R C Jain & Associates LLP
Since 1986…

Topic : Startups

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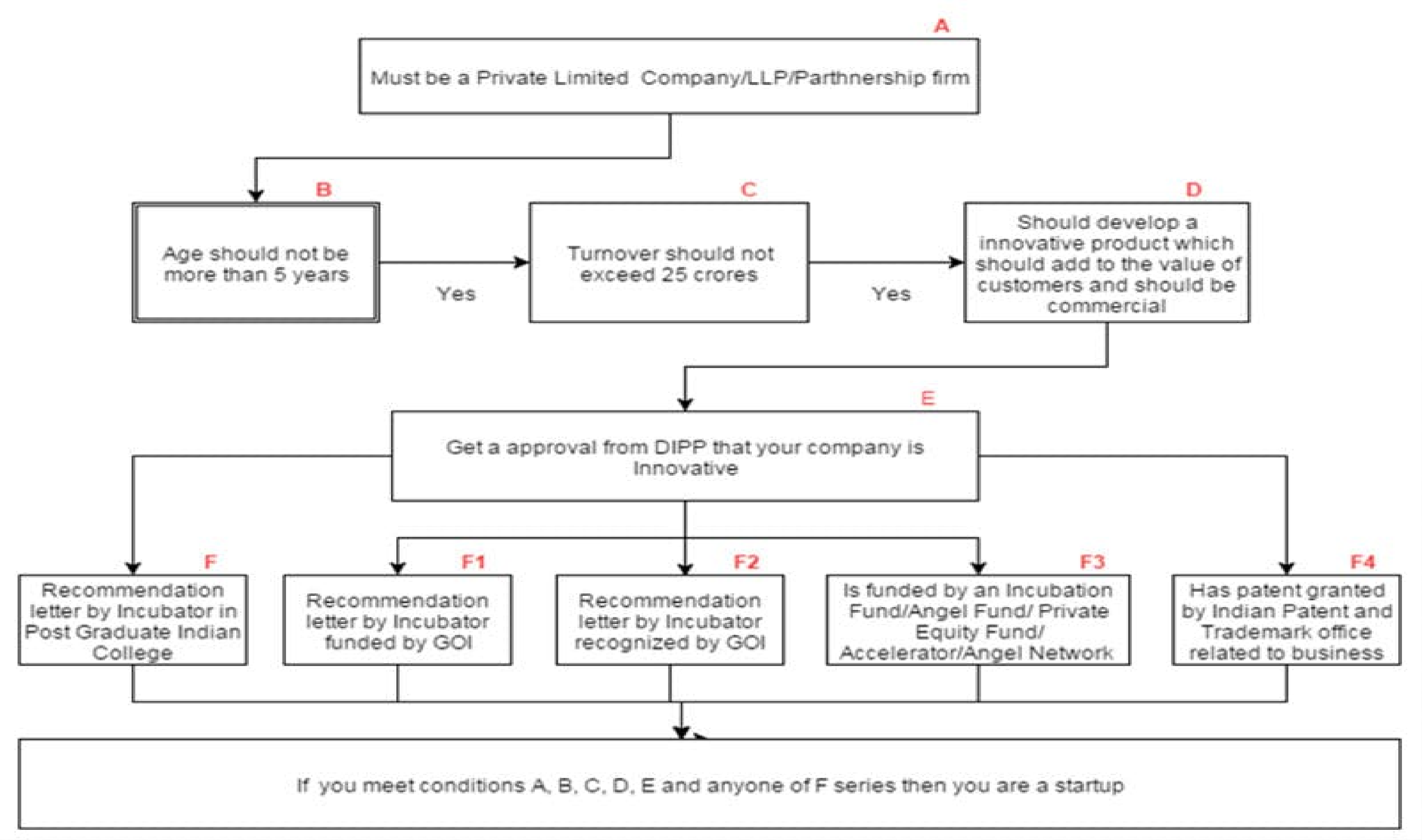
Recognition Criteria



Startup financing lifecycle

Funding by Angel investors/ Seed funds

- Early stage startups rely on angel investors and seed funding
- Invest solely into the entrepreneur with an idea

Venture capital

- Used to scale the company's business model
- Comes from larger institutional funds
- Focus is on building the sales force and establishing a global presence

Public markets

- Late stage startups can feel the need to expand more aggressively or actively innovate the product
- Private equity funds together with public markets provide large amounts of liquidity to late stage startups

Financial Issues

- Lack of sufficient working capital
- Low profit margin
- Not being ready to face sales slump due to unavoidable reasons
- Receiving late payments from clients on a regular basis
- Paying bills late on regular basis
- Too many sales promotions, coupons and markdowns
- Not choosing the right funding option
- Unorganised book keeping habits
- Not being good at cash flow management
- Improper revenue and expense projections

Modes of financing for startups

1.Bootstrapping

An individual is said to be boot strapping when he or she attempts to found and build a company from **personal finances or from the operating revenues** of the new company.

Here are some of the methods in which a startup firm can bootstrap:

- Trade credit
- Factoring
- Leasing

2. Angel Investors

- Angel investors invest in small startups or entrepreneurs. Often, angel investors are among an entrepreneur's **family and friends**. The capital angel investors provide may be a **one-time investment** to help the business propel or an ongoing injection of money to support and carry the company through its difficult early stages.
- Angel investors provide more **favorable terms** compared to other lenders, since they usually invest in the entrepreneur starting the business rather than the viability of the business. Angel investors are focused on helping startups take their first steps, rather than the possible profit they may get from the business. Essentially, angel investors are the opposite of venture capitalists.
- Angel investors who seed startups that fail during their early stages lose their investments completely. This is why professional angel investors look for opportunities for a defined exit strategy.

3.Venture Capital Funds

Venture capital is financing that investors provide to startup companies and small businesses that are believed to have **long-term growth potential**. Venture capital generally comes from well-off investors, investment banks and any other financial institutions.

Characteristics of Venture Capital Financing:

- **Long time horizon**: The fund would invest with a long time horizon in mind. Minimum period of investment would be 3 years and maximum period can be 10 years.
- **Lack of liquidity:** When VC invests, it takes into account the liquidity factor. It assumes that there would be less liquidity on the equity it gets and accordingly it would be investing in that format.
- **High Risk:** VC would not hesitate to take risk. It works on principle of high risk and high return. So, high risk would not eliminate the investment choice for a venture capital.
- **Equity Participation**: Most of the time, VC would be investing in the form of equity of a company. This would help the VC participate in the management and help the company grow. Besides, a lot of board decisions can be supervised by the VC if they participate in the equity of a company.

Stages for funding venture capital

1. **Seed Money**: Low level financing needed to prove a new idea.
2. **Start-up**: Early stage firms that need funding for expenses associated with marketing and product development.
3. **First-Round**: Early sales and manufacturing funds.
4. **Second-Round**: Working capital for early stage companies that are selling product, but not yet turning in a profit.
5. **Third Round**: Also called Mezzanine financing, this is expansion money for a newly profitable company.
6. **Fourth-Round**: Also called bridge financing, it is intended to finance the "goingpublic"process.

Financial Stage	Period(funds locked in years)	Risk Perception	Activity to be financed
Seed money	7-10	Extreme	Concept or Idea or R&D for product develpoment
Start up	5-9	Very high	Initializing operations
First Stage	3-7	High	Start Commercial marketing production
Second Stage	3-5	Sufficiently High	Expand Market & growing working capital need
Third Stage	1-3	Medium	Market Expansion
Fourth Stage	1-3	Low	Facilitating Public Issue

Tax Benefits

1)Section 80-IAC

Deduction of 100% of profit under this section shall be available to an eligible start-up for **three consecutive assessment years out of seven years** at the option of the assessee if

(a)it is incorporated on or after the 1st day of April, 2016 but before the 1st day of April, 2021 and

(b)the total turnover of its business does not exceed **twenty-five crore rupees** in any of the **7 previous years** commencing from the date of incorporation and

(c) it is engaged in the eligible business which involves innovation, development or improvement of products or processes or services, or a scalable business model with a high potential of employment generation or wealth creation.

2) **Tax exemption to Individual/HUF on investment of long-term capital gain in equity shares of Eligible Startups u/s 54GB.**

- The existing provisions u/s 54GB allows the exemption from tax on long-term capital gains on **the sale of a residential property** if such gains are invested in the small or medium enterprises as defined under the Micro, Small and Medium Enterprises Act, 2006. But now this section has been amended to include exemption on capital gains **invested in eligible start-ups also**.
- Thus, if an individual or HUF sells a residential property and invests the capital gains to **subscribe the 50% or more equity shares** of the eligible startups, then tax on long term capital will be exempt provided that such **shares are not sold or transferred within 5 years** from the date of its acquisition. The startups shall also **use the amount invested to purchase assets** and should not transfer asset purchased within 5 years from the date of its purchase.
- This exemption will boost the investment in eligible startups and will promote their growth and expansion.

3)Setoff of carry forward losses in case of Startups

The carry forward of losses in respect of eligible start-ups is allowed if **all the shareholders** of such company who held shares carrying voting power on the last day of the year in which the loss was incurred continue to hold shares on the last day of previous year in which such loss is to be carry forward.The restriction of holding of 51 per cent of voting rights u/s 79 has been relaxed in case of eligible startups.

Patent Fees Benefit

- Startups will get an **80% rebate on patent costs**. This means, that if and when a startup applies for a patent, the government will come to its aid by funding the cost of the patent. The company will thus get a rebate of 80% in the fees.

Impact of GST on Startups- Startups Stand to be Benefited by GST

1)Higher threshold for registration

As per the current VAT structure, any business with a turnover of more than Rs 5 lakh has to get VAT registration and pay VAT (different in different states). Under GST this threshold is 20 lakhs thus exempting many small businesses including startups. GST also has a scheme of lower taxes for small businesses with turnover between 20 Lakhs to 1 crore though its optional. It is called the composition scheme. This will bring down tax burdens to newly established businesses.

2)Startups can enjoy tax credit on their purchases

A lot of startups are into service industry i.e., they pay service tax. Under GST regime they can setoff the VAT paid on the purchases (say office supplies) with the service tax on their sales which they cannot under current regime.

For example-

A startup buys office supplies of 20,000 paying 5%. It charges 15% service tax on services of Rs. 50,000. Currently it has to pay 50,000*15%= 7,500 without getting any deduction of Rs. 1,000 VAT already paid on stationery.

Under GST (assuming GST= 18%)

GST on service @18%	9000
Less: GST on office Supplies(20000*18%)	3600
Net GST to Pay	5400

Successful startups in India

OLA

- Co-founded in 2010 by tech graduate Bhavish Aggarwal, Ola Cabs is the biggest online taxi and car aggregator in India today, strongly rivalling Uber.
- The transportation startup was founded in Mumbai and raised angel funds from Snapdeal co-founder Kunal Bahl and Shaadi founder Anupam Mittal. Valued at over US$5 billion now, Ola has about 250,000 cabs and auto rickshaws in its app, operational in about 85 Indian cities.

FLIPKART

- Sachin Bansal started Flipkart in 2007 from a one-room apartment in Bangalore along with his schoolmate Binny Bansal. The store started by selling books online and later expanded to categories such as apparel and electronics.
- Now valued at over US$17 billion, Flipkart is amongst the top 10 ecommerce companies in the world. Earlier an employee at Amazon India, Sachin is now amongst the wealthiest millionaires in India.

Open House Discussions


Thank you