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A Critical Study of Startup Financing Dynamics and Emerging Approach to Attracting Capital Resources

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Abstract: ***This study delves into the diverse landscape of startup financing in India, examining the sources of funds and emerging approaches to attracting capital resources. Through an analysis of general statistics, including the types of startups, gender distribution of founders, and funding sources, the study provides insights into the dynamics of the startup ecosystem. The findings reveal that a significant portion of startups rely on internal sources such as family and friends, personal savings, and bootstrapping, while external sources like angel investors, venture capitalists, and government grants also play a crucial role. Additionally, the study explores various financing options available to startups at different stages of their lifecycle, including debt financing, commercial lenders, government programs, and leasing arrangements. By shedding light on these financing avenues, the study aims to inform entrepreneurs, investors, and policymakers about the evolving landscape of startup finance and facilitate informed decision-making.***

Keywords: Sources of Finance, Angel Investors, Banks, Lending, Venture Capitals, Private Equity and Financing Patterns.

1. INTRODUCTION

At the heart of the entrepreneurial function are the creation and/or recognition of opportunities. The classic entrepreneurship is the ‘Start-Up’, where a raw idea develops into a potentially high-growth company, and the success involves strong main entrepreneur and its team with complimentary talents. That team has the ability to see opportunity where others see contradiction, and the mail entrepreneurs is making sure that the start-up does not run out of money when it needs it most. There is no precise definition is available regarding start up, that accepted its overall characteristics due to its span of age, scale of operations, and mode of funding. It is usually defined as a young company, a few years old, and yet to establish a steady stream of revenue. These firms have a small scale of operations, usually with a

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working prototype or paid pilot with the potential to grow and scale rapidly. They are initially funded by the founders' own private network of friends and family and actively seek additional funds to sustain themselves and become a viable business.
The GOI's Startup India program defines a "startup" as a company (PIB 2017) that is:

- Headquartered in India with not more than ten years since incorporation or registration
- Having an annual turnover of less than INR 1 billion (roughly $14 million) (Startup India 2019)"

Total 55,000 startups lunched in India till 2020, but among them 40,000 have active recently. The 33,000 is registered under DPIIT. Among, 385 funded startups have shutdown. Till 2020, $63Bn funding raised by the startup in India. This paper aims to explore various financing sources for startups in India.

2. RELATED WORKS

Kumar et al. (2021)[1],"*Alternative financing models for startups: The role of crowdfunding",* exploring as a means of raising capital from a large pool of individual investors. Their research examined the benefits and challenges of crowdfunding platforms and analyzed factors contributing to campaign success. By studying crowdfunding campaigns across different industries and geographic regions, Kumar et al. provided insights into the dynamics of online fundraising and its potential implications for startup financing.

Smith et al. (2020) 2, "*Startup financing options: A comprehensive review",* emphasizing the importance of understanding the diverse range of funding sources available to entrepreneurs. Their study identified personal savings, angel investors, venture capitalists, and government grants as primary sources of funding for startups. By analyzing the characteristics, advantages, and limitations of each funding option, the authors provided valuable insights into the decision-making process for entrepreneurs seeking capital.

Jones (2019)[3], *"Strategies for attracting capital resources: A focus on networking and relationship building",* explored the strategies with potential investors. Through interviews and case studies, Jones highlighted the significance of personal connections and effective communication in securing funding for early-stage ventures. The study underscored the importance of building trust and credibility with investors through transparent and compelling pitches tailored to their interests and preferences.

Patel and Gupta (2018)[4], "*Government initiatives and startup financing: A case study of Startup India"***,** analyzed the effectiveness of policy interventions, tax incentives, and regulatory reforms in fostering a conducive environment for startup growth and investment. By evaluating the implementation and outcomes of Startup India, Patel and Gupta provided valuable insights into the role of government support in shaping the startup ecosystem.

Garcia and Rodriguez (2018)[5], "Risk management strategies in startup finance." focused on risk management strategies in startup finance, highlighting the importance of assessing and mitigating financial risks to ensure the long-term viability of early-stage ventures. Their study

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examined risk factors such as market volatility, competition, and regulatory compliance, offering recommendations for effective risk management practices. Garcia and Rodriguez's research underscored the need for startups to adopt proactive risk mitigation strategies to safeguard their financial health and sustainability.

Brown and Lee (2017)[6], "*Investor behavior and decision-making processes in startup finance."* delved into investor behavior and decision-making processes in startup finance, shedding light on the factors influencing investment choices and risk perceptions among angel investors and venture capitalists. Through surveys and interviews with investors, the study identified key drivers such as market potential, team expertise, and scalability of business models. Brown and Lee's findings emphasized the importance of aligning startup pitches with investor preferences and addressing concerns related to risk and return on investment.

Objective of the Study

- To describe and evaluate the different financing Dynamics or source for startups.
- To describe the emerging approaches or strategies to attracting capital resource.
- To provide the relevant information to the startups, investors and other related party which helps to them in decision making?

3. RESEARCH METHODOLOGY

Research Approach: The Mixed research approach is selected as per the requirement of the study. It is trying to explore and describe all the significant facts to achieve the research objectives.
Data Types: This study is broadly used to secondary data, as per the nature of the study Primary data also collected as per the requirement of the study.
Data Collection : secondary data are collected through the various researches, Valuable websites, Journal, books and magazines etc. and Primary data are collected through conducted various Interviews with experts, leaders, and various key persons of the startups.
Sampling Techniques: Purposive sampling method is used to select the sample size of the data.
Data Analyses: Data are analyzed with the help of descriptive statistics. This study broadly based on the extensive literature survey. Various charts, diagrams and tables are used to represent the data.

Research Problem

The landscape of startup financing is dynamic and complex, with entrepreneurs facing numerous challenges in securing adequate funding for their ventures. This research aims to address the following central question:
What are the critical factors influencing the choice of financing sources for startups, and how do these factors impact the success and sustainability of these ventures?
This overarching question encompasses several sub-questions, including:

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- What types of financing options do startups commonly pursue, and what are the motivations behind their choices?
- How do factors such as industry, company size, and geographical location influence the selection of financing sources?
- What are the key challenges and opportunities associated with different startup financing methods?
- How do startup financing choices impact long-term business growth and viability?

Data anlyses

Part A: General Statistics of Start-Ups in India

Figure 1: Types of start-ups in India

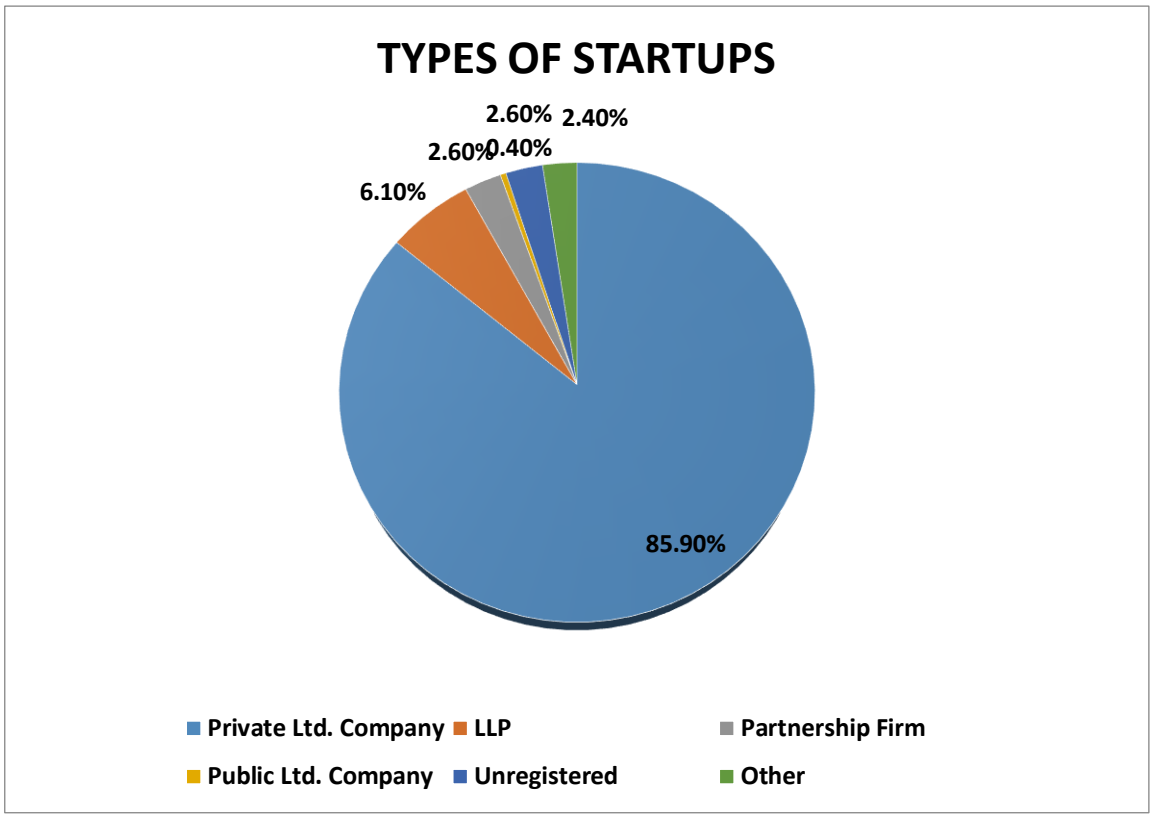
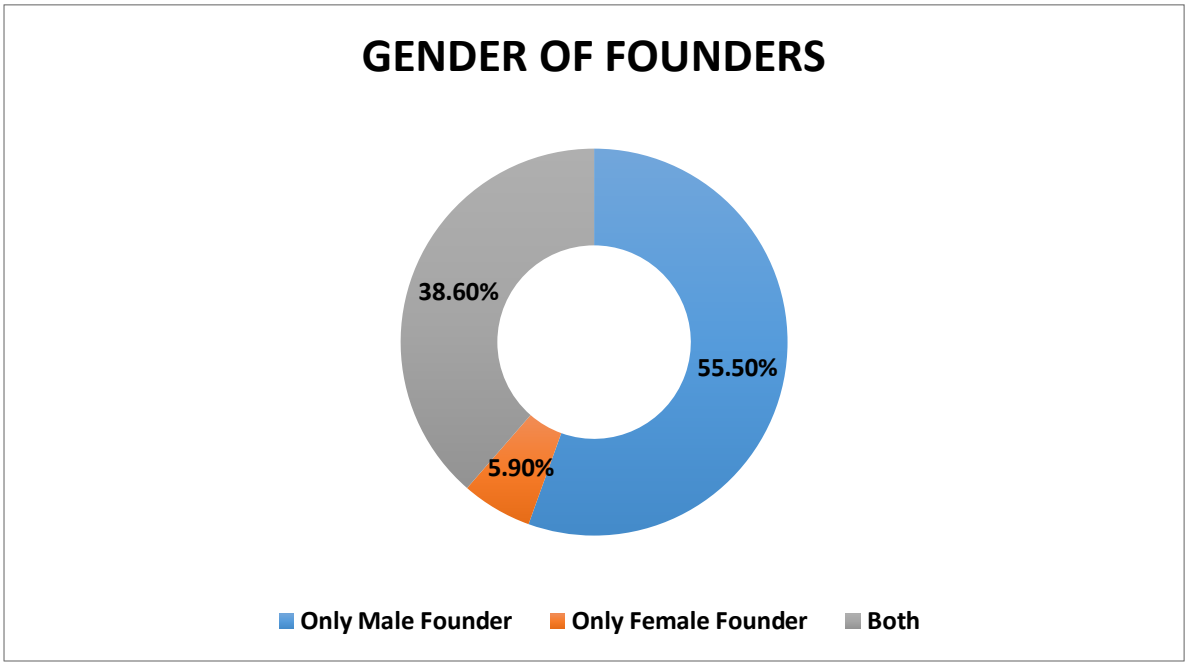


Figure: 1 exhibits that Private Ltd. Companies held maximum market capture of start-ups in India i.e.85.90%, LLP 6.10%, partnership firm 2.60% , Unregistered sector 2.60% , Public co. 0.40% and other sectors 2.40%.

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Figure 2: Gender of start-ups' founders



It is exhibits from figure: 2, 55% founders of start-ups are male, 5.90% female founders and 38.60% are both.

Figure 3: Sources of Funds (%)

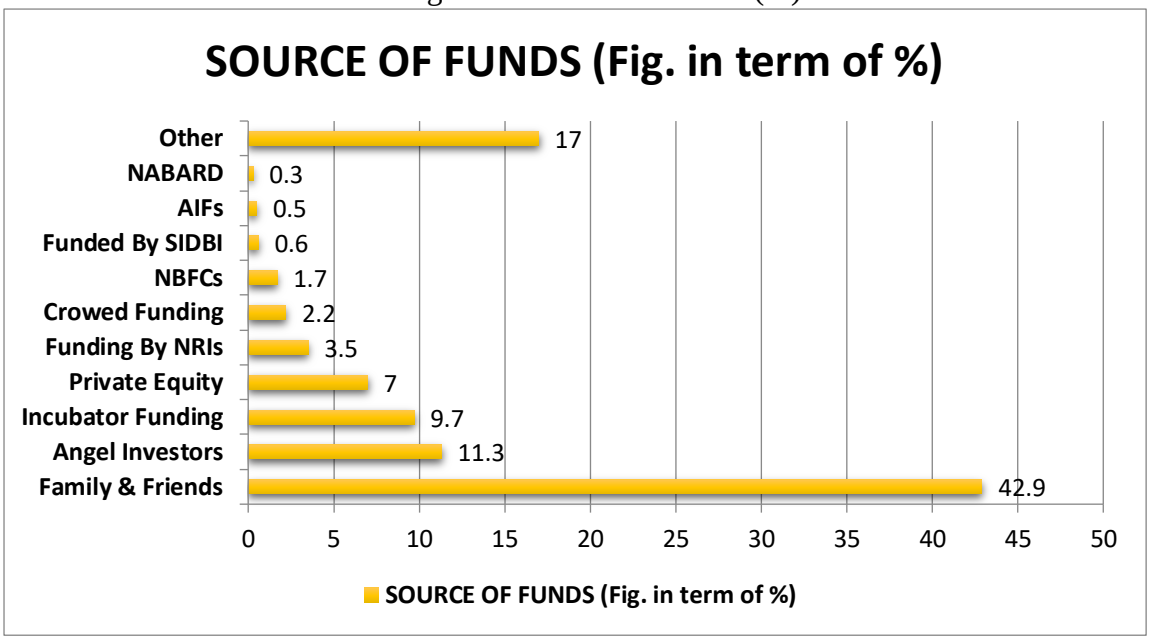


Figure 3 shows the source of funds exhibits that maximum trend of 42.9% from Family & Friends and lowest trend from Finance from NABARD (0.3%) followed by AIFs (0.5%),

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SIDBI (0.6%), NBFC (1.7%), Crowed Funding (2.2%), Private equity (7%), Incubator Funding (9.7%), Angel Investors 11.3%) and other sources by 17%.

Figure 4: International Funding Received

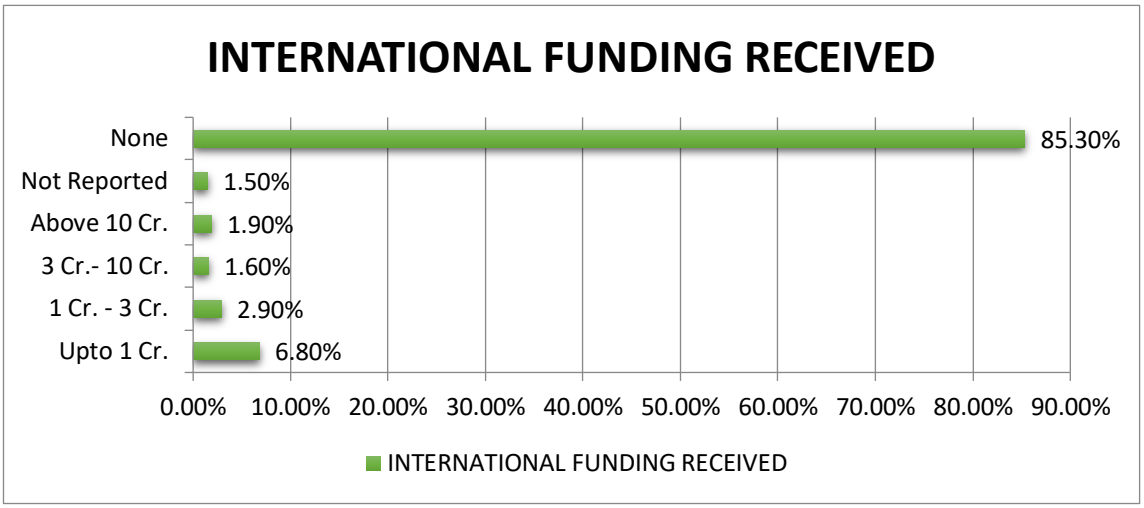


Figure 4 shows the start-ups expression about their International Funding Received, exhibits that No funding received by 85.30% of start-ups. 6.80% Start-ups received up to Rs. 1 crores, 2.3% Start-ups received 1-2 crores, 1.6% Start-ups received 3-10 crors, 1.9% start-up received above 10 crores rupees.

Figure 5: Capital Infused

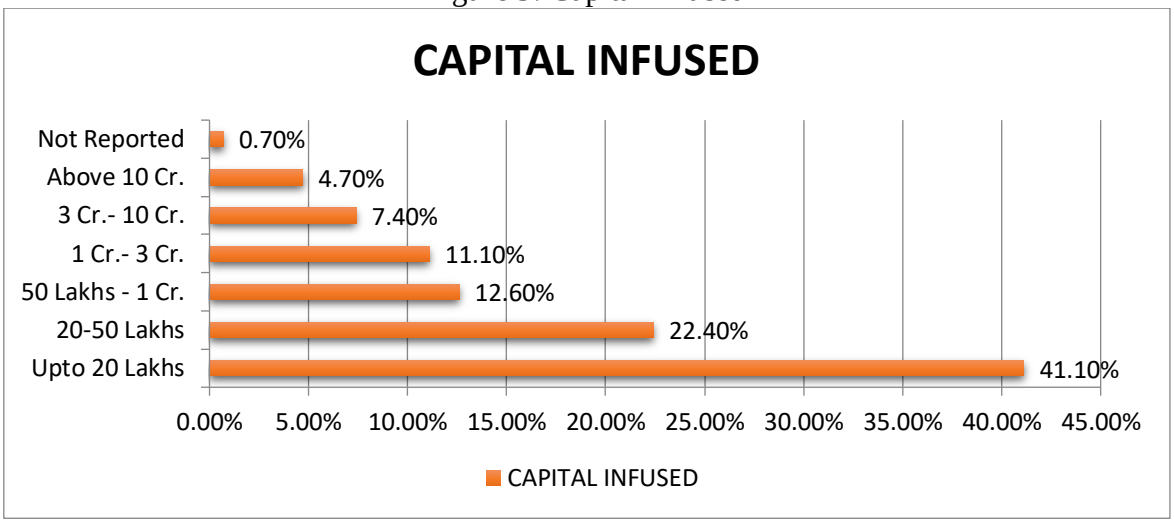


Figure 5 shows the start-ups expression about their Capital Infusion, exhibits that Highest of 41.10% start-ups with up to 20 Lakhs, and least of 7% start-ups with above 10 crores. and other start-ups are exists in this range.

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Figure 6: Working Capital Requirement

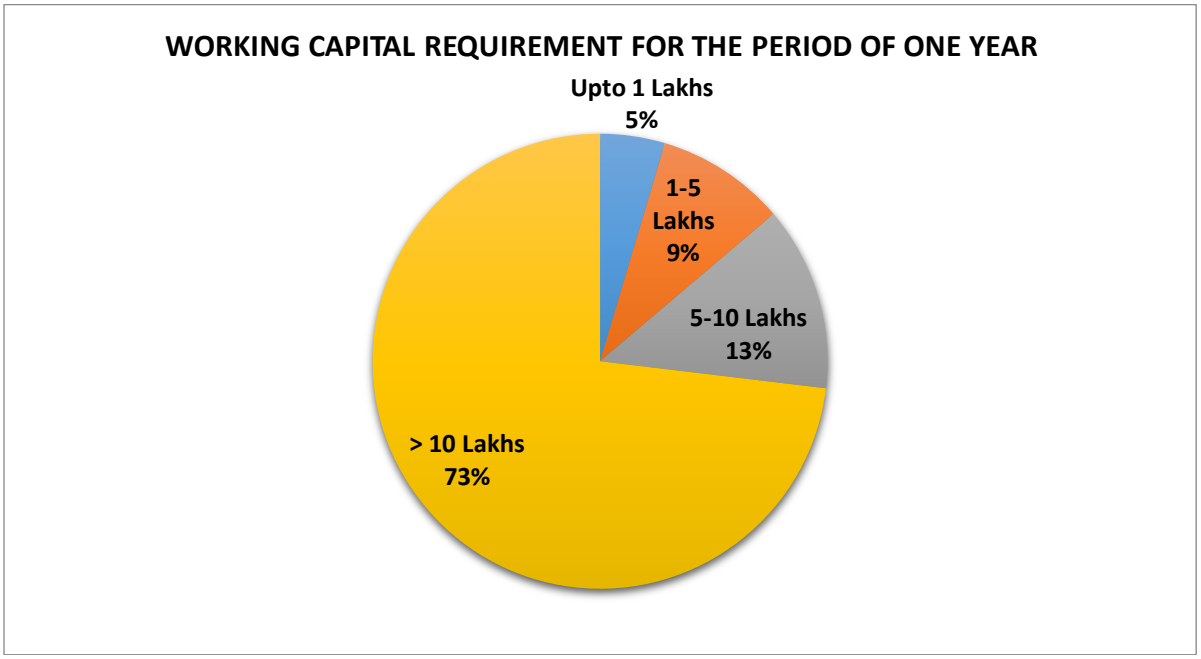


Figure 5 shows the start-ups' working Capital requirement for the period of one year, exhibits that Highest of 73% start-ups having above 10 Lakhs, and least of 5% start-ups having requirement of up to 1 laks rupees followed by 9% startups having 1-5 laks criteria, 13% startups are required under 5-10 laks rupees criterion.

Part B: Sources of Finance and Emerging Approach to Attracting Capital Resources

There are different types of financing options that are available for the startups during the different stages of the firm life cycle. The financing types are based upon the level of growth of the startups from the first stage of the firm life cycle to the final stages along with their growth and production scale. Since the type of finance vary across different stage of the firm life cycle.

1. Internal Sources of Funding

a) Family and Friends

At the nascent stages of a start-up, founders often turn to family and friendship circles to secure initial financing. This involves private equity arrangements, where friends or relatives become stakeholders in the venture. Despite the personal nature of these investments, the transactions often adhere to formalities akin to external investor engagements.

According to a comprehensive survey conducted by Startup Insights in 2021, 30% of start-ups secure their first round of funding from family members, and an additional 20% from friends, emphasizing the critical role these close connections play in the early stages of a business.

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b) Personal Savings

Entrepreneurs frequently tap into their personal savings accrued from business or non-trade activities. This approach reflects a commitment to and personal investment in the success of the start-up, showcasing the founder's confidence in the venture's potential.

Finance Trends' study reported that a substantial 40% of start-ups heavily rely on personal savings as their primary source of initial capital. This emphasizes the entrepreneurial spirit and risk-taking inherent in utilizing personal funds for business initiation.

c) Bootstrapping

Bootstrapping involves a highly creative acquisition and utilization of resources without resorting to capital from traditional sources or bank loans. This strategy relies heavily on internally generated retained earnings, credit cards, home mortgages, and customer advances. While advantages include better terms for equity financing and greater control for entrepreneurs, disadvantages encompass potential limitations in sales, market share, competitive position, and limited support for high-growth prospects.

Entrepreneurial Insights' report indicates that around 25% of start-ups adopt bootstrapping strategies. While allowing founders to retain control, this method poses challenges, highlighting the delicate balance between resourcefulness and sustainable growth.

2. External Sources of Funding

a) Angel Investors

Angel investors, affluent individuals with a keen interest in fostering innovation, are pivotal contributors to the early-stage growth of start-ups. Their role extends beyond providing capital; angels often become mentors, sharing industry insights and expertise with the entrepreneurial ventures they support. This symbiotic relationship is characterized by flexibility in deal structures, allowing angels to tailor their investments to the unique needs of start-ups, setting the stage for a collaborative and mutually beneficial partnership.

Despite the evident advantages, the realm of angel investing is not without its challenges. Investors must carefully balance the inherent risks associated with early-stage ventures against the potential for substantial returns. Thorough due diligence becomes imperative as angels assess the viability of start-ups, scrutinizing business models, market potential, and the competency of the leadership team. Diversification of investment portfolios is a common strategy among angels, spreading risk across multiple start-ups to maximize the chances of overall success.

Recent trends in angel investing underscore the growing importance of collaborative networks.

b) Venture Capitalists (VCs)

Venture capitalists (VCs) are pivotal players in the financial landscape, providing essential support to innovative and high-potential start-ups. This form of financing has evolved over the years, shaping the trajectory of countless entrepreneurial ventures. Venture capital serves as a catalyst, fueling the growth of companies with promising ideas, technologies, or business models. Understanding the role, dynamics, and impact of venture capitalists is crucial in comprehending the intricate workings of the start-up ecosystem.

Venture capital refers to funds allocated for start-ups and small businesses with exceptional growth potential. Unlike traditional financing, venture capitalists do more than

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provide capital; they actively engage with management, contribute strategic guidance, and add value to the company through their industry knowledge.

Venture capital means funds made available for startup firms and small businesses with exceptional growth potential. Venture capitalist generally-

- Finance new and rapidly growing companies
- Purchase equity securities
- Assist in the development of new products or services
- Add value to the company through active participation.

Stages of Funding for VC:

Financial Stage	Periods	Risk Perception	Activity to be financed
Seed Money	10-Jul	Extreme	For supporting a concept or idea or R&D for product development
Start Up	9-May	Very High	Initializing prototypes operations or developing
Second Stage	5-Mar	Sufficiently high	Expand market and growing working capital need
Third Stage	3-Jan	Medium	Market expansion, acquisition & product development for profit making company
Fourth Stage	3-Jan	Low	Facilitating public issue

c) Government Grants-

Central and state governments of India often have financial assistance in the form of grants and/or tax credits for start-up or expanding businesses.

d) Initial Public Offerings-

Initial Public Offerings (IPOs) are used when companies have profitable operations, management stability, and strong demand for their products or services. This generally doesn't happen until companies have been in business for several years. To get to this point, they usually will raise funds privately one or more times.

e) Debt Financing:

Debt financing involves borrowing funds from creditors with the stipulation of repaying the borrowed funds plus interest at a specified future time. For the creditors (those lending the funds to the business), the reward for providing the debt financing is the interest on the amount lent to the borrower. Debt financing may be secured or unsecured. Secured debt has collateral (a valuable asset which the lender can attach to satisfy the loan in case of default by the borrower). Debt financing (loans) may be short term or long-term in their repayment schedules.

f) Banks and Other Commercial Lenders

Banks and other commercial lenders are popular sources of business financing. Most lenders require solid business plan, positive track record, and plenty of collateral. These are usually hard to come by for a start- up business. Once the business is underway and profit t and loss statements, cash fl owes budgets, and net worth statements are provided, the company maybe able to borrow additional funds.

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g) Commercial Finance Companies

Commercial finance companies may be considered when the business is unable to secure financing from other commercial sources. These companies may be more willing to rely on the quality of the collateral tore pay the loan than the track record or profit projections of your business. If the business does not have substantial personal assets or collateral, a commercial finance company may not be the best place to secure financing. Also, the cost of finance company money is usually higher than other commercial lenders.

h) Government Programs

GOI have running various programs designed to assist the financing of new ventures and small businesses. The assistance is often in the form of a government guarantee of the repayment of a loan from a conventional lender. The guarantee provides the lender repayment assurance for a loan to a business that may have limited assets available for collateral. The best known sources are the "startup-India" program.

i) Lease

A lease is a method of obtaining the use of assets for the business without using debt or equity financing. It is a legal agreement between two parties that specifies the terms and conditions for the rental use of a tangible resource such as a building and equipment. Lease payments are often due annually. The agreement is usually between the company and a leasing or financing organization and not directly between the company and the organization providing the assets. When the lease ends, the asset is returned to the owner, the lease is renewed, or the asset is purchased. It is often. 18% of start-ups utilize leasing arrangements, with an average lease value of $50,000. This approach allows for flexibility in asset use without the immediate financial burden of ownership.

3. Approaches /Strategies of Attracting Capital Resources

Attracting capital resources for startups requires a comprehensive strategy that encompasses various avenues and approaches. Here's a strategy outline:

3.1. Define Funding Needs: Clearly articulate the financial requirements of the startup, including initial capital for setup, operational expenses, and growth plans. Assess the funding needs at different stages of the startup lifecycle.

3.2. Craft a Compelling Business Plan: Develop a detailed business plan that outlines the startup's vision, mission, target market, competitive analysis, revenue model, and growth projections. A well-structured business plan serves as a roadmap for potential investors and demonstrates the startup's potential for success.

3.3. Identify Target Investors: Research and identify potential investors who align with the startup's industry, stage, and funding requirements. This may include angel investors, venture capitalists, corporate investors, crowd funding platforms, government grants, or strategic partners.

3.4. Build Investor Relationships: Establish and nurture relationships with potential investors through networking events, industry conferences, pitch competitions, and

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introductions from mutual connections. Engage in meaningful conversations to understand their investment criteria, preferences, and expectations.

3.5. Create a Compelling Pitch: Develop a concise and compelling pitch deck that highlights the startup's value proposition, market opportunity, competitive advantage, traction, team expertise, and financial projections. Tailor the pitch to resonate with the interests and priorities of each investor.

3.6. Demonstrate Traction and Milestones: Showcase tangible progress, milestones achieved, customer validation, revenue growth, partnerships, product development milestones, and key performance metrics. Demonstrating traction increases investor confidence and reduces perceived risk.

3.7. Leverage Technology and Platforms: Utilize online platforms and technology-enabled tools to streamline the fundraising process. Crowd funding platforms, online investor networks, and fundraising marketplaces provide access to a broader pool of investors and simplify the investment process.

3.8. Diversify Funding Sources: Explore multiple funding sources to diversify risk and optimize capital acquisition. Consider a combination of equity financing, debt financing, government grants, bootstrapping, strategic partnerships, and alternative funding mechanisms.

3.9. Focus on Investor Due Diligence: Prepare comprehensive due diligence materials, including financial statements, legal documentation, intellectual property rights, regulatory compliance, and risk factors. Address potential investor concerns proactively and transparently.

3.10. Negotiate Terms and Close Deals: Engage in negotiations with potential investors to finalize terms, valuation, investment structure, and governance arrangements. Seek legal counsel to ensure compliance with regulatory requirements and protect the interests of the startup and its stakeholders.

3.11. Maintain Investor Relations: Foster open communication and transparency with investors post-fundraising. Provide regular updates on business progress, financial performance, strategic initiatives, and key milestones. Cultivate long-term relationships to secure follow-on funding and support future growth initiatives.

4. RESULTS AND DISCUSSION

Results:
The data analysis reveals several key insights into the startup financing landscape in India. Private Ltd. Companies dominate the ecosystem, capturing 85.90% of the market. This is

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followed by LLPs at 6.10%, partnership firms and unregistered sectors each at 2.60%, public companies at 0.40%, and other sectors at 2.40%.
In terms of gender distribution among founders, men represent 55% while women account for 5.90%. Startups founded by both genders make up 38.60% of the total.
Family and friends are the primary funding sources, contributing 42.9%. Other sources include angel investors (11.3%), incubator funding (9.7%), private equity (7%), and crowd funding (2.2%). Less common sources are NABARD (0.3%), AIFs (0.5%), SIDBI (0.6%), and NBFCs (1.7%).
A significant majority (85.30%) of startups have not received any international funding. Only 6.80% received up to Rs. 1 crore, 2.3% received between Rs. 1-2 crores, 1.6% received Rs. 3-10 crores, and 1.9% received above Rs. 10 crores.
Regarding capital infusion, 41.10% of startups have infused up to 20 lakhs, with only 7% infusing above 10 crores. In terms of working capital requirements, 73% need more than 10 lakhs for a one-year period, 5% need up to 1 lakh, 9% need 1-5 lakhs, and 13% need 5-10 lakhs.

Discussion:
The predominance of Private Ltd. Companies suggests a preference for their flexibility and limited liability. The significant male dominance among founders highlights a need for policy support to encourage female entrepreneurs. The reliance on family and friends for funding indicates challenges in securing formal financing, emphasizing the entrepreneurial resourcefulness required.
The low percentage of international funding suggests barriers such as limited global network access and regulatory challenges. Enhancing global visibility and partnerships could benefit startups. The varied levels of capital infusion reflect diverse funding needs across different growth stages, indicating that many startups are in early development stages.
The substantial working capital requirements underscore the need for ongoing financial support to sustain operations and growth. Addressing these needs through accessible funding options is crucial for maintaining business continuity and scaling.

5. CONCLUSION & RECOMMENDATIONS

In conclusion, the research findings shed light on the diverse landscape of startup financing options and emerging approaches to attracting capital resources. Through an in-depth analysis of general statistics, funding sources, and strategies, several key insights have emerged.
Firstly, the data analysis revealed a predominant reliance on internal funding sources, including family and friends, personal savings, and bootstrapping, particularly in the nascent stages of startup development. These avenues underscore the entrepreneurial spirit and risk-taking inherent in launching new ventures, highlighting the crucial role of personal investments and resourcefulness in business initiation.
Secondly, the research elucidated the significance of external funding sources, such as angel investors, venture capitalists, government grants, and debt financing, in fueling the growth and expansion of startups. These avenues offer access to capital, expertise, and strategic

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partnerships, enabling startups to scale operations, penetrate new markets, and drive innovation.

Thirdly, the study underscored the importance of strategic planning, relationship-building, and effective communication in attracting capital resources. Crafting compelling business plans, engaging with potential investors, and demonstrating traction and milestones are essential components of a successful fundraising strategy. Moreover, leveraging technology, diversifying funding sources, and maintaining investor relations are critical for long-term sustainability and growth.

Overall, the research highlights the dynamic and multifaceted nature of startup financing, characterized by a blend of traditional and innovative approaches. By understanding the evolving landscape of funding options and adopting tailored strategies, startups can enhance their fundraising success and accelerate their journey towards achieving their goals and objectives.

Recommendations:

1. Concentrate on securing larger investments from a select group of investors rather than spreading efforts across numerous smaller sources.
2. Tailor investment pitches to target investors, emphasizing market traction, scalability, and growth prospects to capture their attention effectively.
3. Cultivate strong relationships with key investors through regular communication and updates on business progress and milestones.
4. Leverage networking opportunities, industry events, and referrals to expand investor reach and access to potential funding sources.
5. Highlight a clear and strategic plan for capital allocation, demonstrating a disciplined approach to financial management and resource utilization.
6. Incorporate feedback from investors to refine funding strategies, emphasizing the potential for substantial returns and the ability to mitigate risks effectively.
7. Prioritize building credibility and trust with investors by maintaining transparency, integrity, and accountability throughout the fundraising process.
8. Explore alternative financing options such as government grants, incubator funding, and strategic partnerships to complement traditional sources of capital and diversify funding streams.

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