FOOD STARTUPS ARE... ROASTED!

A number of startups that made a beeline for the food ordering and restaurant listing segment are bearing the brunt of what is turning out to be a tough business, writes **Shelley Singh**

Food tech startups were the toast of the town not long ago. Today, most are well, toast. Take a look. Dazos has shut shop. So has Eatlo. SpoonJoy has been snapped by grocery shopping app Grofers. Tiny Owl and Food Panda are struggling. According to a January 28 report in The Times of India, Rocket Internet backed Foodpanda has not found a buyer even with a rock bottom price tag of $10-15 million. The company laid off 300 people in December 2015, about 15% of its workforce. In September 2015, TinyOwl had fired 100 employees in its Mumbai and Pune offices. And in October, Zomato sacked 300 workers. UK based Just Eat entered and exited the market faster than you would order and receive pizza.

Most of the startups are barely surviving. Of course, there are a few that continue to receive funding. Yet, there seems to be ruin all around the segment in which barely 18 months ago there was a scramble to launch business.

How did things come to such a pass? For starters, the prize was too good to resist. The size of the food ordering business over phone is $15 billion and startups waded in, aiming to move the business to apps. Investors were lavish with funds. In 2015, there were 54 deals in the food startup space with investments totalling $235.66 million, according to VCC Edge. But the deals also created many 'me-too' businesses, when the need of the hour was building scale, by carefully connecting the backend (restaurants) with the frontend (customers). The fierce Darwinian struggle among businesses didn't help – companies began to woo customers with deep discounts.

"Food is a scale business—optimising on pricing and managing costs is very important," says Rajan Anandan, managing director, Google South East Asia & India.

Problem was startups were reckless. Unlike selling T-shirts or mobile phones online, food business needs a deep understanding of the locality to be relevant to the user. They must be connected to as many restaurants as possible in a city, even neighbourhood, so that they can take orders and deliver food regardless of where the order comes from.

Some of the startups that failed were a victim of underestimating the business. At first glance, the food ordering business is simple. Scores of people eat out every day, right? How difficult can it be to coax them to become customers? The rub is these

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customers face a problem of plenty. They not only have more than 20 food tech startups apps to choose from, but also have food directories of their own.

Rashmi Daga, CEO, Fresh menu, a cloud kitchen company, says, "Everybody eats food and the opportunity is huge. But the shakeup has come in little faster than in other sectors."

K Ganesh, a serial entrepreneur and co-founder of FreshMenu, says recent months have seen uncontrolled and sometimes an insane amount of funding. "Business models and excesses in the space that have led to the current situation."

Let's talk about the business models first and how they are faring. Startups typically target three opportunities in the food business. One, a directory of restaurants, with revenues coming from ad sales. Restaurants advertise on the site and the startup can get about 80% margin. Users come to check out restaurants, menus, ratings and reviews. This accounts for 80% of the business for Zomato, which started in 2008 as a restaurant listing site. Zomato, funded by InfoEdge, Sequoia, Tamesak, and others, is the dominant startup in the segment with 5,000 restaurants in India advertising on the site.

This segment is doing alright. Restaurants are keen as ever to list on such apps and websites.

Two, food ordering, which is the largest space and the most crowded segment. Zomato entered this space in mid-2015 while Tiny Owl, Food Panda, Swiggy and at least a dozen others started as food ordering sites and apps. Says Niren Shah, managing director, Norwest Venture Partners India, "It's the way Ola, Uber work with cab drivers. Food tech startups use the platform to connect users with restaurants."

A Menu of Models

The top 25 cities have around 75,000 restaurants, including organised chains and standalone restaurants). The number of daily orders over phone for food (mainly lunch and diner) range between 0.7 million and 1 million. Dominos alone does 1.8 lakh to 2 lakh orders a day and has built a ₹1,800 crore business in India.

Swiggy, which recently raised a fresh round of funding, does about 15,000 orders a day and Zomato does 13,000. Overall food tech startups cater to less than 50,000 orders a day. That's just 5% of the total daily orders.

Evidently, the potential is huge. Which explains why more than 20 startups entered the space within 18 months, most with me-too models. Desperate to convert users from phone to apps ordering, startups sold meals at deep discounts, upsetting the unit economics and making their business unviable.

Not surprisingly, this is the category which has seen most pain points as well. Companies have laid off staff, cut back expansion plans and have had to shut shop as they ran out of money. Anandan says this space has been challenged due to unit economics. "You can't sustain if you sell a ₹130 meal for ₹100 and that's what happened."

Deepinder Goyal, co-founder, Zomato, says companies were buying at 100% prices and selling at discount. "This led to negative gross margin."

Sumer Juneja, principal, Norwest Venture Partners India, argues companies have not been smart about discounting. "Restaurant food cost is 30-35% and margin is 60-65%. Startups can manage without discounts, by entering into arrangements with restaurants. Besides, in this space customer experience is important as well as shown by Domino's and its 30 minute delivery. Customer will pay and give repeat orders if he has a good experience." Norwest is one of the investors in Swiggy.

The third model is cloud kitchen. Here the startups such as Hola Chef, Fresh Menu, Bhukkad own the food and delivery part of the business. This gives better margins but the challenge is to build scale with an army of chefs in various cities.

Saurabh Saxena, CEO, Holachef, says customers recognise who is making their food and this creates an emotional, personal touch. "The centralised kitchen is an opportunity for our chefs to scale." Holachef operates in Mumbai and Pune and plans to add two more cities by end -2016.

Fresh Menu operates in three cities—Bengaluru, Mumbai and Gurgaon. It has a central team of five chefs in Bengaluru and the satellite kitchens have two chefs each. This segment is relatively new, with fewer players than its counterparts in the other food tech segments. So these are early days to estimate how it is faring.

As is happening with other ecommerce sectors, many food startups are caught in a vicious cycle. To woo customers, they resorted to offering deep discounts. If they don't, they risk losing customers reaching out to restaurants directly. Deep discounts delay profits. That strategy itself might not always pay off because of the fierce competition and customer's fleeting loyalty.

The food business also has a unique set of challenges. "A new mobile phone purchase or clothes purchased online can be delivered in one, two or more days and it won't bother people. But in the food business, fulfillment has to be within 30-40 minutes," says Daga. "Besides, there has to be a very tight control on quality of food and service, else people will reject it. Customer expectations are high."

Fortuitously for startups, the steady stream of negative news has not driven away investors. January 2016 alone has seen three deals worth around ₹300 crore

FOOD DEALS

	No. of deals	Deal Value ($ m)
2013	9	39.48
2014	13	70.71
2015	54	235.66
2016 (YTD)	3	51.46
Total	79	397.31

Source: VCCEdge

ON THE MENU

Various types of food startups

Restaurant Listing: Companies offer a directory of restaurants & make money on ad sales

Players include: Zomato

Food Ordering: Startups develop apps and sites to connect customers to restaurants, like Uber does for cabs and Airbnb for rooms

Players include: Swiggy, FoodPanda, Tiny Owl, Zomato

Cloud Kitchen: Startups hire chefs to serve the customer directly

Players include: HolaChef, Bhukkad, Fresh Menu

Fixing the Kitchen

The business came under a cloud when a raft of players began entering the segment in a short span. Soon, many players faced a cash crunch, which eventually led to a massive shakeup of the segment.

Even Zomato was not spared. On January 11, Zomato announced shutting down business in four cities—Coimbatore, Indore, Kochi and Lucknow. It runs a food ordering business in 10 cities now. "From a management bandwidth view, these (cities) were not viable as we were getting just 2% of business from here. We had a bigger fish to fry in other cities and hence cut back," says Goyal.

Goyal does not deny that it is a tough business. Once the platform is there (app), a startup needs customers and restaurants. "It's a chicken and egg problem—customers won't come if restaurants aren't on your list and restaurants won't come if you don't have enough customers. You have to give choice to users. Some startups used our listing and gave a perception of choice to their users. It doesn't work that way. Market has had a reality check," says Goyal.

Zomato, which has raised $225 million so far, says it will break even by June.

Fortuitously for startups, the steady stream of negative news has not driven away investors. According to VCCEdge, January 2016 alone has seen three deals with around ₹300 crore being raised by food tech companies. The largest was ₹230 crore raised by Swiggy from Norwest Venture Partners, Saif Partners and others.

Food Tech

OPPORTUNITY

Total addressable market **$15 b** (this is estimated food ordering–over phone–business in India)

0.5-1 m orders per day for food over phone

Less than **1%** of the market has moved to apps

There's room for at least **3 or 4 big players** (potential unicorns); much like e-commerce has 5 large players

CHALLENGES

Need huge amounts of capital to scale. Money raised by startups in India is less than **$0.5 b**; while in China it is **$3 b**

Startups burning cash indiscriminately to acquire customers & unable to raise fresh funds leading to layoffs

Too many players with 'me-too' models

Very little opportunity beyond top 25 cities; Not a tier2, tier 3 city game; Have to build partnerships within top 10 cities

Source: Industry

Investors have turned wiser. Only the good businesses (those not depending solely on discounts to acquire customers) are getting funds now. The focus has shifted from acquiring customers anyhow to unit economics, much like it has in other e-commerce segments.

Some companies like Swiggy now run on a 'no discounts' strategy. "Competition is de-intensifying due to capital and quality issues," says Sriharsha Majety, CEO, Swiggy.

No one is doubting the potential of the business in India though. Experts point to global companies in the space as evidence. In China, food tech startups have attracted $3 billion in funding (more than six times that in India) and have built companies with multi-billion dollar valuations. Chinese startups Meituan-Dianping and Ele.me are now valued in excess of $5 billion each. Meituan now also delivers movie tickets.

Anandan, who had to write off his investment in Dazos as it could not raise Series A funding, believes there will be at least three big players in food tech in India. "In this business being small is trouble. A business needs good unit economics and money to scale rapidly. Startups realise that throwing money at the problem (of acquiring customers) won't help and they have to focus on unit economics and great service, he says. "This shakeout is good for the sector."

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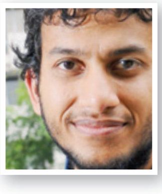
College Startups Receive a Break

Educational institutions are allowing students to take a break from studies and pursue their entrepreneurial dreams, write **Shailesh Menon & Rica Bhattacharyya**

DROPOUT ENTREPRENEURS



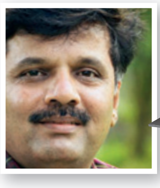
Ritesh Agarwal (Degree course dropout) Oyo Rooms

Kunal Shah (Management studies dropout) Freecharge

Rahul Yadav (Engineering dropout) Housing.com

Ankit Oberoi & Atul Agarwal (Degree course dropout) Adpushup

Bhavin Turakhia (Degree course dropout) Directi



Kailash Katkar (High-school dropout) Quick Heal Technologies

DROPOUT INCENTIVE

The Thiel Fellowship

The Thiel Fellowship gives $100,000 to young people (under 22 years of age) who want to drop out of college. About 25 fellows get selected for the fellowship every year. Mentoring and networking opportunities are other add-ons, if you get selected. Ritesh Agarwal of Oyo Rooms is a Thiel fellow (2013 batch).

TWO SIDES OF DROPPING OUT

ADVANTAGES	DISADVANTAGES
It gives time to start early in life	Not having a formal degree
Chase dreams, ideas	Nothing to fall back on, if the venture fails
Thinking out of the box	Makes one ineligible for hiring
Taste failure early in life, when students are not bugged by familial pressures	Lack of experience
Early specialisation	Difficulty in raising funds

In 2014, after months of brainstorming over numerous rounds of mid-night tea and deep-fried snacks, Ayush Agrawal and his three friends decided to drop out of IIT Kharagpur. They wanted to work on their startup idea.

It was not a difficult decision. IIT Kharagpur had recently introduced a "temporary withdrawal programme", which allowed students to take a break from studies and pursue their entrepreneurial calling. Should the venture fail, they could always return to the campus to complete the course.

"The programme was kind of a back-up plan for us," says Agrawal, who co-founded Intugine Technologies with his friends.

Intugine, which specialises in gesture motion control devices, is popular in the startup circuit. The company is now looking to raise a second round of funding from venture funds.

Agrawal, 22, says he and his colleagues might not go back to college now. "The only thing we miss is food from Tikkaa (a popular hangout joint near the Kharagpur campus)."

In the US, the lore of the tech industry is filled with many such touchstones — Bill Gates founding Microsoft or Facebook co-founder Mark Zuckerberg starting his first software-based company after dropping out of school or college. In India, such examples are rare and the word 'dropout' itself still invites scorn.

That might be changing.

Besides IIT Kharagpur, which is toying with the idea of being "more liberal" with students with an entrepreneurial bent of mind, IITs in Delhi, Madras and Kanpur, a few NITs (National Institute of Technology) and private engineering colleges like Manipal Institute of Technology (MIT) and BITS-Pilani are all looking at offering students an option to drop out temporarily.

For many students harbouring entrepreneurial dreams, such an offering is godsend. In recent years, college campuses have turned a hotbed for startups across various sectors. Prospective unicorns like Ola Cabs, Practo, Oyo Rooms, Freecharge and Housing.com, among several others, have encouraged students to start their own venture.

A senior Microsoft official, quoting Thomson Reuters data, recently wrote in his blog that over 315 Indian tech startups have received funding from angel investors and venture capitalists between 2010 and 2013. This produced a total of 478 founders and co-founders. Of those, 228, or 47%, came from the IITs and IIMs.

Padmaja Ruparel, President of Indian Angel Network, says it is heartening to see that families (of students dropping out of college) and academicians are now showing more willingness to accept failure in whatever students do. "This option to return to college will spawn more campus startups."

Take the case of Deepit Purkayastha, who took a one-year break from IIT Kharagpur to start 'News InShorts', a mobile app that delivers news in 60 words, containing only essential facts.

"We could not have waited for the course to end. We had to catch the smartphone boom that was raging across the country, and had to start the venture at that time," says Purkayastha.

Once the mobile app was up and running (with over 3 million subscribers currently), Purkayastha returned to the campus to secure his computer science degree.

Some teachers frown if students who take the offer do not return. "Once they make it big, they would not want to complete the course. Even students who failed in their venture would find it difficult to complete their course if there's a break in between," argues KR Venugopal, principal of University Visvesvaraya College of Engineering, Bangalore.

Some Riders, Please!

This has made forced institutions to introduce strict conditions.

IIT Delhi allows students to take academic breaks for up to two semesters, but for a year. Graduate courses in IITs have eight semesters that students need to mandatorily complete. If students decide to drop out from one semester, they will not be registered for that semester, but they continue to be on the rolls.

"We started the one-year break option to encourage students who are interested in pursuing their own ventures. These students find it very difficult to handle both their enterprise and studies at the same time. The one-year break will help them focus on their venture," says Anurag Sharma, dean – academics at IIT Delhi.

PP Das, professor - department of computer science & engineering, IIT Kharagpur, says his institution allows students temporary withdrawal for two semesters. "But it has to be properly certified by the mentor professors."

Besides parents and teachers, investors too have embraced the idea of dropouts starting a business.

"Being a dropout, to some extent, helped our case. Investors appreciated the headway we got in business. They liked our thought clarity. Investors do not have any taboo investing in startups by dropout entrepreneurs," says Ankit Oberoi, co-founder, Adpushup, an 'AdTech product' that helps clients optimise online ad revenues by using advanced algorithms.

Oberoi and his partner Atul Agarwal dropped out of their BBA course (in the first year) to start their own venture. Adpushup mobilised over "half-a-million US dollars" in the first round from a group of investors a few months ago.

PADMAJA RUPAREL
PRESIDENT, INDIAN ANGEL NETWORK

It is heartening to see that families and academicians are now showing more willingness to accept failure in students

"If education institutions are becoming more liberal, in terms of giving more elbow room to students, there'll be more dorm-room startups," says Oberoi.

Vinod Murali, MD of Innoven Capital, which has funded over 100 startups since 2014, says there're several young dropouts who manage their startups very well. "There are experienced graduates who mismanage also. As an investor, we're not worried about qualification or age of the entrepreneur, as long as the business idea is good."

So far it was anxious family members and societal pressures rather than worries about funding that prevented youngsters from discontinuing their studies and starting a venture. Students from conservative backgrounds also dread the tag of being just a "baarvi pass" (12th class pass), in case their business ventures fail. A 'return to campus' option, like the ones started by premier engineering colleges, will go a long way to assuage such fears.

AJAY RAMASUBRAMANIAM
DIRECTOR, ZONE STARTUPS

By allowing a break between semesters, these institutions are allowing students to gain work-related experience and make them job-ready

"Parents are more open to the idea of dropping out now. Support from colleges will help students convince their parents," says Oberoi.

Private engineering colleges like MIT and BITS-Pilani have the leeway to give "academic break" to students desirous of starting a venture. The four-year bachelors' engineering programme offered by these institutions can be extended to 8 years if respective academic councils feel their students have a genuine startup idea. "There's no need for us to get any extra permission to allow students a sabbatical if they have a genuine startup idea. We're not against the idea of giving students some two years' time-off to focus on their startups," says GK Prabhu, Director of Manipal Institute of Technology.

S Arul Daniel, Dean (academic) at NIT Trichy, holds similar views. "Our four-year BTech programme can be completed in 6 years; so if any student is keen to take a break and focus on his start up idea, we'll not say no to him," he adds.

These institutions, at some level, are aping the curriculum structures of foreign universities, which liberally allow their students to take breaks between course semesters. Ivy league colleges like Harvard University, Stanford and Massachusetts Institute of Technology have similar liberal policies to encourage and mitigate the risk for students who want to start their entrepreneurial ventures.

"By allowing a break between semesters, these institutions are allowing students to gain work-related experience and make them job-ready," says Ajay Ramasubramaniam, director, Zone Startups, an accelerator jointly managed by Ryerson University Canada and BSE Training Institute.

However, a few successful "dropout entrepreneurs" like Kunal Shah of Freecharge feel that merely by giving a "few semesters break" would not help much in creating a startup ecosystem on campuses. "They have to encourage innovation and appreciate problem-solving skills of students. If a talented student has a great business idea, he'd drop out anyway," says Shah.

"Besides, one cannot do great stunts with a safety net," he says.

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