



## Sources and patterns of Indian e-startup financing: An analysis of a selected organization

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### Abstract

**Purpose:** Based on the combined sources of financing of e-startups, the purpose of this paper is to empirically investigate the association between sources of finance advancement with it, which explains the financing trends of Indian e-startups.

**Design/methodology/approach:** chi-square test has been used to analyse the association between sources of finance and their stages of development. For it, top 100 e-startups companies financial data have been collected from secondary sources.

**Findings:** Empirical results suggested that sources of finance and their stages of development have been associated. In their financing patterns, most of the fund has been raised through venture capital from series B.

**Originality/value:** The results of the study enhance the review of literature on financing patterns of e-startups in India from several ways.

**Keywords:** E-startups, India, capital structure, financing patterns

### Introduction

Technology, in its evolutionary form and its revolutionary form, has changed our lives and helped in the development of India. The term start-up is a newly established venture without having the previous history but the term e-startup is a part of this new technology, innovation, and revolution which is directly related to internet business. In today's scenario, Indian e-startups or startups ecosystem are positively correlated with economic development. On January 16, 2016, the Prime Minister of India unveiled the Start-up Action Plan, 2016, which includes a mobile app and start-up portal, in response to the encouraging growth of start-ups.

In this action plan they say "I see start-ups, technology, and innovation as exciting and effective instruments for India's transformation." After inspiring it the AICTE (All India Council for Technical Education) prepare a startup-policy AICTE 2016 for all the technical institution in India. The aim of this policy is to make out the student's potential and make them into start-up entrepreneurs. India's e-startup market is growing year to year as facts shows that from 2014 to 2017 was accounted as 0.8%, 1.7%, 2.6%, and 3.6% of total % of Indian retail market and expected to reach in 2019 up to 4.8% but still it is on puny stage as compared to US market share because that was 16% in 2017. And according to the advisory firm Red Seer Consulting the Indian e-commerce, it was reached up to US\$ 17.8 billion in 2017 and expected to grow up to US\$ 200 billion by 2026 (Aranca research 2018). Due to these facts, outside investors are interested to invest in Indian e-startups although they are in loss. The statistician, however, claims that the Indian e-startup sector has a very high exit value. Importance of e-startup industry can be seen by the big deal of Flipkart and Wal-Mart after the deal value \$16 billion which make a history in the Indian market. For providing the funding and mentoring help with central government total 18 states make a startup policy for financial and non-financial support to them, so this is a right time for a young generation to take out the benefit of startup policy launched by different-different states.

In the coming years, India's young generation is ready to start working on new and innovative ideas with all other nations on the world. By 2020, it is anticipated that 112 million Indians would be employed in the 20–24 age range, marking a significant advancement for the country. Indian entrepreneurs are collaborating with enterprises from other nations in recent years.

The Government of India is taking various steps to improve the ease of doing business with the launch of the "StartupIndia" movement. India's ranking on ease of doing business has increased from 142 to 100, per the World Bank Report (2017) (Economic Times, 2017).

Indian e-startups such as Flipkart, Snapdeal, Paytm, Olacabs, and Shopclues, etc. have been received various rounds of financing from their existing and new investor.

### 1. Importance of e-startup in India

1. Fast selling of goods and services
2. Fast transmitting of data and funds
3. Fast supply chain management and effective logistic
4. Automated data collection system
5. Customer can engage with e-startup at any time due to availability of 24\*7
6. Due to web page management system it saved operational cost
7. Due to data driven sales it can re-market with their customer through various sources.
8. No need of caretaker of good
9. Barrier free sales
10. Fast order processing
11. Reduction of paper storage
12. Freely availability of product comparison before purchase

### Review of literature

The literature review helps to the researcher in compare and contrast by providing historical context on the research topic, as well as helpful in search out the research gap on a particular work. In this section, through literature review we will explain regarding capital structure or financing pattern

decision, financing sources for e-startups, and stages of development of e-startups.

### 1. Financing Pattern of e-startups

There are various sources for e-startups from which they can mobilize the funds. The respective share of each source in total funds exposed the ratio of internal and external sources which predicted the financing pattern of an entity (J. Dennis Raja Kumar, 2001). And in the view of (Beck et.al 2004) financing pattern showed the financing trend of different years in form of debt and financing sources which combined makes a capital structure for a company or e-startup. Hackethal, A. and Schmidt, R.H., (2004) <sup>[29]</sup> found that financing pattern means time period data on the specific financial instrument. They also point out that an entity can determine which source is more effective by looking at its financing patterns. On the basis of above researchers, it can be concluded that combination of various debt and equity sources makes a capital structure or financial structure or financing patterns for e-startups or any entity.

### 2. Financing patterns with sources of finance for e-startups or startups

#### 2.1. Angel funding

Angel investors were also known as informal investors (Sahlman *et al*, 1999). However, Timmons and Spinelli (2008) wrote in their book on entrepreneurship that after the funding from 3Fs (founders, family and friends), angel funding was considered as the first source for external financing. Broadway show entrepreneurs are the ones who first used the term "angel investor." According to Shane (2009), an angel investor is "someone who contributes money, either in the form of debt or equity, from his own funds to a privately held company and operated by someone else who is neither a friend nor a family member" in this definition they stressed on that angel investors are those who invest in those startups which are run by others not among 3Fs.

Macht and Robinson (2009) <sup>[40]</sup> defined angels as "private wealthy individuals" who invest their money and experience in small, unquoted, entrepreneurial ventures. Additionally, this was backed by (Freear *et al*, 2002) <sup>[26]</sup>. The researcher like Rastislav Petráš and Jana Šnircová (2013) found that business angels were the possible source of finance for the development of the company and for startups development they shared their knowledge and experience. (Hellman and Thiele, 2015; Chemmanur, 2014; Kerr *et al*, 2011) <sup>[21, 34]</sup> suggested that with investment process they tried to build an association between company and portfolio outcomes. Dhruva Nath (2015) said that the new angel investors known as "Emerging Angel Investors" because several young angels aged between (20 to 30) invested in startups and mentoring to them.

Veland Ramadani (2014) said money invested by angel investors is a smart money because with money they share their experience. G. Sabarinathan (2014) <sup>[47]</sup> issued a working paper for understanding angel investing in India, the researcher found that angels investors focused sector were new high growth sector such as online services, e-commerce, IT products and services, education and healthcare these result was based on the public domain data. Morisetti (2007) and Andrew Wong (2001) said that publicly available data left out the several aspects related to their behaviour and motivation. A further research is also

done by (G. Sabarinathan 2017) for knowing that angel networks and individual angels have some difference in an emerging economy they found that, with the help of angel network, startups are able to maintain an effective portfolio in their mentoring by which next stage investors can be easily attracted for investment and also helpful in higher exit return for angel investing.

Van Osnabrugge and Robinson (2000) <sup>[55]</sup> noticed that angel investor invested in the high-tech firms at their early stage of development. Mason and Harrison (2002) found that the ratio between demand and supply of angel market fund was the mismatch from the supply side, due to various reasons like their returns, risk aversion, regulatory framework and investment policies at the early stage of startups. In 2006, OECD (Organisation for Economic Co-operation and Development) noticed that 80% of OECD countries had faced a shortage of early-stage equity. According to Jeffrey E. Sohl (2006), angel investors continue to be the primary source of seed money for businesses, whether they do so individually or in groups. Harrison and Mason (2010), Sohl (1999), Freear and Wetzel (1990) said that angel investors were able to fill the funding gap.

As per Mason and Harrison (2000) <sup>[41]</sup>, investors could depart through trade sales, acquisition sales, share sales to other shareholders, sales to third parties, initial public offerings (IPOs), and liquidations of assets but out of them in the UK the most common exit route for angel investors were trade sale of acquisition. In Indian scenario, their most common exits routes are mergers & acquisitions and strategic buyouts but after 2 to 3 year. After amendments (2016) now exit time for angels is one year. In India, top three angel investors are Rajan Anandan, Girish Mathrubootham, and Satveer Singh Thakral.

#### 2.2. Bootstrapping

Bootstrapping was a creative financing approach for startups (Lahm, Little, 2005) <sup>[39]</sup>. Through bootstrapping methods, start-up companies can be arranged the fund independently without third-party investment. According to Worrell (2002) bootstrapping funding was helpful for startups when they did not require a big investment. Bhide (1992) <sup>[14]</sup> concluded that without dilution of ownership and control funding could be arranged through bootstrapping methods. However, Colombo and Grilli (2007) said that entrepreneurs felt to himself in isolation if he/she was young and less experienced because they feel experienced partners and business contractors were not be helpful for them. The researcher like Robert J. Lahm Jr & Harold T. Little, Jr. (2005) said that bootstrapping was a way by which human capital can be transformed into financial capital and it was used when other choices like formal venture capitalists, banks, and angel investors did not exist. They also suggested that for bootstrapping funding, startups should prepare a perfect business model and also emphasized on pre-launch preparations.

#### 2.3. Bank loan

The bank loan was one of the oldest formal financial sources for many entrepreneurs but most of the startups avoided to take bank loan (Brown, Degryse, Hoewer and Penas, 2012). they also mentioned that most of the startups were founded by young entrepreneurs with the absence of individual's credit history and property, due to this reason funding from bank loan was not easy for them. Åstebro and

Bernhardt (2003) discovered a negative relationship between bank loans and the start-up company's sustainability. They also identified survival rates of highly qualified startups owners were high as compared to those startups who arranged the funding from bank loans. This was also supported by (Cressy 1996) <sup>[23]</sup>. Personal bank loans—were the most important sources of funding for startups (Alicia M. Robb and David T. Robinson 2012). They also suggested the top three sources of financing for most of the startups were bank debt, personal equity, and trade credit. Brierley (2000) concluded that new technology-based firms have to face many difficulties to raise the bank loan due to lack of tangible assets that can be used as collateral, and have little or no track record. However, again Brierley (2001) <sup>[16]</sup> noticed that venture capitalists and angel investors were faced many difficulties to identify and evaluated the prospective of high-tech companies or startups. It was also supported by Audretsch (2002). Robb and Robinson (2010) found that more than 40 percent of the total funds of U.S. startups were funded by bank loans and lines of credit. (Cressy and Olofsson, 1997; Winborg and Landström, 2001; Klagge and Martin, 2005) <sup>[22, 36, 57]</sup> studied on the Swedish market and found that bank lending was one of the most common ways to financing the small companies.

#### 2.4. Seed Funding or funding from friends, founders and family

Krishnan (2010) <sup>[38]</sup> said that startups should try to collect their initial funds from those people who were closest and familiar with them such as friends and family (informal sources of financing) before moved to external investors like business angels, venture capitalist, and banks. Alicia M. Robb and David T. According to Robinson (2010), in their early stages, businesses can secure up to 40% of their funding from seed sources. R.H. Hamilton (2001) <sup>[30]</sup> concluded that seed funding was arranged from angel investors because they were the less risky funding source. The researcher like Avery, Bostisc, and Samolyk (1998) <sup>[4]</sup> and Mann (1998) predicted that personal guarantees and personal assets were the main sources of financing for startups. In India, the best funding firms for startups are Accel Partners and Kalaari Capital.

#### 2.5. Venture capital

Venture capitalists were focused on high-risk projects with the expectation of high return on their investments (Ramana Nanda and Matthew Rhodes-Kropf 2013) <sup>[43]</sup>. According to Cvijanović, Marović, and Sruk (2008), they typically made investments in businesses during their early and growth phases. After the study of 470 Silicon Valley start-up companies (Davila, Foster and Gupta 2000) proved that companies which had been using venture funds as the financing source grew faster than other startups, by whom some other source of financing were used and this statement was also confirmed by (Ramana Nanda and Matthew Rhodes-Kropf, 2013) <sup>[43]</sup>. However, the researcher like Thomas Hell Mann and Manju Puri (2002) stated that venture capitalists as financial mediators performed more active role but they were a costly source of financing.

##### 2.5.1. Venture round funding or series funding

Round funding (first round, second round etc.) or series funding (A, B, C etc.) was an another effective form of justifying risks as offered by venture capitalist to startups, if

startups were able to perform as expectation of venture capitalist than they were ready to further invested through other series in the same startups (Tian, 2011; Wang and Zhou, 2004) <sup>[53]</sup>. Through different- different investment round, venture firms did work as a monitoring mechanism for startups also able to share their risk (Wright and Lockett, 2003 and Brander *et al.*, 2002) <sup>[15]</sup>. however, the researcher like Swati Panda Shridhar Dash (2016), Shepherd and Zacharakis (2001) <sup>[52]</sup>, Becerra and Gupta (1999) stated that for next stage funding through venture capitalists the startups founders should be followed some points like they should fair, open communication, honest, positive attitude and maintained signalling commitment with consistency. (Guangsug Hahn 2017) found those venture capitalists were invested in the early stage of startups due to signalling effect for example if venture firm invests in seed round, but after this investment, they decided not to go in the series A, that's called a "signalling effect". That means a venture capitalist has been sending a signal to the other venture capital community that something may be wrong with this startup.

#### Sources of finance with stages of development

(Cassar, 2004; Huyghebaert and Van de Gucht, 2007) <sup>[19]</sup> said that startups have no reputation or track-record or prior financial or operating history; therefore they had to face many problems throughout each phase of their growth (Walker, 1989; Ang, 2000; Cassar, 2004) <sup>[19]</sup>.

However, researchers like (Hédia Fourati and Habib Affes 2013) and OECD (2004) found that at each growth phase of startups they raised fund from different-different sources. At seed stage or initial stage, most of the startups were raised fund through personal savings of owners and from family and friends due to high risk and negative earnings. And at second phase fund raised through business angels and venture capital but still, startups investment were highly risky with high failure rates and in some cases raised fund from private banks with a high rate of interest. Kerr and Nanda (2009) found that VCs were helpful in minimized uncertainty because, for own stake, VCs monitored the performance of the companies after providing nonfinancial resources like customer and supplier contacts, employee recruitment and technical expertise, which were helpful for improving the business model of startups. Berger and Udell (1998) <sup>[10]</sup> found that for startups most common sources of funding were the principal owner, commercial banks, and trade creditors. But this result did not match with Portugal startups (Abreu, 2012). The researcher also found that the sources of financing had been shifted from traditional to newer methods. with it they concluded that family, friends, and relatives were the main sources of financing at an initial stage of development, with it (Paul, Whittam and Wyper 2007) proved that the creators of the start-up initially used internal funding, or their own money, before looking for outside funding. Finding investment opportunity to launch or expand a start-up was one of the biggest obstacles faced by many entrepreneurs (Berger and Frame, 2007) <sup>[12]</sup>. Kotha and George (2012) <sup>[37]</sup> studied that entrepreneurs experience was more helpful in raising funds for their startups from both formal and informal sources as compared to non-experienced entrepreneurs. Andrew Atherton (2012) <sup>[3]</sup> found that in multiple cases new ventures were funded by equity alone, or by a combination of equity and grants.

**Results and analysis**

**1. Types and sources of e-startups in India**

Funding sources are broadly defining in two categories mainly debt sources and equity sources and a mix of both sources make a capital structure for e-startups or venture. But literature review described there are various categories of debt and equity source after combining these categories funding pattern of e-startups generated. After combining sampled companies data Table-4 represents the possible source of e-startups in India or funding pattern.

The result of the figure shows that major sources of funding are through Series B than followed by the Series A. The possible explanation may be that in this study most of the e-startups are in presence from five or seven years due to this reason they were not able to reach other sources. Other reason might be approximate 90% failure ratio of e-startups

in the world according to the survey based study done by the IBM Institute for Business Value (IBV) which creates dishonest in the mind of investors. In these sampled companies no fund was arranged from crowdfunding source because of their legal issue i.e. equity-based online crowdfunding is not legalised in India as SEBI in 2016 but in 2017 after amendments, SEBI finalised norms for crowdfunding.

**2. Stages of development for Indian e-startups**

The phases of development of Indian e-startups have been determined by the review of the literature, startups India, Yes Bank, NASSCOM, and ASSOCAM report on Indian startups.

are divided in basically four categories according to funding amount and year:

**Table 1**

Stages of development	According to funding amount	According to time
Seed stage	(<=USD 1Mn)	(< one year)
Early stage	(USD 1to 5 Mn)	(1 to 3year)
Growth stage	(USD 5 to 20 Mn)	(> 3 year)
Expansion stage	(>USD 20Mn) (Source: NASSCOM report 2016 on startup)	(Source: ASSOCAM report 2016 on startup)

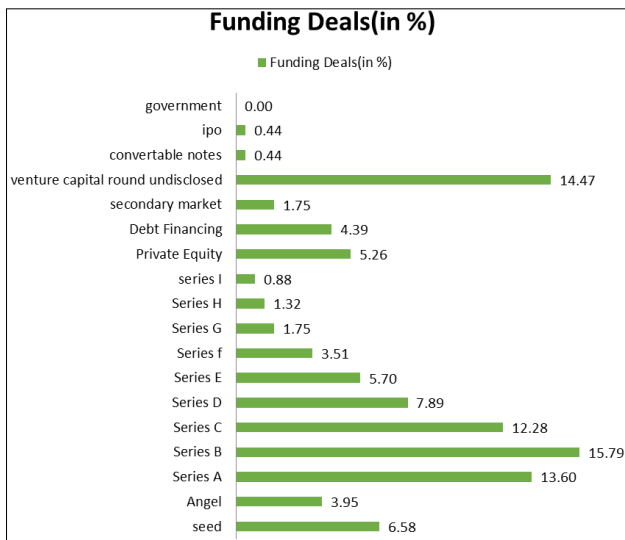
**3. Testing of hypothesis**

To test the above hypothesis, cross tabulation were carried out because sources and stages both are non-metric. For solving these hypotheses the categorisation of stages of funding has been divided into three part i.e. seed stage, early stage and growth stage. The sources of funding have been decided according to time period i.e. (a year). Here seed

stage means one or less than one-year, early stage time period is one to three year and growth stage is for more than three years. Prior studies and data from around the globe suggest that funding varies based on the start-up company's stage of development. But the result of Klacmer calopa et.al (2014) was opposed to this result as studied on Croatian startups.

**Table 2: Funding Deals Of e-Startups**

Source of funding	Number of funding deal	% of funding deals
Seed	15	6.58
Angel	9	3.95
Series A	31	13.60
Series B	36	15.79
Series C	28	12.28
Series D	18	7.89
Series E	13	5.70
Series f	8	3.51
Series G	4	1.75
Series H	3	1.32
Series I	2	0.88
Private Equity	12	5.26
Debt Financing	10	4.39
secondary market	4	1.75
venture capital round undisclosed	33	14.47
IPO	1	0.44
Government subsidies	0	0.00
Convertible notes	1	0.44
Total	228	100



Source: Author own calculation

Fig 1

for e-startups is venture capital which had been raised through different – different series funding. But most of the e-startups were able to raised funding through series B. It is indicated that the business model of these e-startups was based on horizontal approach (1 to n) means they are copied to other e-startups. As a suggestion for raised more funding from different rounds they should work on vertical approach (0 to 1) as mention in the book of Peter theil zero to one. With it, the signalling consistency had been found in all unicorn e-startups and almost 70 to 80 percent investment had been done by outside investors from India, with this hope that these e-startups will be profitable in future. As an association between sources of finance and development stages indicated that the Indian e-startups were able to raise fund from different- different sources at their development stages.

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