Investments in start-ups down 24% in Mar quarter

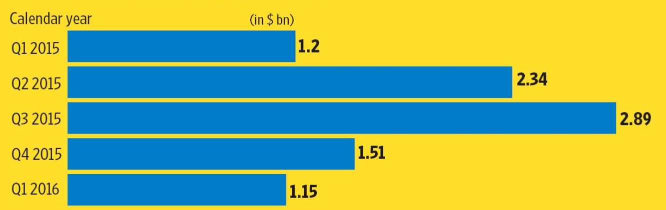
THE START-UP SCENE

Most active VC investors in Asia (Q1 2016)

Rank	Investor	Rank	Investor
1	500 Startups	5	IDG Capital Partners
2	Accel Partners**	10	Sequoia Capital India*
2	East Ventures	10	IMJ Investment Partners
4	CyberAgent Ventures	10	SAIF Partners**
5	Matrix Partners China	10	Blume Ventures*
5	BEENEXT	10	Ping An Ventures
5	Gobi Partners	10	Lightspeed Venture Partners
5	Sequoia Capital China		

* India focused fund;
** Investments in India, China and parts of Asia

INVESTMENTS IN INDIAN START-UPS



Source: KPMG-CB Insights report

PARAS JAIN/MINT

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Even India's top start-ups are struggling to raise cash at their current valuations.

Mint reported on 14 April that Flipkart Ltd and Snapdeal have held funding talks with several investors over the past six months, all of whom have refused to invest in the companies at their preferred valuations of $15 billion and $6.5 billion, respectively.

Both denied that they have been trying to raise fresh funds.

There are two main reasons why companies are struggling to raise money, said Aseem Khare, co-founder of home services start-up Taskbob, which raised ₹28 crore in February.

"First, companies have been using investor money for giving away discounts that have beefed up top-line numbers but have not been able to create brand loyalty. Due to this, the percentage of revenue that comes through discounts is very high and has put doubts on the business model. The second reason is that of unit economics. There are businesses that are solving a problem, but the margins are too low for them to be sustainable or operationally profitable," Khare said. By unit economics, Khare's reference is to the cost and revenue from one transaction—say, a food delivery order taken online, and fulfilled.

The funding slowdown is not restricted to Indian start-ups alone, said Varun Khaitan, chief executive at home service app UrbanClap.

"The US has much bigger problems. And since some of the biggest investors are US-based, this problem has flowed into India. But if a company is doing well, then irrespective of the environment, it will attract investors," he said.

The report by KPMG and CB Insights confirmed Khaitan's views and said start-up deals in the US were much lower in the first quarter compared with the peak levels seen in 2015.

"The first quarter of 2016 extended the global decline in VC (venture capital) activity with both total deal volume and deal value declining further following a major dip in the fourth quarter. Some of the factors driving VC investors to take a more measured investment approach include an economic slowdown in China, rising interest rates and an approaching election in the US and a June referendum over the UK's future in the European Union," the report said.

Investors expect the funding environment to remain depressed for some time to come.

While start-ups have started to conserve cash by reducing discounts and other expenses this year, it's not clear how young Internet companies will sustain their high growth rates without the lever of ultra-low prices.

"For the slowdown to end and for funding to return in a big way, there needs to be a trigger. Right now, there is a lot of uncertainty over macroeconomic factors like China's economy and what's happening to US start-ups. Plus, the Indian unicorns are also facing a rough patch. So it's hard to see where a positive trigger will come from," an executive at a firm that has invested in Flipkart said on condition of anonymity.

The government has added to the troubles of start-ups with new regulations governing e-commerce.

India on 29 March allowed 100% foreign direct investment in online retail of goods and services under the so-called marketplace model through the automatic route, which would legitimize existing businesses of e-commerce companies operating in India.

Three conditions attached to the government's approval, however, could either hurt e-commerce companies or force them to find new ways to get around them. One, no group company or seller on a marketplace can contribute more than 25% of the sales generated. Two, marketplaces cannot influence product prices. Three, small sellers will now have to take responsibility of quality of goods and after-sales support.

Many Indian e-commerce companies will have to restructure their businesses as a result of the new regulations, *Mint* reported on 31 March.

Sharan Poovanna in Bengaluru and Ashna Ambre in Mumbai contributed to this story.

Is start-up bubble bursting?

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earlier.

A quick crunching of the numbers shows that average deal size has dropped precipitously, too.

What this tells us is that VCs throughout Asia are losing their appetite for the sky-high investments of just six months ago and are starting to close their wallets. Rocket Internet's fire sale of Asian online retailer Lazada to Alibaba this week is a classic example.

Once considered the king of Southeast Asia's e-commerce scene, Lazada struggled to raise another round of funding last year, leaving it cash-strapped and desperate, according to TechCrunch. Alibaba's largesse came just in time, TechCrunch reported, citing multiple people.

To be sure, the flipside is that Chinese players like Alibaba are keeping the party going with such bailouts (and a Chinese photo-editing app still thinks it's worth $3 billion), but it won't be long before everyone starts to realize that these are the exceptions that prove the rule.

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