

“Is it so hard for entrepreneurs to comprehend that raising money from VCs or global funds too soon might actually be a bad thing? More companies die of indigestion than starvation.”

♦ KASHYAP DEORAH, AUTHOR OF *THE GOLDEN TAP*

INTERVIEW

Funding, a double-edged sword



*The end of the ‘startup bubble’ is a common phrase that one hears and reads about in newspapers and business conventions; doomsday predictions are now a norm. Discussions have moved beyond ‘will it burst?’ to ‘how big will be the explosion?’ In the midst of this, serial entrepreneur and investor Kashyap Deorah offers another perspective of the startup scenario in *The Golden Tap*.*

Presently, most of the hyper-funded tech and food startups end up holding on to myths—India is the next China, big is better, size alone leads to profitability, and last but not the least, the war chest is key to winning the war—as their beliefs. Many of these beliefs, Kashyap says, “are borrowed from the views of the investors who are basing them on experiences in different context.” Indian startups will survive and succeed when they realise, ‘to be what you are, it is important to know what you are not’ and start to think for themselves. In this exclusive with Indian Management, Deorah tells us while it is no longer a ‘bubble’, it is time these firms prepared for a long winter.

You believe Indian startups and their funding have moved past the saturation point. However, there is another school of thought that believes this is not the 'end' but just the 'beginning' of the boom. So are not critics and insiders such as you being harsh in predicting the bust?

I am long on India and short on the hyper-funded startups created in the last year or two. Digital India has come of age and we have a lifetime of growth ahead of us. On the other hand, hyper-funded startups that have built large money sinks will go through a difficult phase and find their valuations drop significantly from their present levels. How they cope with these drops will determine whether they exceed their peaks in the long term or survive at a lower value. Many companies that did not get hyper-funded and kept building healthy unit economics during times of exuberance will come out stronger on the other side of this trough.

A few unicorns and hyper-funded startups will consolidate and become Indian subsidiaries of listed Chinese companies.

You say many (angels, investors, journalists, and entrepreneurs) mistake India for China and that India is different. And hence the story and its script will play out differently here. Given this, how do you envision the scenario, a few years from now?

Most technology unicorns of today would be worth lesser than their current valuations. Originals like Uber and Amazon will be market leaders in a fragmented Indian market viz. they will have one-third market share, top three will own two-thirds to three-fourths market share, and there will be a number of smaller players in regional or vertical niches. A few unicorns and hyper-funded startups will consolidate and become Indian subsidiaries of listed Chinese companies. Enterprise software companies out of India would be first to go public on Nasdaq ahead of consumer businesses. Consumer businesses that are growing organically and profitably will outpace the hyper-funded ones in going public. I hope to see ten Indian companies listed on NASDAQ by 2020 with \$1 billion plus market cap each.

What differentiates Indian startups from those in other countries?

I believe the strategy of 'first scale then profits' will fail in India. Startups that have best cost structures and operating margins will be rewarded. Those with market share but high operating losses will



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It is product innovation that disrupts an unsuspecting market space rather than a copy-pasted or adapted product that disrupts a market.

find it hard to turn around cost structures at scale.

US has consumerism—consumers pay for convenience. China has manufacturing and infrastructure—product margins have high elasticity. India does not have either. Consumers are highly tolerant of pain. Highest selling product categories are the ones

that are traded in India but manufactured in China or elsewhere. With variable-cost-heavy structures, it will be hard to retrofit profits.

How much of this is a factor of consumer behaviour, product or service innovation?

Hyper-funded Indian startups are market space bets (1 to n) and not product innovation bets (0 to 1). They are low margin and distribution oriented by definition. Operational innovation can accelerate growth when capital is infinite. However, operational innovation will be insufficient to earn the margins needed to get profitable when capital eventually looks for returns. Loss-making startups will find that consumers would not pay for convenience, and extra product margins at scale hit a glass ceiling that is lower than they are anticipating.

What makes Indian startups a big attraction for investors?

- New and young consumers
- Mobile internet penetration
- Consistent GDP growth
- Foreign-friendly disposition
- Emerging as third largest economy with a large number of digital consumers

All true macro trends in my opinion and the reason why I am long on India.

The book gives a stark view of the strategies employed by global fund houses to ensure ROI. Case in point is the story of Letsbuy and its eventual integration into Flipkart. While consolidation is considered to be a necessary good/evil for an industry,

how will this kind of forced consolidation impact the startup scenario?

Startups dependent on funding for their survival will learn that it is a double-edged sword. The ecosystem will learn to build businesses that do not depend on funding for survival. Entrepreneurs will learn the ability to raise and invest smart when investment is available and grow organically when investment is not available.

The book presents two contra points: it is survival of the richest and not the fittest; overfunding kills companies. But most startups struggle to get out of this conundrum—if they do not have funds their competitors will have it and buy market share, so they will eventually fall by the way side. And if they do have a rich war chest they will anyway get killed while trying to reach for the sun. Given your experience in starting companies and advising companies, what is your suggestion on avoiding this scenario?

Indian startups that are funding oriented tend to define themselves as a market space. When they start, most investors agree that it would be a large market space. This makes them a commodity business from the time they start. The best startups are those that see a trend that most others do not see. It is product innovation that disrupts an unsuspecting market space rather than a copy-pasted or adapted product that disrupts a market obvious to all. The former owns large market share and margins. The latter owns small market share and is commodity. It is more fun to create something while partnering with the ecosystem than to compete in a commodity market to build a business for investors.

Many early-stage businesses believe that entrepreneurship equals venture capital. Is this not a myth?

Yes. It is unfortunate that startups have become synonymous with funding. The absence of actual risk capital for product innovation—this myth is

setting us back rather than moving us forward. Those who are innovating are getting disheartened. And those who are hyper-funded are skating on thin ice with disillusionment ahead.

The difficulty of an IPO in the Indian markets (three-year profit clause) is one of the reasons why most fund houses consider foreign markets to list Indian startups. Do you believe that relaxation of listing norms will help entrepreneurs step off the vicious cycle of seeking more funds from private VCs and thereby build a sustainable business?

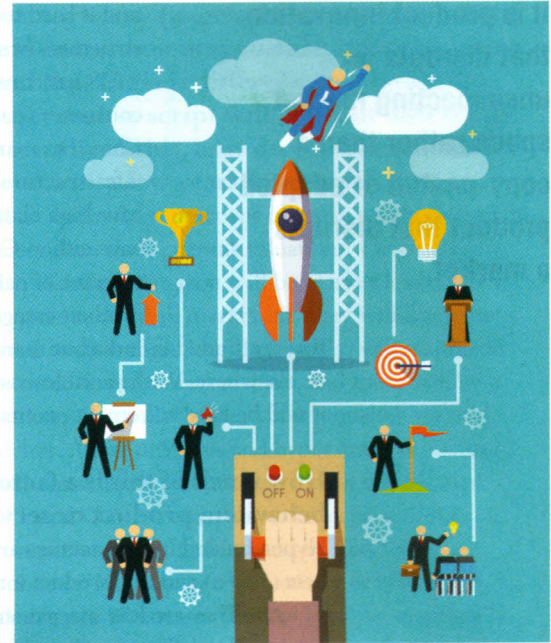
Yes, liquidity for investors, founders, and employees in local markets will foster local innovation. Relying on foreign funds and foreign markets will be subject to the investment theses of foreign investors. This can catalyse certain proven market spaces where India is seen like an extended territory. However, it cannot catalyse innovation like local IPOs can.

Global fund houses now consider venture capital as an asset class and are edging out other smaller players. Are we witnessing the death of the ‘angel investor’? If there is a future for them, what would be their role?

On the contrary, it is making angel investing an asset class as well. Larger number of people are looking at startups as an asset class to allocate smaller ticket sizes to. Just as any fund can now invest in startups without needing domain expertise, any retail investor can become an angel. A lot of people will lose a lot of money, but the few people next door who win the lottery will egg the others on to keep buying lottery tickets.

Despite all this you say “startup survival in India is higher.” Why?

Survival rate of hyper-funded startups betting on known market spaces will be lower than the Silicon Valley (say). Survival rate of regular startups growing through customers’ money will have a higher survival rate. India is different from Silicon Valley in that there is more fragmentation. It is



harder for the 100th company in a market space to survive in the US. In India, the 100th company in a market space will find a small number of customers to serve despite marginal differentiation. We are a human-powered service economy and not a technology-powered product economy.

You have said that Indian startups are currently running on borrowed beliefs and business models. But given that they need to do this to gain access to large capital funding (this of that excel), how can they break this loop?

We either have market space bets that are large cash sinks operating on borrowed beliefs or local products and services growing profitably. In the wide space in between, risk capital is scarce and so are product innovation-oriented entrepreneurs. The loop will break when a few product innovations will win big in a way where investors feel they lost out. This is likely to come from enterprise software companies building the infrastructure for digital India or servicing global markets over the cloud. ■

(As told to Poornima Subramanian.)