

Corporate Financing Choices of Startups vs. Large Firms in Asia

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Abstract

(In Asia) Start-ups generally rely on such sources of funding which pour in resources in exchange of equity benefitting those not having any assets for collateral based lending.

Large firms tend to use their assets, including goodwill, to judicious use either by financing through borrowing against collateral or issuing bonds to which retail or institutional investors subscribe to due to the firm enjoying high public goodwill.

The method for collecting data for this research paper are case studies of various Asian start-ups and conglomerates. Relying on secondary data, numerous financial ratios and techniques are used.

From the analysis of different entities, it is therefore found that start-ups enjoy the ever-evolving funding-verse finding it relatively easier to raise funds nowadays as to what established companies faced in the 20th century and early 21st century. This research paper will help to clarify and understand corporate finance strategies in Asia, besides also laying a clear path for emerging start-ups on how and which source will benefit them the most.

I. Introduction

Firstly, what exactly is corporate finance? Corporate finance is a specialised area of how entities manage, allocate and optimise financial resources to enhance overall value and achieve the ultimate goal of maximising shareholder's wealth. It deals with three main areas involving capital structure i.e. the mix of equity and debt (or internal and external funds); capital budgeting decisions relating to investing for potential growth in the future; and working capital management to meet resources needs in the day-to-day operations of an entity.

By effectively performing the said three functions, which is the work of a Chief Financial Officer (CFO) and its team, an entity supports achieving long term strategic goals and maintaining financial stability.

Next, how does one differentiate between a start-up and a large established firm? A start-up is an entity that has been established not long ago with a purpose of majority of them to innovate and introduce a product or service in the market which the consumers will actually use and adopt in their lifestyle. On the other hand, a corporate business has been ongoing for years or even decades; having a larger span of workforce and navigating through a number of crises'. They can be compared with an example of a kayak to an aircraft carrier. A start-up, similar to a kayak accommodating to the water currents, has to pay heed to the market turbulence while a big corporation although moving slowly is unfazed by the same like an aircraft carrier.

Why is funding important for any business entity? This question relates to the economic concept of how economic resources are scarce and unevenly distributed. Any entity to continue business will at one point of time need funding to continue operations. This could arise due to many reasons: investing in R&D to further offer better products, the need to maintain working capital for day to day operations, growth and expansion by purchasing and acquiring more assets are few of the most common reasons.

Even for competing in the market, businesses have to offer promotions requiring funds. Nevertheless, this concludes that funding is the most integral part core to an entity.

II. Methodology

Secondary data has been compiled for the purpose of this research paper. Using financial information published by entities (bound to publish financial information in compliance to laws) and analysis of such information by various financial analysts, results have been drawn down below further in this paper.

Top Asian start-ups such as Grab, a transport service entity from Singapore; Phonepe, a payment solution service app from India and Zhipu AI, a technological platform from China have been taken into consideration for the sample. In addition, corporations like SoftBank, Vedanta Limited and Adani Power have been included.

For analysis of the above sample entities, various financial techniques and methods have been put to use for determining financing methods. Ratios considered are Debt to Equity Ratio, Equity to Asset Ratio, Interest

Coverage Ratio and Total Debt Ratio. These also imbibe the financial position of the entity by looking at Balance Sheet' as well as Statement of Shareholder' Equity Report.

The limitations to gather data for the research paper arise from those entities which are privately held and not compelled by law to publish financial reports. These serve as a hindrance to analyse financial position and funding methods for those entities.

Analysis

The current Debt to Equity Ratio for Grab stands at 0.31 implying that the company does not overly depend upon external debt and holds a strong financial position having a very minute chance of insolvency. The interest coverage ratio stands at 2.46 meaning it has moderate earnings to service its interest obligation and also a risk indicating if earnings drop, it will become difficult to do so. Grab has a net cash reserve enough to serve financial obligations and an equity to asset ratio of 56.4% meaning more than half of Grab's funds are sourced through equity financing.

Similarly, Phonepe also exclusively is dependent on equity financing having almost negligible long-term debt. It has raised funds through 14 rounds primarily based on equity dilution. Interest Coverage Ratio is not a sufficient metric due to low long-term debt. Phonepe has nearly 99% of its capital equity based, indicating an equity heavy structure.

Zhipu AI has a Debt to Equity Ratio of 0.73 reflecting a capital-intensive approach. It has equity holding of 74.6% which has been diluted down due to the IPO. Since Zhipu AI is not profitable yet it had to issue shares to the public to collect capital and service debt obligations. Having only 25% of capital structure as debt, assets are financed through shareholder equity.

Softbank stands on a D/E Ratio of 1.27 and Total Debt Ratio of 42%. This shows that it enjoys good financial goodwill which helps to raise funds through debt in spite of having a high debt component in capital structure. Similarly, Vedanta Ltd. and Adani Power also have high D/E Ratio of 1.90 and 0.81 respectively. Vedanta has a total Debt Ratio of 47.6% while Adani Power has a little lower of about 38%. All these three companies are publicly listed and traded on respective stock exchanges.

III. Result

From the above analysis, it has become very clear that big companies, due to their financial goodwill and trust from borrowers, rely more on debt component to source funds for operations. This is mainly because over the time they have almost exhausted the ability to use equity financing and have reached such positions that if they dilute more of their equity, they will have a big risk of a takeover which means another company may buy their shares from the stock market to reach a majority stake holding position and have better control over the entity.

More reliance on debt is also because, across the life span of the company, it has established enough cash reserves that the interest liability becomes a better option rather than equity dilution. Also, the process to raise funds through equity financing is a long and tedious process involving several complications while borrowing through loans or bonds is relatively quicker.

For start-ups raising funds through debt is not favourable due to several reasons. They do not have the credibility in the initial stages which serves as a hindrance to the lenders. Also, if the entity in the starting phase has a high interest obligation, it will not be able to readily expand operations and capture a bigger market share. Because of this, they turn to angel investors, investment banks and other equity financing sources including incubators and venture capitalists, who all offer capital by acquiring equity in the entity with the hope that in future it will yield them good returns with a multi bagger exit.

Bibliography

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