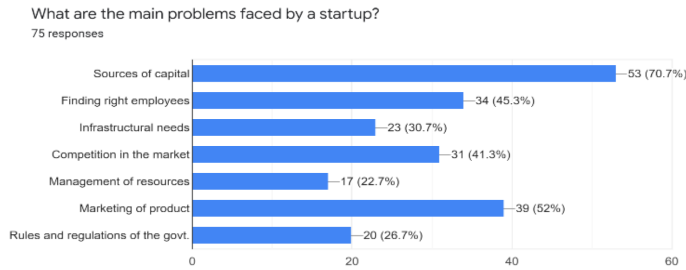

Fig. 3. What are the main problems faced by a startup?

As can be observed by the above graph, finding sources of capital accounts for the highest percentage (71%) of distribution among all the other problems faced by start-ups. Other major problems being marketing of the product (52%) and finding the right employees (45%).

3. *Distribution of the funding options selected by the start-ups:*

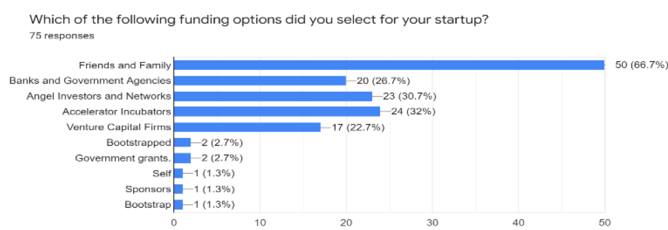

Fig. 4. Which of the following funding potions did you select for your startup?

The majority of the people (67%) consider friends and family as the funding option for the business. Following which there are other options such as banks, government agencies, angel investors and networks. It is evident that almost no or very little percent of people self-fund their businesses or are bootstrapped.

4. *Whether start-ups find funding scheme beneficial or not :*

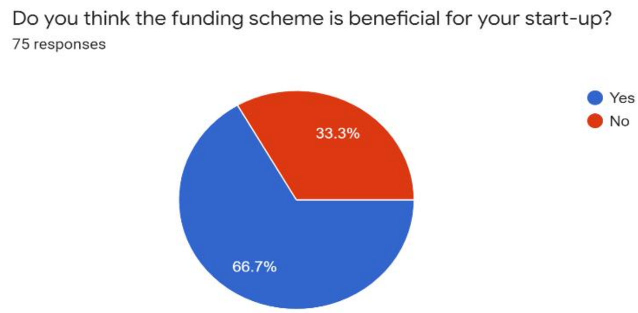

Fig. 5. Do you think the funding scheme is beneficial for your Start-up?

50/75 people finds funding scheme beneficial for their start-up for some of the following reasons:

1. It provides the capital required to prove the product and helps to raise further rounds of funding.
2. It helps boosting business
3. It helps to pay for resources and staff and file patent globally
4. It helps to raise funding
5. It enables us to fulfill our requirements and create a good team.
6. It motivates me to work harder without worrying much about financial planning.
7. It encourages expansion and development of the startup.
8. Government schemes can invest in innovative ideas which may seem too risky for retail investors
9. It gives a head start and helps to grow and compete with already existing players in the market.
10. It encourages entrepreneurs to focus on other domains like development and invest in the best resources to make it successful without worrying about finance.
11. Startups require high growth which results to a lot of cash burn, without funding it is difficult to sustain such high growth
12. It helps the company to experiment and grow.

25/75 people find it not beneficial for their start-ups for the following reasons :

1. The system is not transparent
2. A lot of criteria are required to be matched
3. Capital funding is too less
4. Majority of the schemes are sector-specific. One’s startup might not directly fulfill those criteria.
5. The scheme is available only for research carried out in academic settings
6. Has too many conditions to avail.
7. Fickle Government Guidelines

5. *Problems faced while receiving funding :*

Adequate funding allows startups to hire talented individuals, develop and refine their products or services, conduct marketing campaigns, and expand their customer base. Without sufficient capital, startups may struggle to survive or miss out on growth opportunities. Finding the right source for startup funding is complicated. Every source has its own limitations, processes, and challenges. Following challenges were most faced by startups:

i. Winning trust
ii. Requirement of immediate marketable product
iii. Selling the pitch and convincing the investors that the project will work as the market is huge and some feel that idea already exists.
iv. Explaining future scope and convincing investors that the business model is profitable
v. Tough competition in the market
vi. Need to pitch down the idea at multiple seminars and investment sessions and convince them with a full proof plan.
vii. Lack of startup experienced individuals in the incubator panel which might lead to tedious and unfair funding.
viii. Marketing product, fundraising, networking, and investor hunting, difficulty to connect with resourceful people

ix. Years of savings needed to bootstrap

x. Choosing the right source for funding and understanding the process, rules, and regulations involved in it

xi. It is difficult to gather initial funding when the product is not ready or is still in the early stages. Early days are filled with a lot of bumps and keeping investors' confidence is crucial.

xii. Venture Capital firms require a minimum revenue for funding. Revenue-based funding options have high interest. Bank loans have high interest. Most of them require 2-3 years of financial statements for funding.

xiii. Need to build a strong network based on trust and belief in the potential of your idea

xiv. Explaining risk to-return ratio to family specifically, increasing investment after every financial year, in 2020 specifically the turnover and profit margins dropped, and increasing investment in the very next financial year was hard to convince

5. Conclusion

Survey shows that most of the start-ups are self/family funded with a partial workforce who makes it tough to preserve records both financial and operational. Imperfect business models and lack of pioneering revenue strategies have led to the catastrophe of a large number of start-ups, and they are involuntary to shut down operations. Overcoming gratuitous business steps to manage business operations. Capital and access to capital have been persistent problems for start-ups. Government and private sector investors have put aside capital through venture channels but they're not accessible for all sorts of business. The leading problem for such organizations has been to fascinate investors and gain their reliance concerning their mode of operations. Within the preliminary phase of operations, start-ups don't get capital from banks given no credit history of the firm. Additionally, there's an inadequate number of credit score firms for start-ups. Despite having elevated worthy investments, start-ups struggle to continue the competition. Start-ups are unable to alleviate the gap between burn rate and income. Effective money management is a crucial skill to achieve goals both short term and long term. Both the investor and the entrepreneur are now more deliberately concentrating on innovation, money efficiency, and client/customer satisfaction, a view which is bound to impact the investment scenario henceforth (Blessy A.Varghese ,2019).

REFERENCES

[1] Bertoni, F., Colombo, M.G. & Quas, A. The patterns of venture capital investment in Europe. Small Bus Econ 45, 543–560 (2015).

[2] Blessy A.Varghese (2019) . A Study of Financing Sources for Start-up Companies in India International Journal of Engineering Science and Computing, April 2019.

[3] Do Thi Minh Hue, Tran Phuong Thao, Pham Canh Toan, Hoang Dinh Luong, Phan Thi Hao, Do Thi Huyen, Nguyen Thi Hoa, "Factors Affecting Entrepreneurial Motivation and Intention of University Students in Hanoi, Vietnam", International Journal of Modern Education and Computer Science(IJMECS), Vol.14, No.2, pp. 1-13, 2022.DOI: 10.5815/ijmecs.2022.02.01

[4] Fleming, Jonathan. (2015). The Decline Of Venture Capital Investment In Early-Stage Life Sciences Poses A Challenge To Continued Innovation. Health affairs (Project Hope). 34. 271-6. 10.1377/hlthaff.2014.1051.
forecasting for startups in India.

[5] Grohn, Kristopher & Wortel, Danique & LeClair, Nick & Traina, Alison & Zluhan, Eric & Feuer, Gerold. (2015). Lean Start-up: A Comprehensive Case Study in the Establishment of Affordable Laboratory Infrastructure. Journal of Commercial Biotechnology. 21. 10.5912/jcb698.

[6] https://foundr.com/funding-a-startup

[7] https://startupxplore.com/en/blog/startup-investors-criteria/

[8] https://theaccountancycloud.com/resources/blogs/sources-of-finance-for-a-new-start-up

[9] https://www.profitbooks.net/funding-options-to-raise-startup-capital-for-your-business/

[10] https://www.startupindia.gov.in/content/sih/en/looking_for_funding.html

[11] Kuschel, Katherina & Lepeley, Maria-Teresa & Espinosa, Fernanda & Lillo, Sebastian. (2017). Funding Challenges of Latin American Women Start-up Founders in the Technology Industry. Cross Cultural & Strategic Management. 24. 10.1108/CCSM-03-2016-0072.

[12] Marron, Donald & Rosenberg, Joseph. (2015). Tax Policy and Investment by Startups and Innovative Firms. SSRN Electronic Journal. 10.2139/ssrn.2573259.

[13] Saadullah Aleem, Waqas Mahmood, Start-up failures due to Quality Failures (2021) , I. J. Engineering and Manufacturing, 2021, 2, 1-13 Published Online April 2021 in MECS (http://www.mecs-press.org/) DOI: 10.5815/ijem.2021.02.01

[14] Salamzadeh, Aidin and Kawamorita Kesim, Hiroko, Startup Companies: Life Cycle and Challenges (2015). 4th International Conference on Employment, Education and Entrepreneurship (EEE), Belgrade, Serbia, 2015.

[15] Salamzadeh, Aidin, and Kawamorita Kesim, Hiroko, Startup Companies: Life Cycle and Challenges (2015). 4th International Conference on Employment, Education, and Entrepreneurship (EEE), Belgrade, Serbia, 2015.

[16] Trianggoro Wiradinata, Tony Antonio, The Role of Curriculum and Incubator towards New Venture Creation in Information Technology, I.J. Education and Management Engineering, 2019, 5, 39-49 Published Online September 2019 in MECS (http://www.mecs-press.net) DOI: 10.5815/ijeme.2019.05.05