Developing Different Asset Classes for Startup Financing Other Than Venture Capital

Dr. Amartya Kumar Bhattacharya
BCE (Hons.) (Jadavpur), MTech (Civil) (IIT Kharagpur), PhD (Civil) (IIT Kharagpur), Cert.MTERM (AIT Bangkok), CEng(I), FIE, FACCE(I), FISH, FIWRS, FIPHE, FIAH, FAE, MIGS, MIGS – Kolkata Chapter, MIGS – Chennai Chapter, MISTE, MAHI, MISCA, MIAHS, MISTAM, MNSFMFP, MIIBE, MICI, MIEES, MCITP, MISRS, MISRMTT, MAGGS, MCSI, MIAENG, MMBSI, MBMSM
Chairman and Managing Director,
MultiSpectra Consultants,
23, Biplabi Ambika Chakraborty Sarani,
Kolkata – 700029, West Bengal, INDIA.
E-mail: dramartyakumar@gmail.com
Website: https://multispectraconsultants.com

Venture Capitalism has become a major necessity for startups, with it being the only source that allows a startup to transition from and to different stages of its life. However, there are certain restrictions that come hand in hand with its vitality. Venture capitalism involves professionally managed funds offering startups funds for equity. They usually exit when an IPO happens or upon an acquisition. The VCs, at times, force startups to take directions that the original entrepreneurs may not have wanted. Moreover, the endeavour of getting the VC's attention and confidence is a momentous task in itself. Therefore, it becomes crucial to develop different asset classes to allow for a greater spectrum of options for nascent start-ups.

There is a spectrum of alternative options, that involves either conventional sources of asset classes and potential sources of funds.

Bootstrapping: This process involves an entrepreneur using his own finances to facilitate the initial working of his startup. In order to bootstrap effectively, entrepreneurs need to refine their operations so as to be very cost efficient so they can utilise their revenue growth to fuel future investments as well.

Crowd funding: Crowd funding involves a business putting its idea on a platform where different individuals pledge different amounts to the success of the project. However, crowd funding is highly competitive and the business idea must be fully formed and tested. Crowd funding serves a dual purpose as marketing as well as financing. Crowd Funding platforms are relatively new with their development in their nascent stages in countries like India. To make these avenues feasible, there is a need to create awareness among people.

Angel investors : Angel investors are individuals who provide a one-time boost in the form of funding to a startup. They are usually either family members or friends of the individual. Angel investors are simply informal investors that are more fixated on the growth of the startup as opposed to immediate profit needs. Unlike venture capitalists, angel investors usually invest their

own money. Therefore, there is greater likelihood of the goals of the investors and the startup being in tandem.

Private lending: Borrowing money from either conventional banks or specially-designed financial institutions that fund small and medium businesses is also an alternative. These loans however increase the firm's financial risk which restrict a company's ability to scale or take operational risks. However, loans do come at a benefit of having no dilution of ownership.

This particular alternative needs a lot more refinement and development in reality. Banks often do not have confidence in new startups or lend to them at predatory rates. This, more often than not, leads to a startup's demise. However, this opens a window of opportunity for us to come up with a different metric for assessing if a startup inspires confidence or not. This new threshold can help actualise this alternative. The right trend can be seen when we see the arrival of institutions specifically designed to encourage startups.

The above are asset classes designed specifically for startups to help facilitate their growth. However we can look at this issue in another way as well.

The conventional class of financial assets namely equities, bonds, real estate, etc. are options that accommodate startups. Upon understanding the constraints that lie in this access, we can better develop these options as possible alternatives as well.

Startups are relatively unknown and often operate under tight liquidity positions. This means that they find it difficult to raise capital from the market. Also, the entire procedure of getting listed and the formalities also eliminate these options.

There are a few possible avenues to eliminate these constraints:

Convertible Bonds: Convertible bonds start as normal bonds with a given interest rate. However, after some time investors have the avenue to covert them onto a profit-sharing instrument. Startups have trouble getting credit due to their lack of credit history. However, when they try to raise money by equity they face several problems regarding valuation. This allows startups to co-opt the best of both these choices by giving lenders the avenue to convert their debt into equity after a certain time. This acts as an additional re-assurance and is cheaper than raising money from equity.

Startup Stock Market: There has been the starting of a new era of startups globally with the arrival of platforms designed specifically to trade share-equivalents of startups. This model is still in its nascent stages as seen in the startup stock exchange; however, if developed this gives startups access to equity.

Therefore, there are several avenues available to startups other than venture capitalism whether conventional avenues like bootstrapping or new innovations like convertible bonds. Eventually, a

startup can also refine its own functioning to generate funds by having pre-order option for products, etc. Every aspect of the startup is capable of being a potential source of financing.

© MultiSpectra Consultants, 2020.