

The ET India Startup Ecosystem Barometer

Is now a good time to be a startup entrepreneur? Who's to blame for unprofitable business models? How long before investors will be bullish again about Indian startups? The most definitive survey of India's most influential startup entrepreneurs and investors threw up a few surprises, report **Madhav Chanchani & Aditi Shrivastava**



Indian startups are at a crossroads this year. The past couple of years, startups were pampered with excessive capital and presented a sounding board in the Prime Minister himself. But this year, with capital slowing, startups that over spent and over hired during their period of exuberance are having to cut down, shed jobs and spout profitability as their definitive mantra.

To gauge the pulse of startups in this period of churn and the challenges they face, The Economic Times conducted an exhaustive survey of the most influential entrepreneurs and investors in the country. The study threw up a few surprises—a majority of the respondents said they believe there couldn't be a better time than now to be a startup entrepreneur; and that investors' belief in the ecosystem will pick up in six months to a year.

Worryingly, though, for Indian startups, an overwhelming majority believe Flipkart and Ola will be

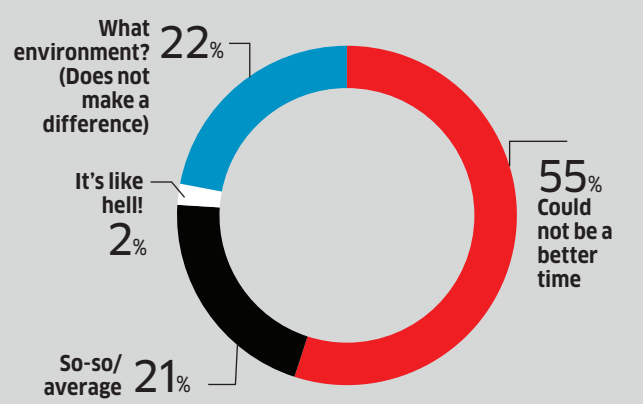
replaced by their American rivals Amazon and Uber, respectively, as the market leaders in the next two years. It is crucial for India's startup ecosystem for Flipkart and Ola to be successful, but they have to be able to stand their ground sans the protectionist moats available for their Chinese counterparts.

The Economic Times India Startup Ecosystem Barometer survey will be presented in two parts. The first focuses on the Big Picture—will domestic startups be able to triumph over the US giants; when will investor sentiment improve; and despite the doom-and-gloom, is it still a good time to startup.

The second part will boil down the specifics—how much have valuation expectations changed; where are companies cutting costs; the direction of salary expectations; and the sectors investors are focusing on.

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How conducive is the current environment to be a startup entrepreneur in India?



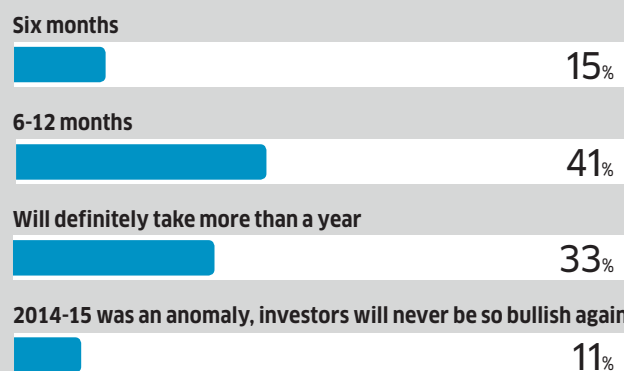
ANALYSIS: Even with the ongoing funding winter, a majority of the entrepreneurs believe it's still the best time for them to be running a company. These respondents believe the slowdown allows them time to re-group and build more sustainable business than be distracted by what the competition is doing. Many of them said this period of churn will help to separate the "wannabe" startups founders from serious entrepreneurs and that capital will always be available for good companies. Some respondents, however, noted that while the startup market has matured significantly over the past 5-6 years, infrastructure issues like patchy broadband penetration and different limitations for specific segments have started to emerge.

Guess the biggest change is in the way society now evaluates entrepreneurship. Less peer pressure to do the 'corporate' thing
— Founder of an online retail company

The Indian startup environment has never been geared in terms of infrastructure. The only plus points used to be the availability of capital and (to a lesser extent) availability of some categories of skilled labour. Now, the funding is drying up. The rest has to be manufactured externally by the entrepreneur. This is not China
— A serial entrepreneur

Just look at the (regulatory) clauses for angel funding to be tax free. We keep hitting red-tape. The regulatory environment is poor. Government folks don't understand new technology. They like public relations and superfluous Twitter activity. But the situation has improved from the past. Has to be much faster
— Founder of a hyper-local startup

How long will it take for investor sentiment to pick up around Indian startups/the technology market?



ANALYSIS: Indian startups saw copious amounts of funding between July 2014 and November 2015. When Flipkart garnered a record \$1 billion in funding in July 2014 in the run up to Alibaba's \$25-billion IPO that September, it put India on the global map as the next big opportunity for investors. Hyper-local delivery startup Grofers mopped up three funding rounds totalling \$165 million in nine months in 2015 as global investors clamoured to get in early on the next big thing. Typically, startups raise one round of funding every 12-18 months. But since the third quarter of 2015, investor sentiment has dimmed. Global investors like Tiger Global Management and Japan's Soft-Bank, which were the most aggressive in 2014-2015, have not opened their purses for new investments this year. Even so, 41% of the respondents are optimistic that the funding market for startups will recover in six months to a year. Many respondents agreed on one thing: For sentiment to pick up, the Indian startup ecosystem needs either a mega exit so investors have proof that big returns are possible or a mega round of funding into one of the billion-dollar internet firms.

There are investors and then there are investors. Good, strategic investors will be back and the pretenders will be gone
— A startup entrepreneur

Don't expect bullish valuation to come back unless there is a blockbuster exit. Other than that, investors are still active
— A Bengaluru-based venture capital investor

The first half of 2015 was an anomaly possibly due to Alibaba's September 2014 IPO. If you take out that period and look at 2013, the second half of 2015, and 2016 so far, there is an upward curve. The first half of 2015 was valuable in giving the industry a strong push and got everyone's attention, from the government to the media. Thus, it was highly beneficial to the industry as a whole
— Mumbai-based early-stage investor

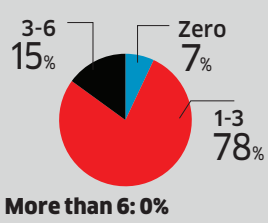
What is the biggest concern among limited partners about India? (Ranked in order of priority)

1. Few Exits
2. High Valuations
3. Concerns about maturity and depth of the startup ecosystem
4. Regulatory/Taxation hurdles

ANALYSIS: Lack of exits in Indian startups is by far the biggest concern among global limited partners, or LPs, who are investors in venture capital and private equity funds. About 78% of the venture capital investors who participated in the survey voted that a lack of options to sell their investments was the biggest concern for their limited partners. While billions of dollars have flowed into India's startup

ecosystem the past 10 years, big exits have been missing. Overall, while Indian startups raised \$12.7 billion in 2014 and 2015, total exits totalled \$1.29 billion, or about one-tenth the total capital deployed, according to data from Tracxn. Some argue that India cannot be compared to China and the United States that have large domestic markets. But even in Israel, 373 companies raised about \$3.58 billion and 69 companies were sold for a total sum of \$5.41 billion in 2015, according to Israeli research platform Zirra. The second big concern about India is the high valuations of startups that are now being seen as unjustifiable given the revenues. This is making exits even tougher in India. The third concern is over the maturity of the Indian ecosystem, highlighting worries that the domestic consumer market may not be large enough yet and that there is not enough managerial or executive strength available here for companies to scale up smoothly. Surprisingly, regulatory and tax-related problems such as the 'angel tax' made the bottom of the 'worry list'.

Of the nine Indian unicorns, how many will go for an IPO by 2020?

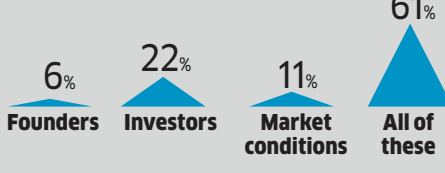


ANALYSIS:

Nine Indian private technology companies are considered to be worth at least \$1 billion, making up the steadily widening Unicorn club. These companies—Flipkart, Snapdeal, Ola, Paytm, Shopclues, Zomato, Quikr, InMobi and MuSigma—are worth a combined \$36 billion. Except Paytm, none of these companies was founded before 2005. While their estimated valuations are eye-popping, the real test for these companies will be when they decide to list their shares in public equity markets and prove to scrutinizing eyes that they are a sustainable

business. India's original technology startup poster boy, Infosys, is worth \$37 billion in public markets. About 78% of the investors polled believe that only up to three of the current set of Unicorns will be able to go for an IPO in the next four years. Some of them expect that many of the other billion-dollar firms will be acquired by companies that will eventually go public. The universe of Indian internet companies that are listed will possibly be much larger as smaller firms will also list their shares on the bourses. But the promise of a large Internet market lies with the IPO of the Unicorns.

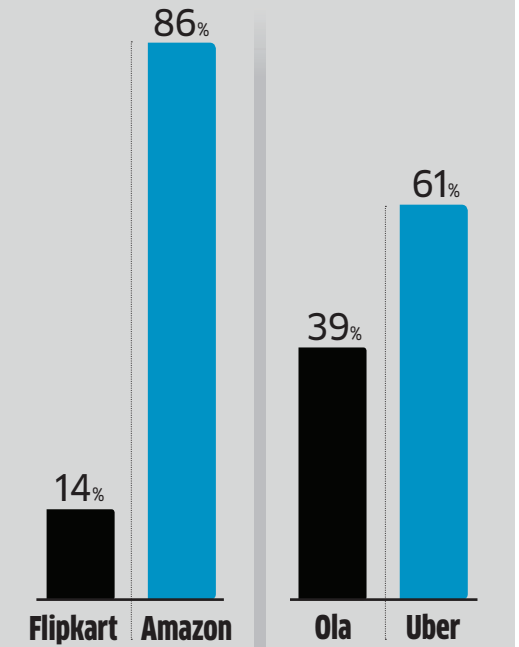
Who is primarily responsible for the lack of profitable business models in the Indian internet/technology space?



ANALYSIS:

While internet businesses have been able to secure venture capital funding consistently the past 10 years, the most well-funded of them aren't yet profitable. Online classifieds InfoEdge and Justdial are making profits but they were founded in the previous century. Who is to blame for this situation? A majority of the entrepreneurs and investors polled were unwilling to pinpoint the reasons. Interestingly, although about one-fourth of the investors polled blamed themselves, none blamed founders. On the other hand, only 8% of the founders blamed themselves and 20% of them pointed fingers at investors for their unprofitable businesses.

Who will be the market leader in the cab aggregation and online retail categories in the next two years?



ANALYSIS:

Any meeting with a startup entrepreneur or investor in India this year is not over until the discussion steers to how the two big market share battles are shaping up. The domestic market leaders, Flipkart in online retail and Ola in taxi aggregation, are pulling all their might to fend off US giants Amazon and Uber. Flipkart and Ola are important to drive investor sentiment in favour of India. The two companies have raised a combined \$4.4 billion so far, as against the overall \$12.7 billion raised by internet and technology companies in 2014 and 2015, according to data from startup researcher Tracxn. Returns on capital raised by these two companies will be pivotal to the success of India's startup ecosystem. What's worrying is that an overwhelming majority of the respondents in the survey believe Amazon will edge past Flipkart and Uber will be bigger than Ola in the next two years given their seemingly unlimited budgets to win in the world's fastest growing major economy.

It's fine. (Flipkart and Ola) will improve or get acquired. These are not monopolistic markets, more duopolistic. It's very far from game-set-match
— A Mumbai-based early-stage investor

Really bad in case of Flipkart. They have the highest invested capital that needs to see an exit for the environment to flourish
— A startup entrepreneur

Both Uber and Amazon, especially Amazon, have spent years executing well and building better India-specific capabilities than their rivals. They are both India companies, not US clones
— Founder of a Bengaluru-based startup

Good for the Indian market. At least we will have sustainable high-quality service even if it comes at a higher price. In the e-commerce space, Indian companies were anyway setting the wrong precedents
— The CEO of a payments startup

The startup ecosystem will learn to build better moats and not take local advantages as the defining ones for their businesses
— A Bengaluru-based entrepreneur

All concept arbitrage players who don't bring any independent IP to bear will be under severe pressure when global category leaders challenge them in India
— A serial entrepreneur

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METHODOLOGY

ET designed two different questionnaires for the survey—one targeting entrepreneurs and the other, investors. While respondents were given multiple choice answers to pick from, they had the option to elaborate on their choice. Some questions were common to both—like when would investor sentiment around internet companies likely pick up. The surveys were distributed to about 120 founders and investors. They were chosen carefully—founders of companies worth at least \$100 million, serial entrepreneurs and managing directors of venture capital firms. They were allowed to respond anonymously. Of the 120 people ET reached out to for the survey, 62 startup entrepreneurs and 27 investors participated.