



**THE INSTITUTE OF  
Company Secretaries of India**  
IN PURSUIT OF PROFESSIONAL EXCELLENCE  
*Statutory body under an Act of Parliament*



**“AVENUES OF CAPITAL RAISING FOR START UPS – CROWD FUNDING,  
VC, PE, SME/ITP LISTING” AT NATIONAL SEMINAR ON CAPITAL MARKETS  
ON 30<sup>TH</sup> MAY, 2015 @ AHMEDABAD**

## SMEs – The Real Engine of Growth

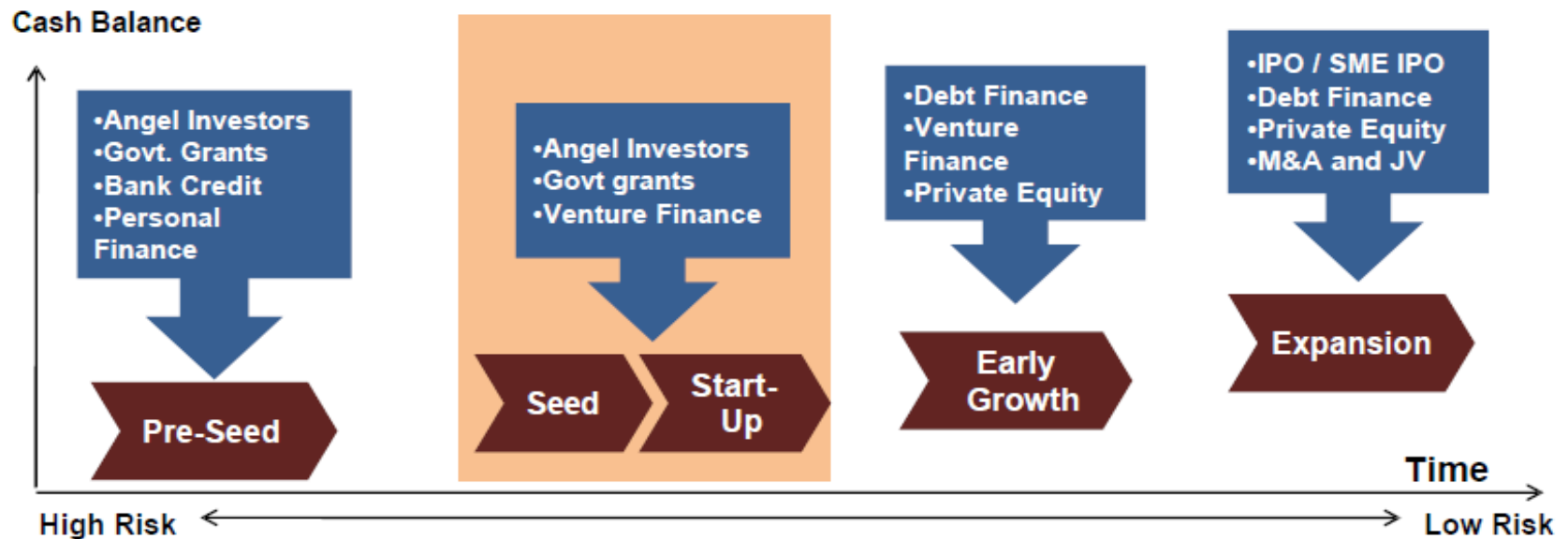
- Small and Medium Enterprises have played a vital role for the **growth of Indian economy** and has been the fountain head for many products and innovations for the Indian and international markets.
- Indian SMEs represent a **diverse asset class of emerging companies** from both traditional sectors and new age economy sectors.
- SMEs are now exposed to **greater opportunities than ever for expansion and diversification** in rapidly growing Indian market across the sectors.

Contribution to GDP	8.7 %
Share of Industrial output	45 %
Share of Exports	40 %
Total Employment	69 million
Job creation every year	1.3 million

*Source : Ministry of Micro, Small and Medium Enterprises, GOI*

- ***Need of the Hour is to empower the SME Sector to take its rightful place as the growth engine of Indian economy.***

## Lifecycle of a SME



- Angel Investors and Government grants are the key sources of funding during pre-seed stage.
- Venture Capital firms are growing averse with risk associated with seed financing due to recession.

- Lack of Venture Financing is affecting startups and early growth companies.
- Most Companies fail to take off in the start up and early growth phase known as the Valley of Death due to lack of Capital commercialization.



With launch of new platforms for SME's and equity Markets bottoming out, one can look for Alternate Funding Options to satisfy their growth needs.

# **What is difference between Private Equity Venture Capital & Angel Investment?**

## Following are the major difference between Private Equity and Venture Capital:

<u>Private Equity</u>	<u>Angel &amp; Venture Capital</u>
<ul style="list-style-type: none"> <li>Private equity funds prefer investments to on-going businesses at later stages of growth via mezzanine or expansion financing. Private equity funds seek companies, which have reached a certain size (revenues exceeding \$10m in), enjoy high operating profit, realise rapid growth, hold considerable market share, and create significant entry barriers in their sectors.</li> </ul>	<ul style="list-style-type: none"> <li>Seed, Start-up or Early Stage Companies with a business or product development plan are generally financed by venture capital funds</li> </ul>



# Type of Private Equity

**Following are the types of Equity:**

[Angel Investment](#)

[Venture capital](#)

[Leveraged buyout](#)

[Growth capital or Private Equity](#)

[Distressed and Special Situations](#)

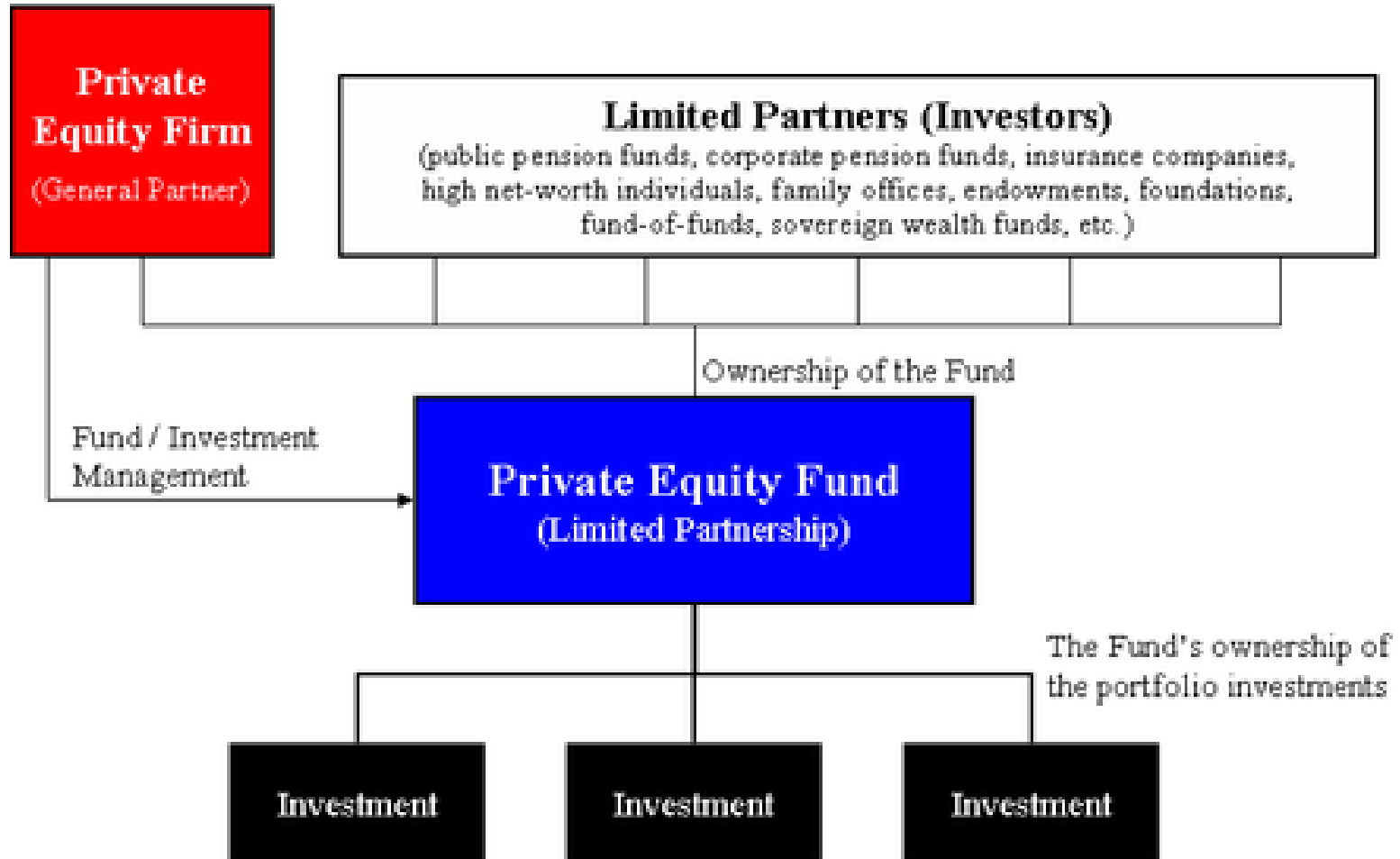
## Other strategies

Other strategies that can be considered private equity or a close adjacent market include:

- Real Estate
- Infrastructure
- Energy and Power
- Merchant banking
- Mezzanine capital
- Structured Capital



# What is Private Equity & Venture Capital Fund Structure?



# **Financial Parameters required to attract Private Equity Investor apart from USP and Marketing Strategy**

**Private Equity Funds generally look at the transactions requiring an equity investment of up to \$10m. This typically equates to an enterprise value of between \$10m and \$50m and provides an equity interest of between 20% and 80% in the investee.**

**While VC Funds Look at the deal size of \$ 1 Mn to 5 Mn.**

**Following are the parameters require to attract Private Equity Investor:**

- **Turnover greater than or equal to Rs. 50 Crores (INR) / \$10 million (USD)**
- **EBIDTA greater than or equal to 18%**
- **IRR greater than or equal to 22%**
- **Shares Dilution greater than or equal to 20%**
- **Business must have scalability**



# How Private Equity Investors Evaluate Investment Opportunity

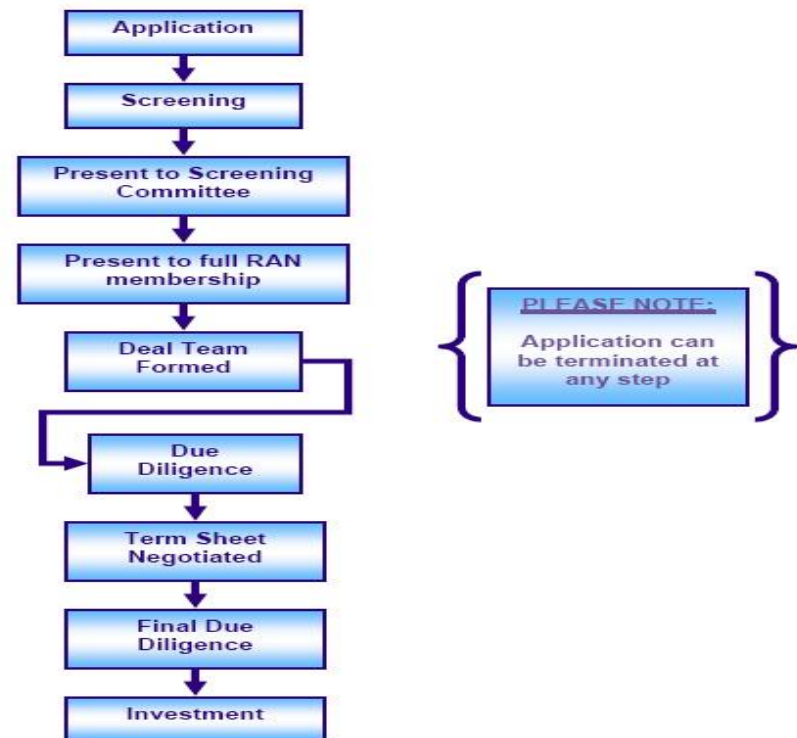
## Considerations for investing in private equity funds relative to other forms of investment include:

- *Substantial entry requirements*
- *Limited liquidity*
- *Investment Control*
- *Unfunded Commitments*
- *Investment Risks*
- *High returns.*

# **What is the Investment process followed by Private Equity Investor?**

## Following are the Investment Process followed by a Private Equity Investors:

- Investee Company may be approached by Private Equity Fund OR Private Equity Fund may be approached by Investee company
- Start with Business Presentation
- Due Diligences
  - Account Due Diligences
  - Legal Due Diligences
  - Secretarial Due Diligences
- Enterprise Valuation
- Term Sheet
- Share Holder Agreement
- Investment





# **Which are the Financial Instruments used by Private Equity Investor for Investing Purpose?**

**Following are the Financial Instruments used by Private Equity Investors:**

**Convertibles Debentures**

**Optional Convertible Debentures**

**Preference Shares**

**Equity Shares**

# Major Terms attached to equity

[Tag Along](#)

[Drag Along](#)

[Call Option](#)

[Put Option](#)

**Private equity firms generally receive a return on their investments through one of the following avenues:**

- *Initial Public Offering (IPO)*
- *Merger or acquisition*
- *Recapitalization or repurchase*

# What is Role of Investment Banker and / or M&A Advisor?

## Investment Banker and M&A Advisor

- **M&A Advisor provide service and advice to companies and organizations.**
- **M&A Advisor also assist and advise companies on mergers and acquisitions, which basically means that they act as the buyer or seller (whatever position the company is taking) and negotiate the transaction.**
- **It is the duty of the M&A Advisor to provide advice on issues such as how to raise capital through equity or debt instruments.**
- **A M&A advisor's main goal is to help clients achieve their goals.**
- **M&A Advisor will assist their clients with the implementation of their chosen plan, including but not limited to buyouts.**
- **In order to provide clients with the most accurate and effective strategy, M&A Advisors need access to in-depth information and comprehensive research and financial modeling tools to analyze the market and formulate likely outcomes.**

# Crowd Funding

- Equity Crowd funding is a mechanism that enables broad groups of investors to fund startup companies and small businesses in return for equity.
- Internet based fund raising program from public in small denominations.
- Project Nature
  - Social and Civic Projects
  - Intellectual Property Exposure
  - Research Driven Projects
  - Litigation Driven Projects

# HOW TO STRUCTURE M & A TRANSACTION



## Types of Mergers

- Horizontal – Merger of companies in the same product range
- Vertical – Merger of companies having customer and supplier relationship
- Market Extension – Merger of companies having presence in different locations
- Product Extension – Merger of companies having different product range in related field
- Business Conglomerate – Merger of companies in different area

## Possible Reasons of Failure

- Acquirer are over optimistic in their assumptions
- An overestimation of the synergies that the merged company will experience.
- Acquiring company overbids.
- Poor Post – acquisition integration.

# Successful Acquisitions Require

- Improving the target company Performance
- Accelerate the market access of target companies product
- Get skill and technology faster than to built
- Consolidate to remove excess competition
- Acquire the target at the early stage of industry before your competitor

## M & A as Value Creation

- Value creation when transaction above fair market value
- Buyer pays for possible synergy and control premium
- Buyer claiming for value created
- Seller claiming value for control premium

# How to evaluate acquisition target

- Determine your strength v/s competition
- Rationalize your core competence
- List out potential targets
- Identify possible synergy and strength
- Identify right size for acquisition

# Negotiation for the Deal

- Initiate from the fair market value
- Claiming the value created
- Identifying bargaining range
- Progression towards concessions
- Identify must have and good to have terms
- Commit within your range
- Agree Material Adverse Conditions

## Ticklish Issue

- Cultural, Customary & Organization structure
- Lock-in of promoters
- Non-compete/Non-solicitation
- Call / put option
- Financial Structure
- Participate Vs. Protective Rights
- Tag/Drag along Rights
- Arbitration Vs. Litigation

# Valuations

**For Merger Acquisitions,  
Investments and  
Joint Ventures**



# Methods

- DCF
  - FCFE
  - FCFF
- Comparable Companies / Relative Method
  - Multiples assigned to Sales
  - Multiples assigned to EBITDA
  - P/E
- Methodology based upon business
- Replacement Value

# Valuation depends on

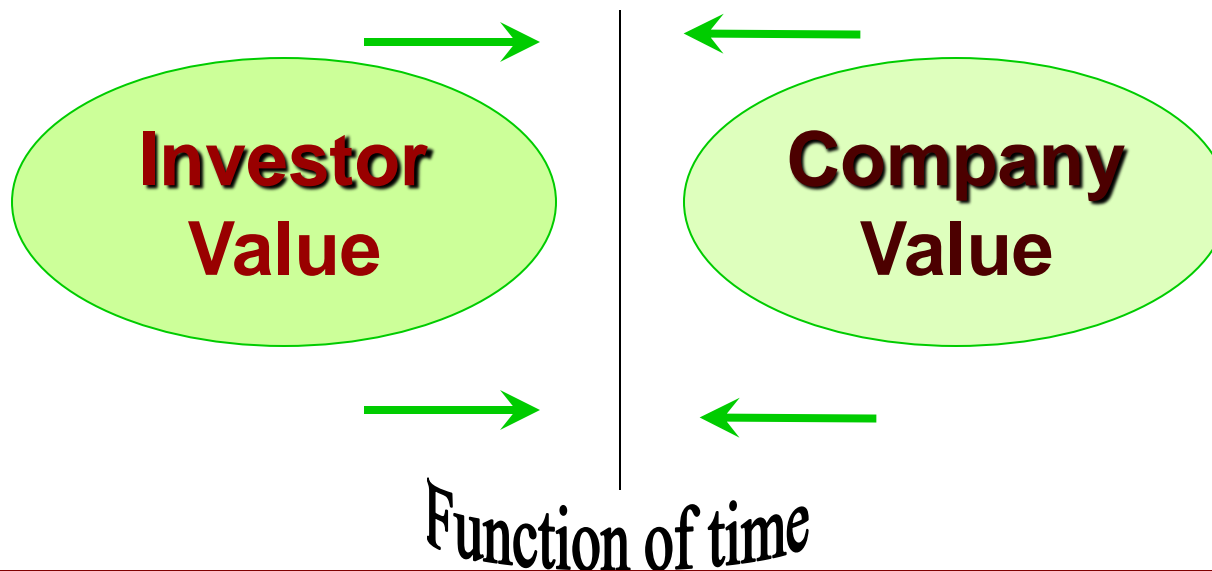
- Management team
- Historical performance
- Future projections
- Project, product, USP
- Industry scenario
- Country scenario
- Market, opportunity, growth expected, barriers to competition

# Valuation depends on

- Nature of transaction
- Whether 1st round or later round
- Whether related or other parties
- Amount of money required
- Stage of company - early stage, mezzanine stage (pre-IPO), later stage (IPO)

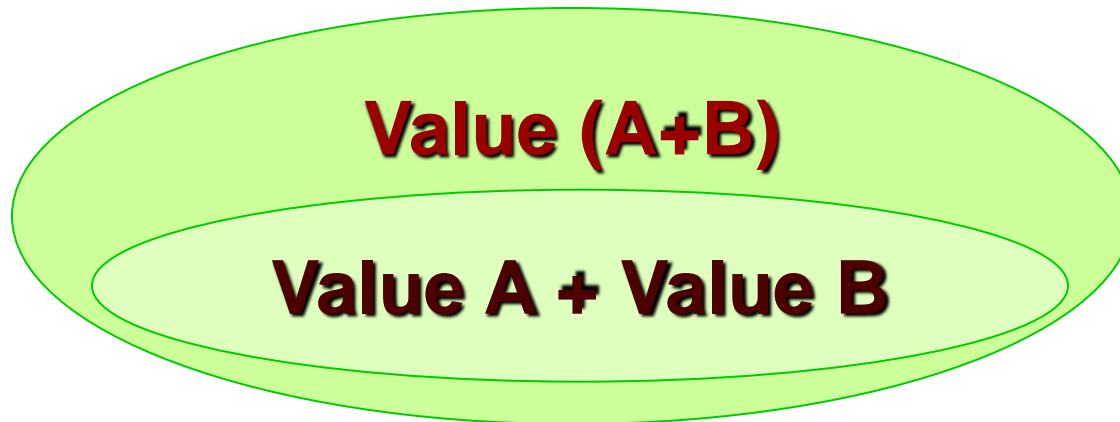
# Valuation: for investment

- Valuation is perception in the eye of the beholder
- It is subject to negotiation



# Valuation: in M&A

- Value of combined business is expected to be more than value of the individual companies



# IPO & SME LISTING

## SME Exchange v. Main Board – Advantage SME

Parameters	Main Board	SME Exchange (BSE)
Post – issue paid up capital	Min Rs. 10 crore	Min Rs.1 crore; Max Rs.25 crore
Minimum Allotees in IPO	1000	50
IPO underwriting	Non Mandatory (Under 50% compulsory subscription to QIB's)	Mandatory (100% underwritten with MB underwriting 15%)
IPO Grading	Not Mandatory	Not mandatory
Track record	Stringent track record norms	Relaxed track record norms
Offer Document vetting	By SEBI	By Exchange
IPO Application Size		Min. Rs. 1 lac
IPO Time frame	Rs. 10000 – Rs. 15000 6 months	2 – 3 Months
Reporting Requirements	Quarterly	Half yearly

## ITP v. SME Exchange v. Main Board

Parameters	Main Board	SME	ITP
Post – issue paid up capital	Min Rs. 10 crore	Min Rs.1 crore; Max Rs.25 crore	Max Rs 25 Crore
Minimum Allotees in IPO	1000	50	NA
IPO underwriting	Non Mandatory (Under 50% compulsory subscription to QIB's)	Mandatory (100% underwritten with MB underwriting 15%)	NA
IPO Grading	Not Mandatory	Not mandatory	NA
Track record	Stringent track record norms	Relaxed track record norms (NSE requires three year track record and positive cash flows of two years)	Nominal Track record with basic hygiene factors
Offer Document vetting	By SEBI	By Exchange	Info memorandum to be approved by Exchange
Trading Lot	No Lot (Even single Share Possible)	Min. Rs. 1 lac	Min Rs. 10 Lakhs
IPO Time frame	6 months	2 – 3 Months	1.5 - 2 Months
Reporting Requirements	Quarterly	Half yearly	Half Yearly



## Key Benefits of Listing



### Funding Convenience

- Access to capital & financing opportunities
- Avoid unlisted space discounting
- M&A Currency
- Entry / Exit platform for PE / other investor



### Tax Benefits

- No Long Term Capital Gains
- Short Term Capital Gain Tax at reduced rate of 15%
- No WHT on Buyback
- No tax on equity infusion in the company
- No tax on 'distress business' purchase



### Others

- Unlocking value
- ESOPs Talent retention tool
- Visibility Profile building
- Improved Governance - Internal systems

**SME Listing – Benefits Galore !**

## Key Benefits of SME Listing ( 1 of 4)



Implications of Listing	Resulting Benefits
Collateral Value	Raising of loans through collateral of listed shares possible
Improves Credit Rating	Cost of finance reduces
Visibility	<ul style="list-style-type: none"> <li>• Brand building</li> <li>• Stock Exchange quote</li> </ul>
Lenders'/Suppliers' increased	<ul style="list-style-type: none"> <li>• Increase in credit period</li> <li>• Lesser negative covenants</li> </ul>
Transferability of shares at market price	<ul style="list-style-type: none"> <li>• ESOPs – Higher compensation for senior executives without cash / P&amp;L burden</li> <li>• Overseas listing possible</li> </ul>

## Key Benefits of SME Listing (2 of 4)



### Tax on Buy Back of Shares

- Unlisted companies subject to 20% tax on buy back of shares



### Tax on Infusion

- Unlisted Companies subject to 30% tax on issue of new shares at a premium exceeding fair value



### Capital Gains tax on transfer of shares

- LTCG @20%



### Purchase of Distressed Asset

- Purchase of distressed asset below NAV is subject to tax @ MMR

All such taxes are NOT applicable in case the shares are listed. This enables tax-free

- entry and exit (through buy back, transfer, fund infusion)
- purchase of distressed assets,
- share transfers (eg. Family Succession, Intra-Group Transfers, Third-party Transfers etc.)

## Key Benefits of SME Listing (3 of 4)



### Valuation benchmarking

- Wealth creation through market cap of shares upon listing

### Listed shares as currency

- Use of shares for takeovers / M&A transactions, leading to inorganic growth

### Promoter Profile Building

- Adds to social reputation and status

## Key Benefits of SME Listing (4 of 4)



Internal Controls

Improved Systems

Better Information Flow

Data management

**Good corporate governance helps companies immensely and also increases the confidence among its stakeholders**

## SME Listing Agreement

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- All SMEs getting listed need to enter into Listing Agreement (LA) with the relevant stock exchange.
- BSE and NSE has adopted model LA released by SEBI.
- Key Requirements include the following :
  - Half-yearly results (Audit / limited review)
  - Half-yearly shareholding pattern
  - Advance notice of Board meetings with specified agenda (e.g. dividend, bonus, buy back etc.)
  - In-principle approval for any further issuance of shares
  - Disclosure of price sensitive information
  - Annual report containing inter alia full financials, consolidated financials, related party disclosures etc. to be uploaded on corporate website
  - Full annual report to be emailed; Abridged annual report to shareholders not on email ids
  - Compulsory migration to main board after the cut- off ceiling

## SEBI ICDR As Applicable to SMEs

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- SEBI ICDR applies to SME listing with specific relaxations
  - Offer document requirements and eligibility norms relaxed
- Appointment of Merchant Banker, and other intermediaries required
  - Lead Merchant Banker to the issue,
  - Rights, obligations, and responsibilities relating to disclosures, allotment, refund, and underwriting obligations
- Book building or fixed priced issue permitted
- Lock-in conditions apply
  - 20% of post-issue capital to be locked in for 3 years; balance promoter shareholding to be locked in for 1 year
  - Non-promoter pre-IPO shareholding to be locked in for 1 year with exception to ESOP shares and shares held by VCF or FVCIs for more than 1 year pre IPO
  - Subject to the provisions of SEBI (SAST) Regulations i.e. Takeover Code, Locked-in shares are permitted to be transferred inter se promoters incl. new promoter(s). The Lock in period shall continue for the remaining period with the transferee.

# Q & A



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