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What Flipkart's devaluation means for Indian startups

May Bring Down Valuations, Halt Discount-Driven E-Comm

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Mumbai: July 29, 2014 marked an inflection point for the Indian startup ecosystem. Emboldened by an ever-increasing smartphone penetration and online shopping reaching millions of customers, this was when India's most celebrated e-commerce company, Flipkart, raised an eye-popping $1 billion in capital, drawing a never-seen-before valuation of $7 billion for any Indian tech startup.

Flipkart was in one shot catapulted to the top tier of privately held internet ventures globally, comprising superstars like taxi-hailing smartphone app Uber, Airbnb, Dropbox and Pinterest. From then till now, the Bangalore-based etailer has had a cascading effect on the overall funding boom in India as a flag-bearer of the country's startup revolution. So when tech news portal The Information broke the news on Friday that Flipkart has lost 27% of its present $15-billion valuation, according to filings made by a mutual fund managed by one of its investors, Morgan Stanley, the clear and present danger of sharp corrections impacting other high-flying startups hit home harshly. Flipkart did not offer any comments to **TOI** on Morgan Stanley slashing its valuation.

"This is very significant as it's the first such public readjustment among the Indian unicorns (privately held startups valued at $1 billion or more). Companies with lofty valuation tags which have no revenue model, forget positive unit economics, would see corrections in the range of 50% or more going forward," says an investor in many of the big-ticket consumer internet companies who did not want to be named.

Having already scooped up $3.1 billion from myriad investors, Flipkart is currently looking to raise fresh funds to the tune of $1 billion but will find it tough to do so at the $15-billion valuation mark. A dogged rival in Amazon, a new CEO in Binny Bansal (Sachin Bansal stepped down from the post in January), a continuous top-level exodus in the past year, and its inability to expand successfully beyond the commerce business, are now being factored in while determining the value of the company founded in 2007 by the Bansals who are unrelated.

CORRECTION OR FALL?

- Flipkart's valuation zoomed from $2bn in May 2014 to $7bn in July 2014
- It has raised $3.15bn in funds across 12 rounds from 16 investors
- Last fund-raise in July 2015 valued it at $15bn
- Morgan Stanley cut value to $11bn in Dec
- Globally, file-sharing startup Dropbox saw its investor

T Rowe Price mark down its holdings by 51%

- Fidelity marked down its investments in startups like Dropbox, Snapchat and Zenefits

Markdowns are neither new nor unique to tech startups. Starting August last year, mutual funds in the US, including T Rowe Price, Fidelity and The Hartford, cut valuations of some of their hottest portfolio companies like Snapchat, Zenefits and Dropbox. The devaluation made tech startups regret taking investments from these so-called crossover funds. Largely comprising mutual funds and hedge funds, the crossover funds have an exposure to both private and public markets. They became integral to late-stage financing, pushing up valuations over the past two years in the private tech market.

Venture capitalists, who were outpaced by these deep-pocketed funds over the past two years, especially in late-stage financing rounds, also revalue their portfolio companies, but that's done privately. Says a VC who has been an active investor in this cycle, "For us it's slightly different and isn't as variable. If we feel the company is valued highly and not reflective of the business, we carry it at some discount. If we sense a company is going down, we take some markdown and eventually take it to zero when it shuts." The large mutual funds, on the other hand, report mark-to-market valuations to their investors every quarter. Each one uses a different methodology.

Indicative of the mood among funds with significant exposure to public markets, New York-based Tiger Global, which owns almost 30% in Flipkart, and is arguably the biggest proponent of the Indian consumer internet companies, has not made new investments in India in the past six months.

"Everyone knew valuations were ahead for many of the Indian unicorns by at least one or two financing rounds. Series C and beyond of funding will be hit. Other e-commerce companies like Snapdeal and Shopclues will also find it tougher to raise money at the present valuation and more down rounds are likely to take place," said another investor. Down rounds happen when investors value companies at less than the previous financing round. Market capitalization of publicly listed companies go through upswing and downswing frequently.

TOI has been reporting since last year how mid-stage startups are facing a severe capital crunch while raising new rounds of funding, which is critical to speed up their growth. Late-stage companies such as Flipkart, which bulked up during 2014-15, have not raised new money since the macro environment globally took a beating and stock markets plummeted. However, its rival Snapdeal completed a $200-million round, majority of which was a secondary transaction providing its early investors liquidity, at a $6.5-billion valuation, up from $4.8 billion in its last fund-raise.

The last quarter of 2015 saw a drop of 50% in the number of series B rounds and an 80% fall in series C rounds compared to the previous three months, according to data collated by Tracxn for **TOI**. Not only has the number of funding rounds, especially in the $15-50-million range, fallen precipitously, the time taken to close fund-raises has gone up considerably.

There's a view among investors and analysts that Flipkart's valuation markdown will help stop the discount-driven customer acquisition model followed by most e-commerce companies and that there will be increased focus on finding new metrics of growth. "Flipkart and Snapdeal founders have been over the last few days talking about logistics, building infrastructure and payments. They know they are not in a position to grow by discounts alone," says Satish Meena of Forrester Research.