

Start Up Funding in India: Stages & Steps

written by Pradyun Chakravarty | October 20, 2022



Are you looking for Start Up Funding in India but are confused about the process?

The process of acquiring money or investment to support a business initiative is known as start-up funding. It is the infusion of finances or a monetary investment that is made by an investor(s) into a business for scaling up the business's inventory, office space, sales, marketing, manufacturing, product development, and expansion. In 2022, even before the end of the year, there are already 20 start-ups which have achieved the most coveted unicorn status [1]. These firms had achieved such a status by collectively raising more than USD 94 billion in funding. Most frequently, such funding is acquired through banks, other financial institutions, angel investors, or venture capitalists.

The starting point for seeking funding is searching for investors. Investors will only invest in start-ups if they believe in the business idea and can foresee making a return on their investments. With the number of start-ups rapidly increasing in India, extracting funding from investors requires some aggression and passion while selling the business idea, either through a prototype or by presenting a concrete business plan.

The booming start-up ecosystem has also led to the government introducing several schemes for supporting start-ups in India such as Start-Up India, which includes provisions for government funding for start-ups in India [2]. To further elaborate on start-up funding in India, this article will deal with the following:

- Stages of start-ups and sources of funding
- Steps to seek funding for start-ups

Stages Of Start-ups And Sources Of start up funding in india

With the multitude of options for the sources of funding available for start-ups in India, it is important to determine which would suit best the needs of the start-up and match its stage of operations. Furthermore, start-ups need to keep in mind that funding from external sources is a time-consuming process. The primary stages are as follows:

Stage 1: Ideation - Pre-Seed Stage

This is the first stage where the founders are working on the idea and the fund requirement is small, with mostly information channels. The primary sources in the pre-seed stage are bootstrapping or self-financing through

savings etc., funding from family & friends, and funding from business plan/pitching events that award grants or financial benefits, etc.

Stage 2: Validation - Seed Stage

At this stage, the prototype for the start-up is ready for a big market launch. The seed stage involves exploring funding from:

- Incubators: Organizations assisting entrepreneurs.
- Government Funding: Start-up India Seed Fund, SIDBI Fund of Funds, etc.
- Angel Investors: Individuals investing money in high-potential start-ups in return for equity.
- Crowdfunding: Raising money from a large number of people, each contributing a small amount.

Stage 3: Early traction - Series A Stage

At this stage, the products or services of the start-up have been launched in the market. Series A stage involves funding by:

- Venture Capital Funds: Professionally managed funds investing in high-growth start-ups.
- Banks/NBFCs: To raise formal debt by showing market tractions and revenue to validate the ability to repay with interest.
- Venture Debt Funds: Private investment funds invest money in start-ups in the form of debt.

Stage 4: Series B, C, D & E Stage

At this stage, the start-up experiences a fast rate of market growth with increasing revenues. The funding sources at this point are venture capital funds and private equity or investment firms.

Stage 5: Exit Option

This is the final stage where the start-up is considering exit options. This can be done by way of:

- Mergers & Acquisitions: Selling the company to another company in the market, i.e., merging the companies.
- Initial Public Offering (IPO): Here, the start-up is listed on the stock market for the first time.
- Selling Shares: Shares can be sold to other venture capital or private equity firms.
- Buybacks: Founders may buy back the shares from the investors.

Steps To Start up Funding in India

A successful fundraising round requires significant effort and time and it involves several steps. Funding greatly depends on the business idea, background, and access to financing. There are a variety of factors that influence funding, which further increases the importance of following the steps outlined below.

Step 1: Assessing need

This involves the reason why the funding is required and the correct amount that needs to be raised. There must also be clear timelines for achieving the goal of the start-up, along with a financial forecast considering the projected sales data, market indicators, etc.

Step 2: Assessing investment readiness

Investors will only consider investing in a start-up in India if they are convinced by the revenue projections and the returns that the start-up promises. Investors look for revenue growth and market position, favourable return on investment, profitability, uniqueness, competitive advantage, etc.

Step 3: Preparation of a pitch desk

This involves a detailed presentation outlining all the important aspects of the start-up and selling your product well to convince the investors to fund it.

Step 4: Investor targeting

It is crucial to target the correct investors. This requires researching the Investment Thesis to understand past investments or similar methods to scout out the right people to fund your idea.

Step 5: Due diligence by interested investors

Angel networks and venture capitalists will conduct proper due diligence before investing by looking at the past financial decisions of the start-up, the credentials, and background of the team, etc.

Step 6: Term sheet

The Term sheet is a non-binding document that summarizes the major engagement areas in the deal. It typically consists of valuation, investment structure, management structure, and changes to share capital.

Conclusion

Establishing a start-up is risky, but if the game is played well, then with the risk comes great rewards. In the aftermath of the pandemic and the general uncertainty of the market, investors globally have become cautious about investing in start-up in India. Start-ups must concentrate on the right investors, develop powerful a sales pitch efficiently and formulate the right team to achieve their goals.

In addition, it is also important for the start-ups to ensure that they do not make common mistakes such as not catering to the market need with the products or services, and contacting investors indirectly. Start up funding in India must be approached systematically and follow the laws and regulations of the nation to ensure that it survives in the sea of competition.

Frequently Asked Questions (FAQs)

Can a private company raise funds from the public?

Private companies cannot raise funds from the public, unlike public companies.

How do Limited Companies raise funds?

Limited companies can raise funds from debt or equity financing.

What are the 5 stages of VC business funding?

Broadly categorized, the five stages of VC business funding are:

1. The Seed Stage
2. The Start-up Stage
3. The First Stage/Emerging Stage
4. The Expansion Stage
5. The Bridge Stage

[1] Unicorn refers to a privately owned start-up that has reached a valuation of \$1 billion or more.

[2] <https://www.startupindia.gov.in/>.