ACCA Think Ahead

FOUNDER'S GUIDE FOR START-UPS AND ENTREPRENEURS:

ROLE OF ACCOUNTANCY AND FINANCE

Foreword

Start-ups in India have seen remarkable growth in recent years, with India emerging as the third-largest business ecosystem for new ventures, globally. Contributing to India's ambitions of becoming a US$5 trillion economy by 2025, start-ups are being seen as the spine of a new India.

Success in entrepreneurship relies on effective financial management. Maintaining financial discipline is crucial for establishing a robust front-end while being compliant with laws and regulations builds a solid back-end foundation.

Accountancy and finance professionals, including accountants, financial analysts and tax experts, play a crucial role in helping start-ups address financial issues: from providing the required maturity in financial processes that is essential to raising an Initial Public Offer (IPO), for example, through to ensuring compliance with regulatory and taxation requirements.

In this guide, ACCA, in consultation with its members and industry practitioners, lays down the dos and don'ts across the key aspects of financial management for a start-up and for an entrepreneur aiming to create a substantial business. It also outlines various touchpoints with accountancy and finance professionals and the skills they need to contribute effectively as thought partners.

Relevant for entrepreneurs, budding entrepreneurs, and accountancy and finance professionals keen to work with entrepreneurs, this guide is ACCA's contribution to supporting the thriving start-up ecosystem in India. In line with ACCA's public value agenda for supporting our members, future members, and the accountancy and finance community at large, the report offers practical tips to empower them to pursue their entrepreneurial dreams.

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Executive **summary**

With more than 200% growth in the number of start-ups over the last eight years (to 100,000+ in 2023 from 450 in 2016), India is now the world's third-biggest start-up ecosystem (Ministry of External Affairs 2023). Thanks to support from the government to improve the ease of doing business, over 80 start-ups are being recognised per day (the highest globally) (Mint 2022).

Managing finances is at the heart of successful entrepreneurship, and that is where this guide will come in handy. Designed with input from entrepreneurs and finance practitioners, it answers the six key questions for entrepreneurs planning their start-up’s financial journey.

1. How to secure a good valuation?

ACCA asked valuation experts for the secret to securing good valuation: a viable product and a strong ‘proof of concept’ is their answer.

As you bootstrap/self-finance your venture in the pre-start-up stage, focus on the idea. A start-up's value comes from having a unique product that people use repeatedly. If the product is fresh and useful and brings long-term benefits, it's valuable. For fundraising at the start-up stage, venture funds and angel investors look at the product, the entrepreneur’s skills, the target market and the growth potential. Develop the idea and test your ‘proof of concept’, as you look to raise funds through instruments such as a merger or acquisition (M&A), an IPO and private placement in the growth phase.

2. How to manage day-to-day finances (cash flow and working capital)?

By managing and allocating resources effectively towards capital and operational expenditures, you can improve financial performance, reduce costs and increase profitability, resulting in sustained growth.

Founders who have been through this journey recommend that you make sure your funder understands your business; plan your needs six to eight months before and explore multiple options of financing; keep your stock reports and other paperwork updated and stay clean financially; extend the period over which you use up your initial capital (ie reduce the ‘burn rate’) to generate value; manage receivables for efficient working-capital management; exercise control over turnover and manage inventory effectively. Hire accountancy and finance professionals to help you or develop the acumen internally: having someone on your team who understands numbers is crucial, as earning and managing money require different skill sets.

3. How to ensure continuous growth?

Accurate and up-to-date information helps you make intelligent and informed decisions for building your future success.

Define the essentials for your business to survive (the critical success factors) and the key performance indicators (KPIs) for each. Set up a financial and performance management system (PMS) that records your progress against the baseline and recommends actions to be taken. Choose a system that is simple and easy to use, provides timely updates, is relevant to your needs and is scalable. Focus on what the data reveals when making operational and strategic decisions. And if this all sounds too complex, hire an accountancy and finance professional, because identifying and reporting on KPIs is one of their core competencies.

4. How do good corporate governance and internal controls help?

The experts tell us they are essential for building a solid foundation. Corporate governance and internal controls can be understood simply as 'doing the right thing' for customers and employees. Having a compliant business with solid internal control mechanisms provides a competitive edge when seeking funds from investors, helps in building the company's reputation, and prevents fraud and errors.

Ensure compliance with relevant laws and regulations because non-compliance will make your business non-viable. As the business grows, invest in strong finance, internal audit and control mechanisms while balancing these against the flexibility required for innovation. Seek counsel from experts to get it right the first time.

5. How much risk is too much risk?

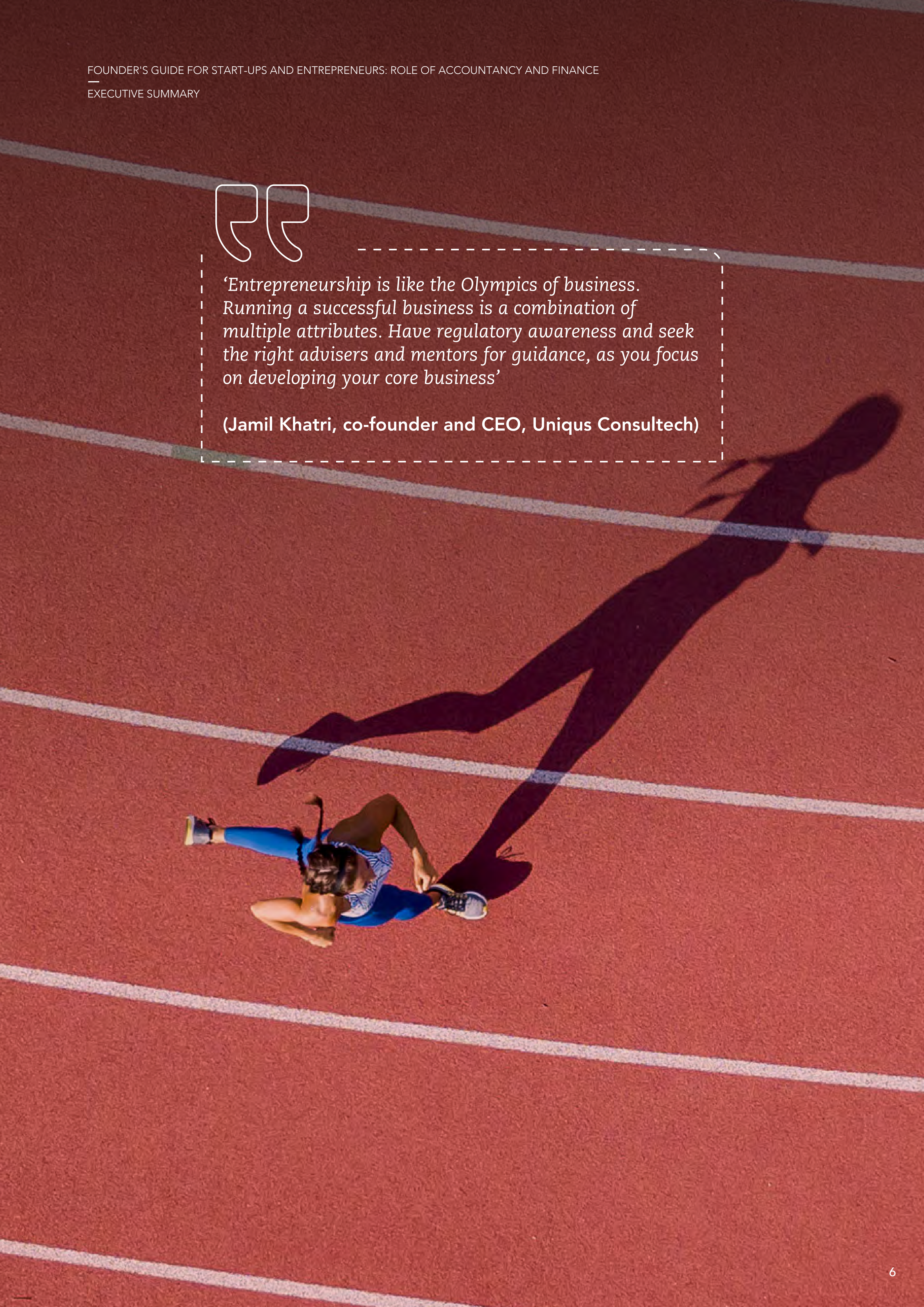
Taking risks is fundamental to entrepreneurship. Risks represent opportunities if you know how to use them but if they materialise they can also be your worst nightmare, if not handled properly.

Prudent risk-taking is the key to success. Take calculated risks and avoid anything that could put a question mark on your business model. As an entrepreneur, you need to embed risk management in the culture of the organisation. Self-examination and delegation are important to enable calculated risk-taking. Have systems and processes in place to monitor risks and reduce their impact, should a risk materialise, through back-up plans. Seek professional help wherever needed – the unpredictability of new regulations presents risks for which entrepreneurs need to prepare, for example, and accountancy and finance professionals can guide you through the processes.

6. How do I manage the regulatory and taxation issues?

While the ease of doing business has improved considerably, regulatory and tax compliances can be intricate and often pose challenges to start-ups. Understanding and complying with regulations is essential for businesses to thrive.

Having a minimum knowledge of the applicable regulations and compliance is essential. When considering regulatory issues, choosing a legal structure suitable for your business is the first step. Understand the licensing and permit requirements for your business, and ensure compliance with labour and environmental regulations as well as the Foreign Exchange Management Act (FEMA) guidelines (if you receive foreign investments). Common taxation compliances include income tax, tax deducted at source, employee provident fund, employee state insurance and compliance with goods and services tax. Seek expert help: accountancy and finance professionals play a key role in helping start-ups with regulatory and taxation issues.



‘Entrepreneurship is like the Olympics of business. Running a successful business is a combination of multiple attributes. Have regulatory awareness and seek the right advisers and mentors for guidance, as you focus on developing your core business’

(Jamil Khatri, co-founder and CEO, Uniqus Consultech)

Introduction

What comes to mind when you hear the word 'start-up'? A valuation of a billion dollars? Or the vision of building something that's going to help solve one of the many challenges that the world faces? Or the wonderful feeling of being your own boss? Irrespective of the objective, the thrill of building a business worth multimillion dollars from scratch is exciting but the thought of figuring out everything, from sales and marketing to managing finances, can be daunting.

Managing finances is at the heart of successful entrepreneurship. And that is where this guide will come in handy. Designed with input from entrepreneurs and finance practitioners, it sets out step-by-step planning for the financial journey of your enterprise. It outlines the processes across the six key financial management stages and highlights the dos and don'ts, with examples from people who have already been on this journey, whether as founders, accountancy and finance professionals working with founders, or investors and incubators.

Whether you are an entrepreneur, planning to become one, or an accountancy and finance professional keen to work with entrepreneurs, this guide is for you. Here are the three areas and six key stages you need to plan/help plan, which we will look at in more detail below.

Figure I1: Planning to launch your start-up

1. Financing the business
- Valuation
- Cash flow and working capital

2. Business improvement
- Performance management

3. Corporate governance and controls
- Ethics and governance, and internal controls
- Managing risks
- Regulatory & taxation issues

1. FINANCING THE BUSINESS

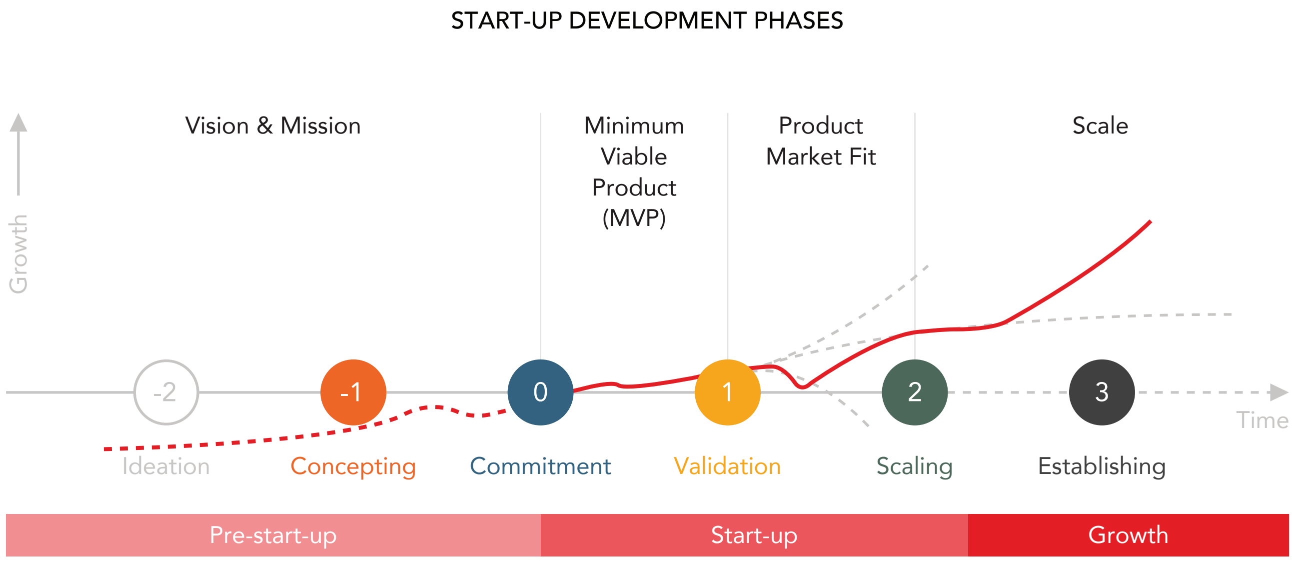
1. Financing the business

So, you have your proof of concept and are ready to get things started. Understanding how to finance your business sustainably is the first step. The right financing can do more than just provide the cash your venture needs to function. It can also minimise costs and reduce risks (see ACCA 2016).

1.1 Valuation

Evaluating a start-up is both a science and an art. Valuation determines the worth of a new firm and how much money anyone with a stake in the company will make on exit. Finding the sweet spot of your company's valuation can make or break a potential supporter's decision to invest in your company. What are the key stages in a start-up's journey leading up to the valuation stage and what are the means of securing a good valuation? These are the key questions you as a budding entrepreneur need to consider.

Figure 1.1: Key stages for start-ups and sources of funding



Source: Mavilach (2020)

Pre-start-up

Bootstrapping/self-financing involves starting the business with little or no venture capital or outside investment. The initial investments (pre-seed and seed funding) generally come from the savings of the founder, or from family, friends or acquaintances of the founder.

> **Aditya Agarwal, cofounder of CampusSutra, explains,** *'bootstrapping is growing a company without taking any external equity funding. Bootstrapped start-ups use personal funds initially and gradually raise money from banks, based on the business's financial health'.*

Start-up

Common funding sources for this stage are **venture capital (VC)** funds that put relatively large amounts of money ('ticket sizes') into their investments. VCs can provide funding for late-stage start-ups. Start-ups generally get funds in multiple stages, referred to as Series A, Series B, Series C, and so on, and successful progression is linked to market performance and growth objectives. Employee stock option plans (ESOPs) are commonly used to attract talent and as a team motivation, as well as a fund-saving tool. **Private equity/investment firms** are another fundraising option for fast-growing late-stage start-ups that have maintained a consistent growth record.

Other options are **1) incubators,** which assist entrepreneurs by offering value-added services (office space, utilities, admin and legal assistance, etc.) and collateral-free debt, by enabling access to low-cost capital provided by the **government of India** (read ACCA's research entitled *Space to grow: new models of business support* (ACCA 2020a) to understand the role of accelerators and incubators as support mechanisms); **2) angel investors,** who invest their money in high-potential start-ups in return for equity, such as Indian Angel Network and Mumbai Angels and **3) crowdfunding** via online platforms, such as Ketto where a number of people come together to contribute relatively small amounts each.

The government of India has also launched initiatives and schemes to support entrepreneurs and start-ups. Here are some examples.

1) The Startup India Seed Fund Scheme provides financial assistance to start-ups for proof of concept, prototype development, product trials, market entry, and commercialisation.

2) Atal Innovation Mission supports the establishment of Atal Incubation Centers (AICs) that provide a conducive environment for start-ups to grow. These centres often offer funding, mentorship and infrastructure support. Read here to learn about the 100+ schemes from various departments and ministries, as well as the state start-up policies (Ministry of Commerce and Industry n.d.). See more details in section 3.3.

Growth

Once there is fast market growth and increasing revenues, you and your investors have various options.

1) In a merger or acquisition, you may decide to merge the company with an existing one or sell your stake in the company. The merger/acquisition at this stage would usually be done with/by a larger, more established company in the same industry.

2) You might decide to list on the stock market for the first time, via an initial public offering (IPO). Private placement is also explored as an alternative to an IPO, that is, where a start-up sells securities to a pre-selected group of investors, thus allowing for fewer regulatory hurdles and media glare.

Accountancy and finance professionals are integral to the IPO process, bringing in the required maturity in financial processes, and ensuring compliance with regulations and the extensive financial reporting requirements. Their contributions extend to prospectus preparation, financial due diligence, and continued post-IPO compliance, fostering investor confidence and facilitating a successful public offering.

ACCA spoke with Darshana Kadakia, Partner and Valuation Practice Leader, Grant Thornton India

ACCA: What determines a good valuation?

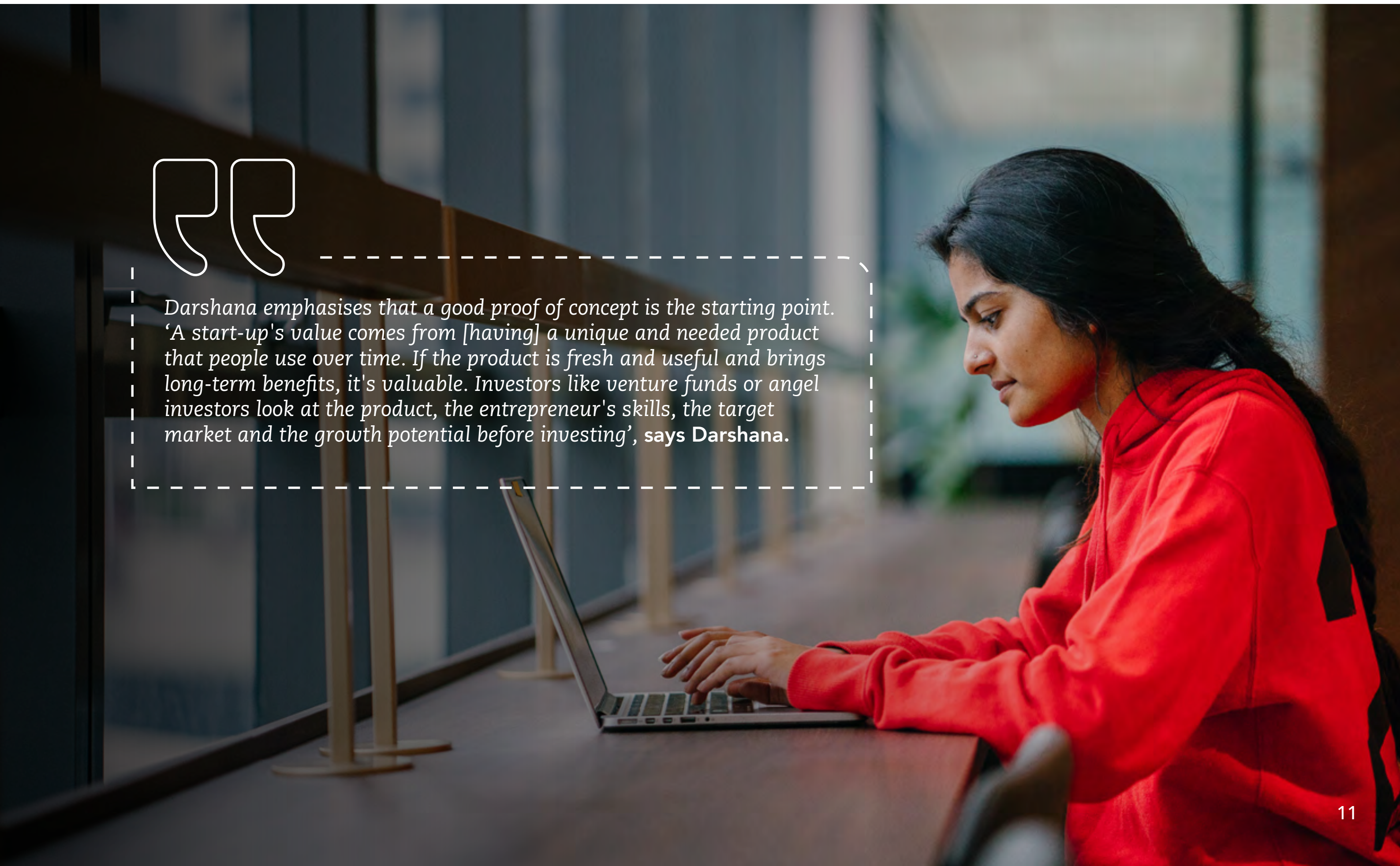
DK: *A viable product and a strong 'proof of concept'. The product should have a longer-term viability for investors to see value in it. Of 100 ideas, only 10–15 are accepted by the market, so do a thorough analysis of your product at the initial stage. Understand the growth potential and the USP [unique selling point] of your product/service as against those of your competitors. Figure out how will you differentiate it and how you will move users from existing service providers to your product/service, or create new users for your product/service.*

ACCA: What are the things to keep in mind as a start-up moves from early stage to valuation?

DK: *Focus on the idea. Conceive and develop it as the actual valuation comes into the picture, when a 'proof of concept' is developed. I'll share the example of this ed-tech company that started very small with the idea of designing content and assistance for schoolteachers using a B2B platform. While the initial value was low, once their concept and content were appreciated (and upgraded [following] feedback), that became their 'proof of concept' to replicate. After that, the start-up started getting higher valuations.*

How do you secure a good valuation?

- **Design a sustainable business model,** emphasising the unique value proposition of the product.
- **Demonstrate the value of, and demand for, the product** through consistent revenue generation.
- Get a **clear understanding of the market and customers** and **leverage technology** to drive efficiency and growth.



Darshana emphasises that a good proof of concept is the starting point. 'A start-up's value comes from [having] a unique and needed product that people use over time. If the product is fresh and useful and brings long-term benefits, it's valuable. Investors like venture funds or angel investors look at the product, the entrepreneur's skills, the target market and the growth potential before investing', **says Darshana.**

1.2 Cash flow and working capital

'While having a good product to secure valuation is important, equally important is managing the fund and understanding the financial implications', **comments Darshana.**

A key part of financial management is managing your day-to-day finances: your cash flow and working capital. 'CapEx' and 'OpEx' are like the yin and yang of a business's financial world.

Capital expenditure (CapEx or capital expenses) refers to capital spent on assets with long-term benefits, such as, property, plant, or equipment. CapEx consists typically of one-time expenses and has a more substantial impact on the company's finances than OpEx. It enables businesses to buy or upgrade long-term assets crucial for starting or expanding operations and increasing production capacity.

Operational expenditure (OpEx or operating expenses) refers to the expenses incurred on day-to-day operations, such as salaries, rent, utilities and maintenance costs. OpEx is usually a stream of expenditure incurred to keep the business running.

Why and how should an entrepreneur maintain a healthy working capital?

- Working capital management involves a) maintaining the working capital operating cycle, ie number of days between paying suppliers and receiving cash from sales b) minimising the amount of working capital, and c) maximising the return on current asset investments.

- Working capital serves as a metric for how efficiently a company is operating and how financially stable it is in the short term. Capital tied up by slow-moving inventory (referred to as 'inventory heaviness'), or high number of outstanding sales invoices can cause liquidity challenges and a lot of operational stress. Dynamic discounting (offering discounts for early payment – on both the supplier and customer side), effective cash flow forecasting that is sensitive to real-time updates, and use of dynamic working capital models and optimisation strategies are critical for effective cash management.

- Some of the ratios to track include:
  - current ratio, which measures a company's ability to cover its short-term liabilities with its short-term assets; a ratio above 1 indicates that the company has more assets than liabilities in the short term
  - inventory turnover, which is cost of goods sold divided by average inventory value – the higher this is, the better
  - days' sales outstanding (DSO), which measures the average number of days it takes for a company to collect payment after a sale. A low DSO indicates fast cash collection.

- By effectively managing and allocating resources towards capital and operational expenditures, companies can not only improve their financial performance but also reduce costs and increase profitability. Ultimately, this can lead to sustained growth, which is the holy grail for any business.

Challenges/ limitations to be considered in working capital management

- **Limited access to funding can lead to cash flow problems,** making it difficult to cover operational costs and invest in growth opportunities.
- **Operating at a high 'burn rate',** meaning spending more money than the company earns, can deplete cash reserves rapidly, leading to liquidity issues if new funding sources are not secured in time.
- **Delayed payments** from clients can disrupt the company's cash flow, affecting day-to-day operations.
- **Economic uncertainties (such as trade wars or economic downturns) and market fluctuations** can affect the funding climate, making it harder for start-ups to secure funding.
- **Overvalued start-ups** might face challenges in meeting investors' expectations, which can lead to a loss of investor confidence and funding issues.
- **Changes in regulations/policies** can disrupt the business environment. Compliance with new rules might require additional investments, reducing the available liquidity.
- **Internal issues,** such as mismanagement of funds, overspending on non-essential activities, or inefficient financial planning can also cause liquidity problems.

ACCA spoke with Aditya Agarwal, co-founder of CampusSutra

ACCA: What are your tips for a steady cash flow and working capital?

AA: *Make sure the financial institution [you approach for investment] understands your business. Break down complexities, so they get it. Financial institutions move slowly. Plan your needs six to eight months before. Mix finances. Explore both banks and NBFCs [non-banking financial companies]. Banks have lower rates, NBFCs are quicker for short-term needs. Follow processes. Keep up with stock reports and other paperwork. Stay clean financially. Follow all the rules to avoid delays in getting funding.*

ACCA: How did you manage the financial aspects, such as cash flow and working capital in your business? Did you have someone with a finance background to help you?

AA: *We managed on our own when we started out as both my co-founder and I have studied finance, so we didn't feel the need to hire a CFO. 20% of our time in the initial two years was spent on figuring out the financial aspects. As we scaled up, we realised the importance of building a finance team and to onboard an expert to manage our relationship with the funders – banks, in our case. As we are present in 26 countries, finance teams, along with making sure everything is compliant, are also helping us make and save money by negotiating the best interest rates across geographies, for example.*

For GenZ entrepreneurs who don't have business acumen, you should either have an accountancy and finance professional to help you or develop the acumen. Vanity matrices, such as number of followers or daily sales, shouldn't be the only criteria. Earning money and managing it are two different skill sets, therefore, having somebody who understands numbers is very important as it holds you in good stead.

ACCA: Any other tips for young entrepreneurs who are just starting?

AA: *Start with [both a] '10,000 feet' and a '10-feet' view of the company. You need to toggle between them initially … for the first three to four years. Don't start out with a very big rigid mission, understand and then make your own vision, mission and values, based on what you have learned. Take insights from successful entrepreneurs but don't ignore your [other] learnings. Once your business is established, you can have your teams focus on the 10-feet vision and you can continue to focus on the 10,000-feet view.*

ACCA spoke with Alex Danylenko, Managing Director and Founder of Boodmo

ACCA: How do you manage your cash flow and working capital requirements?

AD: *Working capital is very crucial right from the start. From my learnings, I will say entrepreneurs should focus on reducing the cash burn rate to generate value, and avoid hurried fundraising. A deeper look into receivables is essential for efficient working capital management. Exercise control over turnover and manage inventory effectively.*

ACCA: Any other tips for entrepreneurs starting out?

AD: *For entrepreneurs seeking funding in the current environment, it's crucial to demonstrate success before approaching investors. Conduct numerous transactions to test and scale the idea. Show real sales achievements rather than relying solely on discounts for growth, for example. Focus on building a profitable business, emphasising sustainability over rapid but unsustainable expansion.*

Financial discipline plays a vital role in entrepreneurship. Education is valuable, but starting a successful business requires more than just academic knowledge. Seek advice from professionals, especially when dealing with something new or risky. Embrace a learning mindset and prioritise continuous development.

2. BUSINESS IMPROVEMENT

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Business improvements are most successful when backed by good financial management. Accurate and up-to-date information lets you make intelligent and informed decisions for building your future success.

2.1 Performance management

What is 'performance' to you? Is it profits? Is it IPO value? Is it some social goal? What 'performance' means to you is defined by what you have included in your mission statement, vision and objectives.

But how do you know if you have achieved that goal? To answer, you need to ensure that you have a system or a process in place to record what you have defined as 'performance', how you are progressing towards that goal and what actions can be taken to achieve it. Monitoring those areas that are essential for your business to survive is crucial. That's what performance management is all about. Good performance management reduces risk as you keep an eye on both the present and future.

Example of performance management

Let's say you run an online B2C business. To review whether you are doing well, you may want to:

- create a dynamic budget – to identify your initial funding requirement, your revenues, costs and profits, and any new funding requirements
- know the periodic trends of orders, returns, discounts offered, average order value, and so on
- be aware of the overall health of the organisation, such as cash flow balances, repayment capacities, any frauds detected and their value, revenue leakages, stock lying unsold, etc.

The trends and health of the organisation are the CSFs while the specific metrics, such as average order value, are KPIs. Performance management should focus on both the short and long-term goals. Unless you have a PMS, you cannot know this key information.

Managing performance: what do you need to do?

The recipe for good performance management is rather simple – but as with cooking, the success of the result depends on how well you execute the recipe.

As mentioned earlier, the first step is to define those areas essential for your business to survive. These are defined as the critical success factors (CSFs). For each of these areas, you need to a have metric (a measurement) that will tell you how well or how badly you are performing. These are your KPIs. Once you define these, you need to set up a financial system and PMS that records this baseline and your progress against it. If possible, the systems should produce recommended actions to be taken.

PMSs can range from spreadsheet dashboards that track results to well-defined enterprise resource planning (ERP) systems, further supported by visualisation tools. Ultimately, the system you implement should be:

- simple for you and your users
- provide timely and appropriate reports such as KPIs to track the periodic performance, generate periodic financial performance report card, and these reports should be available at the appropriate level of detail to relevant persons only
- relevant to your needs and scalable – if you are a small-scale organisation, spreadsheets might be better than a complex ERP. But as you grow you may need to move to specialised accounting software and then to an ERP.

Focus on what the data is revealing – each data point contributes to a narrative about the current status of your business. Use the data to make decisions on your business operations and strategy.

- **Resource management** – decisions such as whether to make or buy, to outsource, to use short-term resources at higher cost or longer-term resources at lower cost. Employee performance data will show you the areas where your employees need training, who should be rewarded, etc.
- **Product, service and market portfolio** – customer data analyses can tell you what products and services are required by your target market and what should be removed from your portfolio. A decision about whether to move to a new geographical market should be taken using data.
- **Cash flow and investment** – using data helps with decisions on deploying surplus funds into value-added areas to maximise returns (directly or through branding) and with proactive planning to source funds for any interim shortfalls.

All these may sound too complex, but accountancy and finance professionals learn and do these things on a day-to-day basis. Management accountants are performance management experts, and they can help you identify the KPIs and report on them effectively.

They can understand your vision, build and manage your stakeholder relationships and critically analyse internal and external trends, realise insights from your data and provide valuable advice to ensure your decisions are data-driven and not based on 'gut feeling'.

Above all, as an entrepreneur, you need to focus on value creation – not just in monetary terms, but in what you are giving to your 'target market'. Are you solving a problem for society? Are you addressing a requirement? Focusing on value can lead to sustainability. Similarly, non-financial aspects such as customer satisfaction also need to be thought about. Building this into your whole organisation, from the mission statement to your PMS, will ensure that you make a difference in the market in the long run.

For effective performance management and to be future-fit, ACCA's research entitled *Can integrated thinking be the key to SMEs' resilience (Chow 2022)*, recommends using 'integrated thinking' ie identification and organisation of multiple capitals – financial and non-financial (such as human capital or natural capital) – to create long-term value for the business and its key stakeholders. Integrated thinking helps businesses answer three key questions critical to being resilient: *why am I here? What do I need to survive and then thrive? What's next?*

Tips and examples for effective performance management, from our interviewees

Aditya of CampusSutra uses financial and operational benchmarks for performance assessment. 'We are a very data-driven company and our North Star has always been numbers that really reflect the health of the business: top line, bottom line, category sales, year-on-year [y-o-y] performance, style wise m-o-m [month-on-month] and y-o-y performance, categories that are growing and shrinking. The problem statements come from these numbers, which help guide the softer aspects, such as a need for change in style. Along with internal CAGR [compound annual growth rate], our benchmarks are driven by an understanding of how the industry is growing and where it's going. We take category, format – online/offline – and competition numbers to define our benchmarks. We also keep a check on the threats. In our business, for example, dead stock/excess inventory is the biggest killer in the fashion industry. We use a tech-driven in-house model to track inventory and for the last eight years we have had zero dead stock', **says Aditya.**

Alex of Boodmo says, *'setting benchmarks depends on your investors goals. Some may focus on quick returns, others on long-term growth. Understand your investors expectations, agree on metrics, and align goals. Mutual understanding with investors is key'.*

3. CORPORATE GOVERNANCE AND CONTROLS

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'Don't get mired by the technical definition of corporate governance. Focus on doing the right thing for customers and employees. Make sure to be compliant with the rules and regulations of the land. Focus on building a fundamentally strong business and not just valuation' **(Jamil Khatri).**

You must have heard of so many instances where businesses are forced into bankruptcy or get caught up in scandals because the leaders failed to manage the business properly. These failures affect not only the people within the organisation but also all the external stakeholders who depend on the organisation. These failures are often due to a combination of lack of good governance and internal controls, lack of ethical principles and improper management of business challenges. See ACCA's *Risk Culture: Building Resilience and Seizing Opportunities*, which includes ten calls to action to help business leaders drive healthy cultures that get their organisations where they want to be (Johnson 2023). As an entrepreneur, you have to set what is called the 'Tone at the Top'. You are leading the organisation and hence are responsible for the way the organisation operates, the ethical codes and internal controls, and the risk management systems. This naturally leads to the question of what risks are accepted or not.

3.1 Ethics and corporate governance, and internal controls

Good corporate governance encourages companies to proactively identify and mitigate risks, but also enables good things to happen to limit reputational and financial damage. Good governance involves:

- **building trust and credibility among the stakeholders** as such companies are recognised as having transparent decision-making processes and are considered accountable for their actions
- **ensuring compliance with various laws/regulations**, such as the Companies Act, Securities and Exchange Board of India (SEBI) regulations, and taxation laws, to avoid penalties, fines and legal issues; click here for the Ministry of Commerce and Industry's comprehensive list of regulations and policies
- **prudent risk management**, as good governance helps to identify, assess and mitigate financial, operational and reputational risks
- **facilitating funding and investment**, as investors and lenders prefer companies with strong corporate governance and ethical practices
- **attracting and retain talent**, by creating a positive work environment that fosters trust, fairness and accountability in the eyes of the employees.

Learnings from corporate governance failures

Corporate failure can occur through:

- misrepresentation of the financials when, to attract investors, revenue is overstated and financial losses are not reported
- a toxic work environment created by setting unrealistic sales targets and pushing employees towards malpractices, resulting in loss of trust in the employer
- raising exceptionally large amounts of funds through loans from various banks but inability to pay back, leading to legal consequences.

ACCA spoke with Jamil Khatri, co-founder and CEO, Uniqus Consultech

ACCA: What are the common ethical and governance mistakes that entrepreneurs make and how can they avoid these?

JK: *1. Setting up a non-compliant business; 2. not having the right risk management and controls – building the back-end foundation is as important as building a strong front end; and 3. focusing on just the valuation, and not giving enough importance to compliance and risk management.*

To avoid mistakes, seek counsel from experts to learn what works and what doesn't. Don't just ask-listen.

ACCA: What tips can you give entrepreneurs on managing internal processes?

JK: *Entrepreneurship is like the Olympics of business. Running a successful business is a combination of three to four attributes:*

- *a combination of having the mental strength to navigate challenges and having the financial resources in place; you should be clear where the capital is going to come from for doing what you're doing*
- *focus as much on execution as you should do on the idea – nobody else will do it for you; the founding team must be able to execute*
- *non-compliance with law makes your business a non-viable model, therefore being compliant is non-negotiable*
- *a strong finance background is key to understanding that a business's value lies in profits and cash flows, not just revenue; striking a balance is crucial – success, as highlighted by a seasoned chartered accountant, demands vision and broad thinking, so, assemble a diverse, well-rounded team for a strong foundation*
- *as businesses grow, invest in strong finance, internal audit [and] control mechanisms, while balancing the flexibility needed to innovate. Many businesses have failed owing to the lack of the right control and risk-management mechanisms.*

Why does your start-up need internal controls?

Implementing policies and procedures in a start-up ensures that its financial reports are reliable, operations are constantly monitored and are efficient, and activities are compliant with applicable laws and regulations. Internal controls, therefore, play a crucial role for any start-up as they provide a competitive edge when seeking funds from investors by evidencing a mature organisational environment and providing investors with reasonable assurance of the company's financial performance. Internal controls also help in building the company's reputation and in preventing fraud and errors.

Examples of internal controls to reduced risks and improve efficiency

- Set up a good organisational structure which provides clarity on the duties and responsibilities across different job roles and where accountability lies.
- Maintain appropriate segregation of duties to reduce the risk of both erroneous and inappropriate actions.
- Schedule periodic training for employees.
- Frame clear-cut processes to handle financial transactions such as authorisation and approval limits.
- Restrict access to sensitive information in line with each employee's organisational role.
- Standardise guidelines for maintaining financial records such as bills, invoices, and tax receipts.

For further details on objectives, responsibilities and generic categories of internal controls, refer to the article published by ACCA here (ACCA n.d.).

What is 'environmental social and governance' (ESG) and why do you need to think about it?

> *'Don't look at ESG from a namesake perspective, look at it from a sustainability and a profitability as well as an opportunity perspective. Energy conservation, for example, is quite important from an operational efficiency perspective. Embed ESG in your business and be smart in communicating your actions to your stakeholders. Another lens for GenZ entrepreneurs is to look at ESG as a business opportunity, as they have a better understanding of the psyche of future consumers'* **(Jamil Khatri).**

ESG is a framework used to assess an organisation's business practices and performance against various sustainability and ethical guidelines. It also provides a way of measuring business risks and opportunities in those areas. It comprises three elements.

- **Environment**: this refers to how a company affects the environment and deals with risks, which include direct and indirect greenhouse gas emissions, how it handles natural resources, and its readiness to meet climate challenges.
- **Social**: aspects of a company's relationships with stakeholders, which are both internal (eg fair wages, diversity and inclusion, employee engagement) and external (eg impact on the communities in which it operates).
- **Governance**: how an organisation is led and managed, including such aspects as whether leaders are aligned with stakeholders, how shareholders are treated, and the types of internal controls in place to promote transparency and accountability.

In recent times, businesses have benefited from adopting an ESG approach as it:

- helps identify, organise, analyse, prioritise and guide decisions on various business risks
- facilitates sustainable revenue growth
- adds a competitive advantage in the eyes of investors and lenders and therefore helps in reducing the cost of funding
- assists in improving efficiency, resulting in cost reduction
- enables corporate purposes to be achieved and acted on.

ACCA's practical playbook *How SMEs can create a more sustainable world* (ACCA 2021a) outlines the important role that businesses play in the transition to a sustainable and prosperous future by following simple actions. It urges businesses to take practical steps, such as reshaping business models to make them future-ready, acting with urgency on climate change, adopting UN sustainable development goals (17 goals tackling major world issues agreed by 193 UN member states to be achieved by 2030) as a part of their strategy and collaborating with others tackling sustainability. The playbook outlines the tangible benefits of embedding sustainable practices and suggest free tools and resources that can support small entities in their sustainable transformation journey. You can have a deeper dive into mapping UN SDGs to your business goals, supply chain code of conduct and environmental management systems for SMEs accessing our Toolkits series here.

3.2 Managing risks

You have an idea and you believe in the numbers your systems generate; but what can pull your ship down? It is risks. Risk is essentially the possibility that you will fail to achieve your goals. For a start-up, the materialisation of risk may result in your not getting the valuation you aspire to. Generally, risk can be:

- **financial** – aspects that are directly related to money, such as if your customers' fail to pay you, or your vendors suddenly demand payment, and thus you don't have cash to run operations, or your IPO does not realise its value, or it could be something external, such as recession.
- **non-financial** – non-monetary risks arise when a new competitor enters the market and undercuts you or the government brings in new restrictive rules, or staff are unproductive, or changes occur in the tastes/ preferences/perspectives of your target customers.

You cannot fully avoid risks. Nor should you try. As an entrepreneur, your challenge (and your opportunity), is to balance and take on the right risks to ensure the best outcomes for your business while also having a mitigation strategy and strong risk awareness in place. Prudent risk-taking is the key to success.

Examples of failure due to improper risk management

A start-up was founded in 2015 with the aim of automating the pizza-making process; however, after several technological struggles, it changed its business to become a sustainable-packaging manufacturer with projected revenues of $250 million and $1 billion in 2020 Q4 and 2021 Q4, respectively. Despite this pivot and raising hundreds of millions from investors, this start-up shut down in 2023. Why? Well, for a start, the leaders failed to foresee basic problems when cooking using robots in a moving van, such as the melting cheese sliding off the pizza during in-transit cooking. Their packaging also contained some harmful chemicals – this resulted in the banning of the packaging in some jurisdictions, a problem that should have been foreseen while creating the original formula and dealt with by appropriate action. The business tried to use Big Data to predict pizza demand, but this was completely negated by the COVID-19 pandemic. The biggest risk factor was that the business was overly dependent on technology to provide solutions to human problems without factoring in the limitations of the technology.

Further, there was no core focus, moving quickly from pizza making to automated food delivery to automated packaging all within a few years. Food tech as an industry is yet to have a proper standardised measure of success and hence experimenting in that line has an inherent risk of failure. Growing too fast too quickly with high-profile funding and media attention also made the failure more apparent. Even though the COVID-19 risk was not envisaged by the world markets, this start-up's downfall was already set in place by its improper strategy and risk management.

'We have seen start-ups fail trying to do too many things too soon and not being able to manage the operations – opening too many franchisee stores in a short period in the case of a retail business, for example. Focus is very important. Don't try to do too many things. Hold on to your temptations and focus on your core competencies' **(Darshana K.).**

How to plan for risks and navigate them?

Risks represent good opportunities if you know how to address them, but they can also be your worst nightmare if you do not handle them effectively; this is why risk management is fundamental to business. But how do you do that? Here are some general tips.

Be a prudent risk taker. Risk management is not about being pessimistic, but rather about taking calculated risks. Take a 'principled approach' to risk so that you can make the best use of opportunities. You, as the leader of the firm, set the tone of the organisation towards risk: read here to understand the role of leaders in managing risks and setting the risk appetite of the organisation (Johnson 2023). You also need to start thinking creatively and looking at the future and how long-term scenarios affect your business strategy. Take only those risks that you need to take to achieve your goals, directly or indirectly. This report from ACCA on rethinking risk from the perspective of the future (Johnson 2021) can help leaders understand the role of accounting in navigating today's dynamic risk landscape.

Embed risk management in the corporate culture. You cannot handle risks effectively unless you 'embed' risk management into your organisation – everyone, from you to the lowest tier of your staff, must understand and actively manage the risks that they encounter. Read more about embedding risk management here (Lyon 2019). You don't have to be formal about it. In fact, having only a formal code can be ineffective and a flexible approach works better, as identified by a Copenhagen Business School research paper (Juul Andersen and Shaw 2014).

Learn to delegate tasks to professionals. Self-examination is important for identifying your skills as an individual. Learn to delegate. If you are good at selling, for example, focus on business development and get professionals for the other work (such as professional accountants to manage credit and liquidity risks).

Monitor risks and report on them. Continuous monitoring of risks and reporting on them is important. You must have systems and processes in place to spot changes that might damage the business, report them to other chief officer (CXO)-level staff and review them regularly. There are several tools and models that can help with this assessment and review (covered in Section 2 above under 'Managing performance').

Once you identify risks, understand their potential impact should they materialise and take action to mitigate them. If you cannot address a risk, try to reduce its impact through back-up plans or financing, or push the risk to other parties, such as through insurance. In the worst case, avoid the activity linked to the risk, if possible.

Hire accountancy and finance professionals as risk managers or as business consultants – they know about the general market, the risks affecting your business and other aspects outside your focus area. They can help research market-leading practices to identify what should be done, and provide appropriate advice. They can also help temper your valuation expectation to make it more realistic.

Taking calculated risk: tips and examples from our interviewees

- **Darshana of Grant Thornton suggests,** *'avoid concentration risk. ie diversify your customer/vendor base and don't have too much dependency on one customer/vendor'.*

- **Aditya of CampusSutra says,** *'entrepreneurship is risk, without risk there is no business, but risk needs to be rationalised. Maximise the upside and minimise the downside. An example is of managing currency fluctuations while taking a foreign loan (on a lower interest rate than domestic rates, which is an upside), the currency fluctuations could mean a very high interest payment in practice (downside). To manage this, we used hedging on import bill and export remittance to cancel the downside, while making use of the low interest rates'.*

- **He further recommends,** *'any risk that could take you back to square one and [where] your entire business model [would come into question] is non-negotiable. Chase growth, but not at the cost of the business model. In cricket, for example, if you're five down… and if you have to chase 200 runs, then you don't start hitting from ball one. You settle down, you… maintain a good over rate and then … in the finish you go for big hits. Use the same strategy in business'.*

- **For Alex of Boodmo,** *taking risks is inherent in entrepreneurship, and overthinking can be detrimental. Start with small, calculated steps rather than diving into significant changes. Engage financial professionals to conduct regular reviews and assess risks. As your business evolves, adapt your risk policy to address new challenges. Never underestimate the importance of risk assessment, considering both the size and probability of potential risks. Financial professionals play a crucial role in guiding entrepreneurs through this process. Alex further adds that the unpredictability of new regulations presents a risk for which entrepreneurs in India need to be prepared.*

3.3 Regulatory and taxation issues

'As an entrepreneur, you need to have minimum knowledge of the applicable regulations and compliances. Initially, you may not be able to afford internal experts but, once your venture is established hire an independent director/expert who can guide you on the regulatory aspects. Build an ecosystem of support- including accountants and those who understand compliances' **(Darshana K.).**

ACCA spoke with Nachiket Kulkarni and Pranay Doni of NSRCEL, The Indian Institute of Management Bangalore's (IIMB) flagship business incubator (the largest incubation centre in India)

ACCA: What are your thoughts on the regulatory ecosystem for entrepreneurs in India and how it has evolved?

PD: *India is now the world's third-biggest start-up hub with 90,000 start-ups. There is a big push from the government to improve the ease of doing business. Here's how things have changed.*

- *India has jumped from 142nd to 63rd globally for* ***ease of doing business****. The regulatory process is quicker with electronic approvals and a fast-track system.*
- ***Starting a business is faster.*** *For incorporating a business, from requiring 12–15 forms, businesses now need to fill only one form. Founders can certify compliance themselves, reducing the need for consultants.*
- ***Tax laws have been modified to make it easy for start-ups:*** *corporate tax dropped from 40% to 22% and further to 15% for those in manufacturing or the design and export sectors.*

ACCA: What are the go-to sources for budding entrepreneurs and how should they make best use of the support available?

NK and PD:

- ***Government sources: Ministry of Corporate Affairs*** *for guides on setting up a start-up and doing the associated filings. See the Startup India Website for lists of documents needed for funding and rules.*
- ***Tips for making best use of available resources.***
  - ***Know Schemes:*** *Learn about government programmes, such as* ***Mudra Yojana and Startup India Scheme*** *(for mentoring and extra support) (Pradhan Mantri Mudra Yojana n.d.).*
  - ***Reach out to your nearest incubation centres:*** *300+ centres across the country (including tier-2 and 3 cities) provide funding and resources.*
  - ***Startup India Hub:*** *Central hub for funding, activities, and more.*
  - ***Infrastructure support:*** *Low-cost co-working spaces are available.*
  - ***Tax benefits:*** *Explore tax breaks for your business.*
- ***Connect with incubation centres:*** *If you have an idea but don't know the next steps, it's the right time to reach out to an incubator. Incubators such as NSRCEL at IIMB has specific routes you can use to evaluate whether your idea works. The most ideal intervention stage for long-term incubation programmes is when an idea progresses toward a pilot or revenue-generating phase. NSRECL also guides entrepreneurs on entity choices and compliance dos and don'ts, and educates them on such options as proprietorship, partnership, and non-profit structures, explaining the potential advantages and pitfalls.*

ACCA: Do you have any other practical tips for entrepreneurs?

NK: *Check resources like YourStory for articles on venture inception and legal essentials. Consider applying to smaller-town incubators or newer ones for government-initiated funds, as competition may be less intense than for larger-city incubators. The key is to approach an incubator early, use programmes tailored for the idea stage, and leverage the experience to refine your entrepreneurial skills and business concept. Stay informed, explore, and tap into support for a successful business journey!*

What are the common regulatory compliances for start-ups in India?

1. **Business registration and compliance:** start-ups must choose a suitable legal structure and comply with the Companies Act, 2013. The process involves obtaining a unique business name, filing necessary documents, and adhering to registration requirements. For example, companies need to be registered under the Startup India initiative to obtain various benefits.

2. **Licences and permits:** depending on their industry, start-ups may require licences and permits from local, state, and central authorities. These permits range from Goods and Services Tax (GST) registration to specific industry-specific licences.

3. **Labour laws compliance:** adherence to labour laws – including minimum wages, working conditions, provident fund, and employee state insurance – is crucial for start-ups. This compliance is not only a legal requirement but also important for building a positive work environment.

4. **Environmental regulations:** depending on their sector, some start-ups must navigate environmental regulations and obtain necessary clearances, particularly in industries such as manufacturing and waste management.

5. **Foreign Exchange Management Act (FEMA) compliance:** FEMA governs all cross-border monetary transactions. Start-ups dealing with foreign investments or transactions must adhere to FEMA guidelines, including reporting of such investments to the Reserve Bank of India (RBI).

India's taxation structure can be intricate and often poses challenges to start-ups. Understanding and complying with these tax laws is essential for these businesses to thrive. Common taxation compliances include the following.

1. Income Tax: start-ups need to comply with income tax regulations. This includes filing income tax returns, obtaining a Permanent Account Number (PAN), and adhering to TDS (Tax Deducted at Source) regulations if applicable.

2. Tax Deducted at Source (TDS): if the start-up makes payments that are subject to TDS, it must deduct TDS and deposit it with the income tax department within the specified time. This applies to payments such as salaries, professional fees, and rent.

3. Employee Provident Fund (EPF) and Employee State Insurance (ESI): if a start-up has employees, it must comply with EPF and ESI regulations. These include deducting and depositing contributions to these funds on behalf of employees.

4. Goods and Services Tax (GST) compliance: if the turnover exceeds the threshold limit, the start-up must register on the GST portal and file regular returns.

Example of tax-related compliance

E-commerce companies have faced taxation issues, especially related to (a) the collection and remittance of GST (b) tax-related scrutiny related to foreign direct investment in e-commerce and the application of e-commerce policies, especially regarding inventory and pricing.

How to address regulatory and taxation issues

'It is very important to start right. Understand the compliance requirements and the pros and cons of different legal structures, and make sure [the one chosen] aligns with your vision. Seek expert help – talk to accountancy and finance experts. [Your] comfort factor with the expert is important as you should be able to call them when something that you don't understand happens. While compliance isn't a growth function, it is a core function and a hygiene [factor that is] very important to maintain' **(Aditya).**

Accountancy and finance professionals, including accountants, financial analysts and tax experts, play a crucial role in helping start-ups address regulatory and taxation challenges. For **compliance and reporting**, finance professionals can assist start-ups by:

- maintaining accurate financial records and complying with regulatory reporting requirements
- ensuring that the start-up adheres to a legal and compliance checklist, thereby mitigating the risk of legal issues and penalties.

Tax planning is essential for minimising tax liabilities while staying within legal boundaries. Finance professionals help in tax planning by:

- providing expert advice on tax planning strategies
- helping start-ups optimise their tax positions by taking advantage of tax incentives and exemptions where applicable, thereby reducing the overall tax burden.

Accountancy and finance professionals play a key role in helping start-ups with regulatory and taxation issues. As an accountancy and finance professional, what are the skills that you need to make this partnership work? **Here are some tips, as shared by interviewees, for professionals working with start-ups.**

1. *Mental agility:* the ability to grasp complex concepts quickly and navigate dynamic business environments.
2. *Brevity in communication:* convey financial insights effectively and in a concise manner, recognising the limited time and patience of entrepreneurs.
3. *Understanding the business model, beyond numbers:* go beyond the numbers – develop a deep understanding of the business and its dynamics beyond compliance and processes.
4. *Courage to speak up:* challenge assumptions and offer insights even in the face of entrepreneurs who may think they know it all.
5. *Strategic focus:* balance the need for compliance with a strategic focus on the overall goals of the business.
6. *Adaptability:* recognise that working with start-ups demands flexibility and adaptability to changing situations.
7. *Collaboration:* seek counsel and collaborate with others to communicate crucial points effectively to entrepreneurs.
8. *Risk management:* be willing to take calculated risks and navigate the uncertainties inherent in start-up environments.
9. *Stakeholder management:* handle all stakeholders well – shareholders, clients, partners, employees, and family.
10. *Embrace entrepreneurial mindset:* shift towards an entrepreneurial mindset, prioritising people and relationships over financial aspects alone.

We recommend that young start-ups in India proactively engage accountancy and finance professionals, as either in-house experts or external consultants, to ensure they are well-prepared to address these challenges. A proactive approach to compliance and financial management not only safeguards start-ups from legal issues but also results in cost savings and more efficient operations in the long run. By leveraging the expertise of finance professionals, start-ups can thrive in India's complex regulatory and tax environment and continue contributing to the country's vibrant entrepreneurial ecosystem.

> **Earlier in this section, when asked where GenZ entrepreneurs struggle the most, Nachiket and Pranay highlighted regulatory awareness.** *'Compliance is key. Gen Z entrepreneurs may overlook regulatory aspects, causing difficulties later. Small filing gaps can cause delays, affecting investor interest and government support. For example, the Ministry of Corporate Affairs has a rule: inactive director identification numbers will be disabled. If not noticed [at the time], resolving this later takes six to nine months. Entrepreneurs need to stay aware of such rules to avoid delays. Have regulatory awareness and seek the right advisers and mentors for guidance, as you focus on developing your core business'*, **they concur.**

In conclusion, planning finances is crucial for the success of your venture. Develop a viable product or service to start with, manage and allocate resources efficiently to meet expenses as you continue to grow, integrate informed decision-making to ensure sustainability and development, incorporate good corporate governance and internal controls for a solid back-end foundation, and take calculated risks. Financial diligence and compliance are essential for long-term success and sustainability. Effective management of regulatory and taxation challenges can lead to improved financial stability, enhanced investor confidence and growth opportunities. Remember, starting a venture is just the beginning. Sustaining it is the real game, and financial stability is your winning move.

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USEFUL WEBSITES

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Goods and Services Tax portal: register and learn your responsibilities for GST <https://www.gst.gov.in>, accessed 28 January 2024.

Indian Angel Network: 'Money, mentoring and market access' – a platform for seed and early-stage investing <https://iangroup.vc>, accessed 25 January 2024.

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