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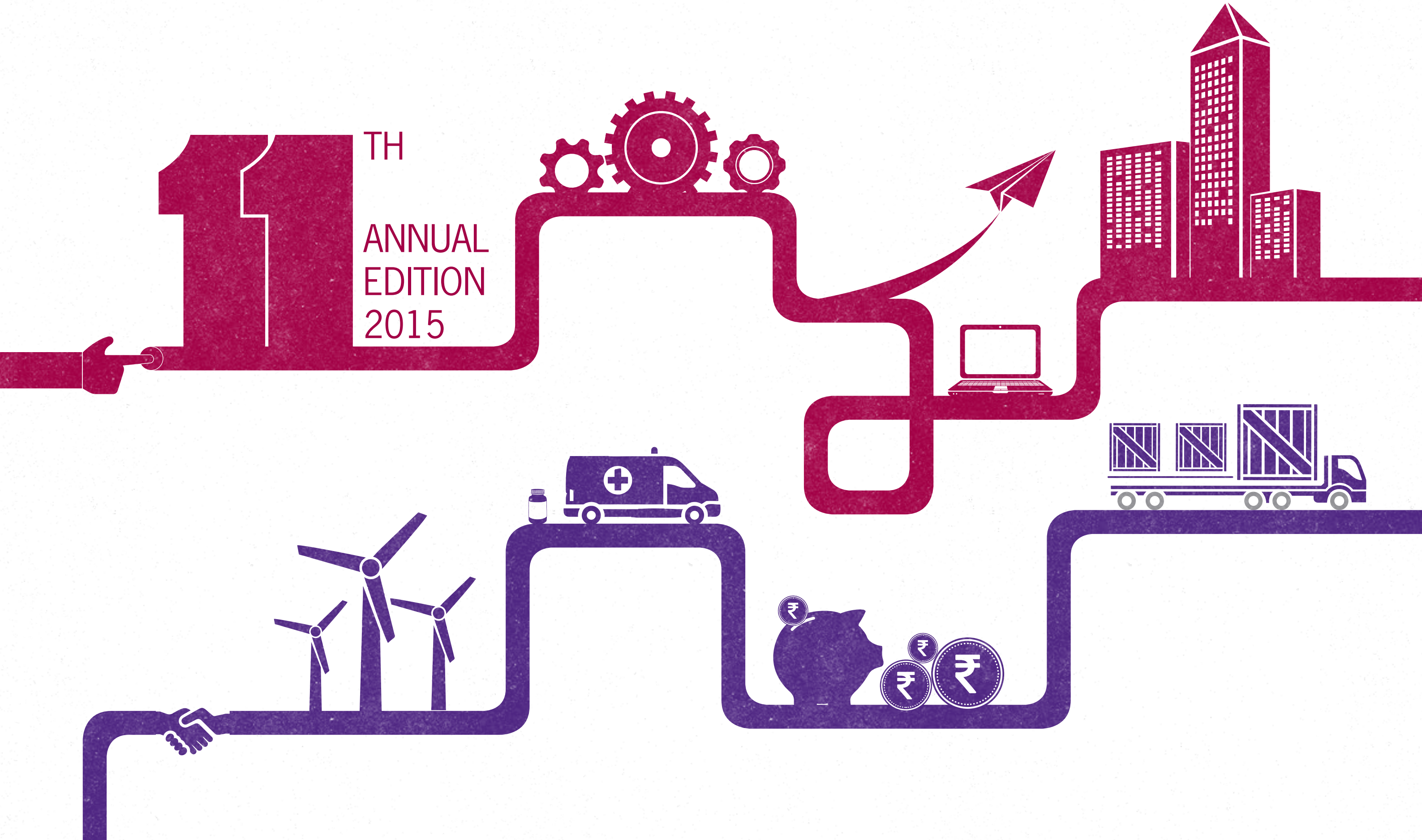
Dealtracker - Startups Special Issue



Foreword

Harish HV

Partner

India Leadership Team, Grant Thornton India LLP and member, policy group of Ispirit which engages actively with Government of India, RBI & SEBI on startup policy issues

Prime Minister, Narendra Modi will launch an ambitious program called Standup India, Startup India this week. This will seek to revolutionise and accelerate the startup revolution in India which is already witnessing a strong traction as seen from the data in this special issue of Dealtracker.

We had an era where we had manufacturing startups in the 70s and 80s and these were supported through seed capital and soft loans by the development financial institutions (DFIs) both at the Union and the State level. Entrepreneurs who were keen to set up factories were supported in their endeavours and several companies which are today household names were beneficiaries of this ecosystem. A few such names include names Reliance, Biocon, Infosys etc. However, the DFIs supported predominantly through loans and when a company did well they got back their money or else ended up writing off the loans. The practice was unsustainable. They did not make significant gains on the successful companies but lost money on failures. As a result and due to liberalisation since mid-90s, we did not have a startup ecosystem. In the past decade, we have seen the rebirth of the startup ecosystem with a more sustainable business model in the form of Venture Capital. This is now taking strong root in the technology related areas and we are now seeing the results of this in cities such as Bengaluru and Gurgaon.

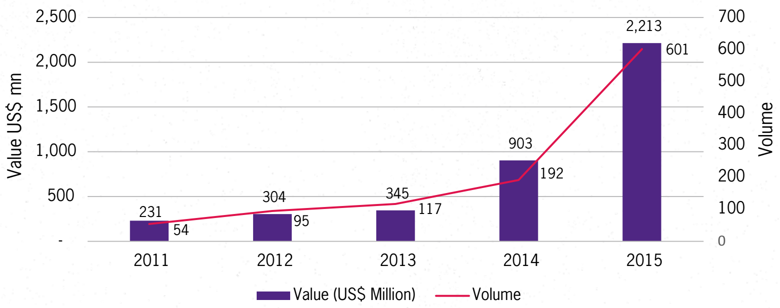
We need a similar ecosystem to develop in the manufacturing space to help accelerate the Make in India program and I believe the government must focus on this area rather than tech startups in the funds they are seeking to create. Of course for both we need significant improvements in the area of Doing Business, certainty and liberalisation in taxation policies and procedural simplifications.

We are pleased to present this special issue of Dealtracker covering deals in the startup space which should give a good sense to the readers on the levels of activity, trends and focus areas for investment.

We look forward to your feedback.

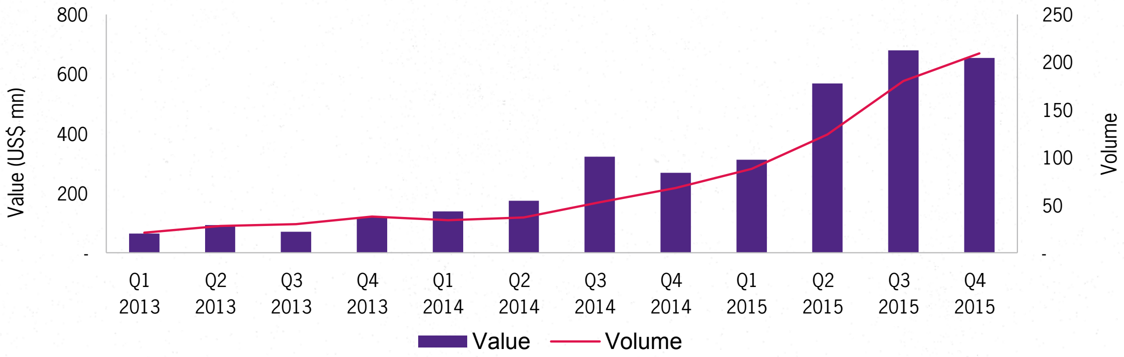
Startup investment round-up

- Investment momentum in startups have increased rapidly over the last five years with investment values increasing at a CAGR of more than 57 percent between 2011 and 2015 while investment volumes have increased at a CAGR of over 62 percent.
- Increase in smaller value transactions due to higher volumes in seed and angel rounds of funding have led to moderation in the average deal ticket sizes in startups in 2015. Additionally, based on our criteria, we have only considered investments at or below Series B stage funding.
  - Of the total deals in this period, three startups have received above US$ 100 mn each while there have been five startup investments above US$ 50 mn each. All three investments occurred in 2015 which include Warburg Pincus' investment in Ecom Express, two investments by Rocket Internet & Goldman Sacs investment in Foodpanda.com (Pisces EServices Private Limited).



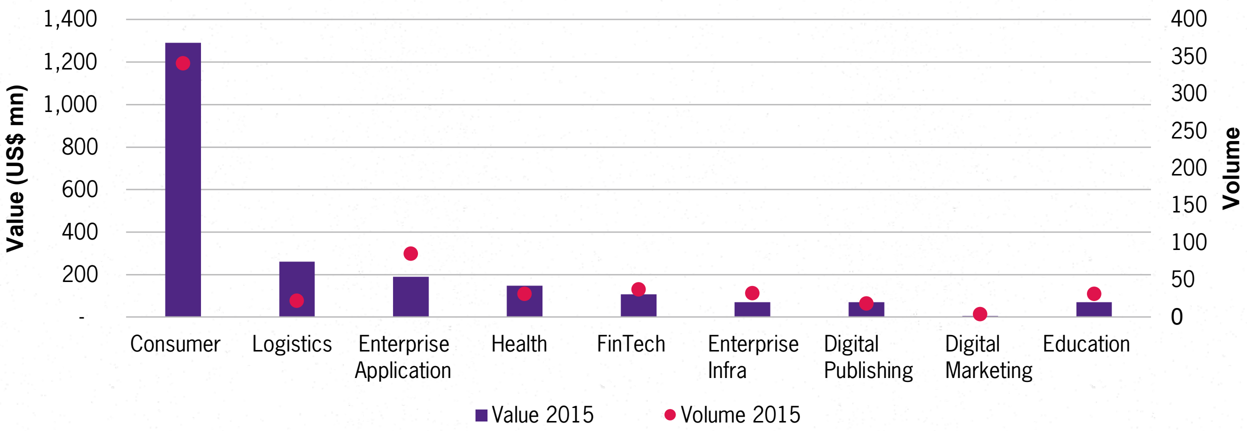
Quarterly startup trends

- Momentum in startup investments has seen an unprecedented increase in 2015, in terms of value and volume. During the period from 2013-2015, investment values have maintained a substantially high momentum of about 21 percent CAGR.

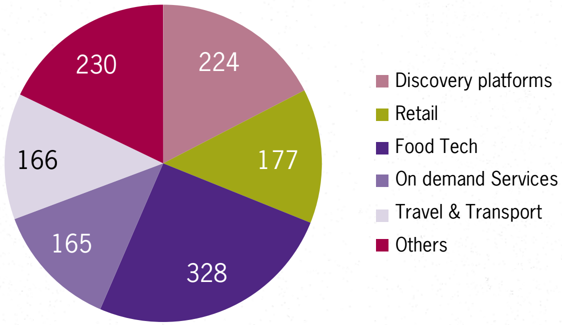


Startup sector focus

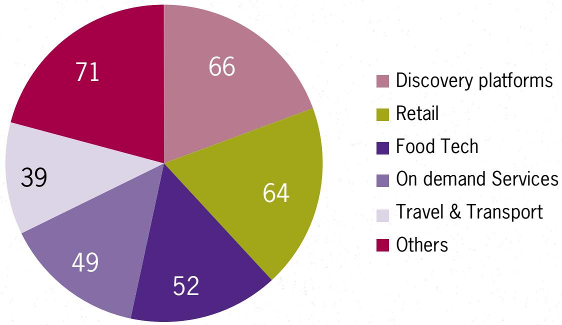
- Investors showed significant interest in consumer focused startups in 2015 with around 58 percent of total startup investments receiving a cumulative funding of US$ 1,290 mn. B2C start-ups that received investment are food tech (25 percent of total investment value), discovery platforms (17 percent of total investment value) and retail (14 percent of total investment value).
- Substantial interest has also been generated in the logistics segment with US$ 262 mn investments primarily driven by investments in e-commerce logistics providers
- Other top sectors which have received investment are:
  - Enterprise Applications: With a growth in ecommerce and startup eco-system, there has been an increase in services providers in B2B retail, business intelligence, HR tech, SaaS, sales and marketing tech are seen receiving increased investments.
  - Health: Investments in startups engaged in providing consumer healthcare services by connecting doctors to patients and by providing healthcare solutions to customers received investor interests
  - FinTech: Startups engaged in banking and consumer finance received US$ 52 mn, payment solutions received US$ 35 mn followed by insurance focused startups which received US$ 16 mn.



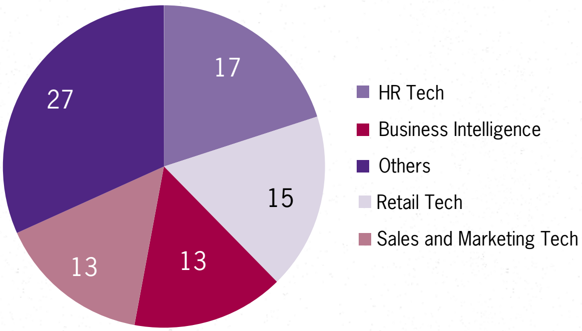
Consumer startups: Value break-up (US$ mn)



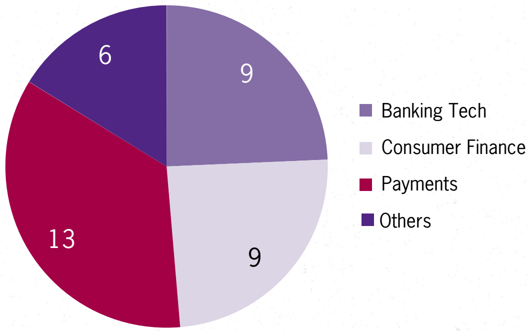
Consumer startups: Volume break-up



Enterprise Application Volume 2015

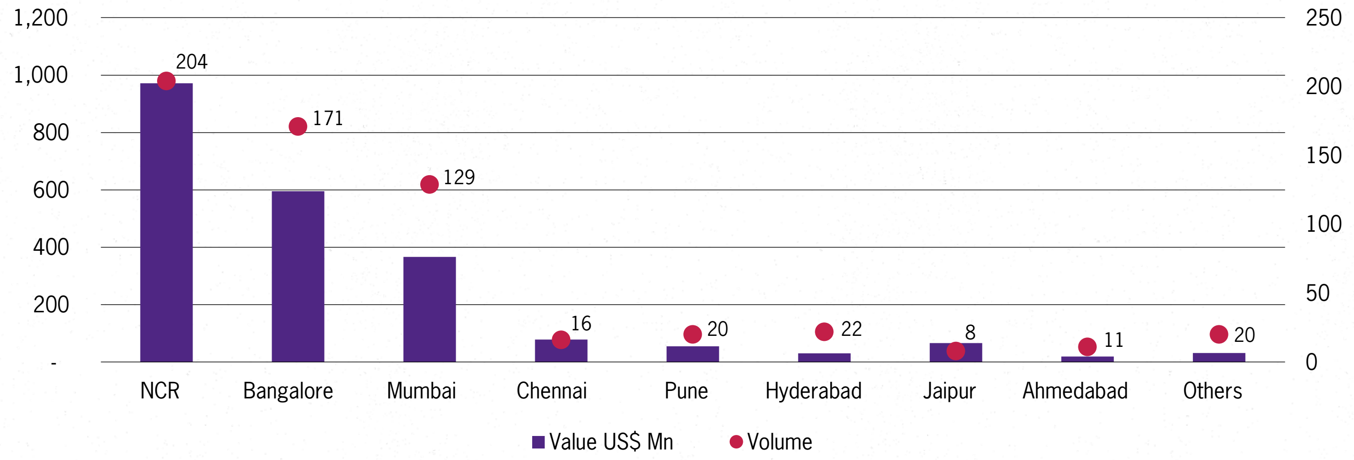


FinTech Sector Breakup Volume 2015



Indian startup cities

- Highest investments in start-ups were made in Bangalore and Gurgaon amounting to US$ 596 mn and US$ 577 mn respectively. This has been followed by Mumbai (US$ 366 mn) and Delhi (US$ 313 mn).
- However, highest amount of investments made in startups were observed in Bangalore and Mumbai with 171 and 129 startups funded, respectively.



Expert speak

1. Trends in startup investment

Introduction

There has been a flurry of new startups and innovations in India in recent years. The Indian startup ecosystem has evolved, being driven by factors such as growth in number of funds/angel investors, evolving technologies, smart phones and the social media penetration, growth in incubators and accelerators, younger demographics etc. Government initiative, 'Standup India Startup India will provide a new momentum to the overall growth.

Trends in funding

2015 witnessed the maximum traction in this space with over 600 companies getting funding; more than US$ 2 bn being deployed by PE and VC funds.

In the earlier years, the sectors in the startup space which attracted funding were limited to IT and consumer and retail. However, recently there has been a huge influx of startups in other verticals such as discovery platforms, payment gateways, hyper local services, e-com logistics, healthcare, food tech, cab aggregators etc. All these in some way or the other are allied to the consumer technology sector enabling e-Commerce.

The B2C is gaining more impetus with more than 300 deals in this space in 2015 which include verticals such as foodtech, hyperlocal delivery, discovery platforms, social platforms etc. The B2B section is also gaining momentum with focussed startups in the enterprise applications and infrastructure space. Majority of the startup companies are based in the NCR region followed closely by Bangalore and Mumbai.

The top deals in 2015 include investments in the usual suspects i.e. investment of US$ 700 mn in Flipkart by Sequoia Capital & Steadview Capital, US$ 500 mn in Snapdeal by Alibaba, Softbank & others, US$ 1100 mn in Olacabs by a group of investors including Tiger Global, Softbank, DST Global etc.

Other fairly large transactions include investment in Quickr, Jabong, Ecomexpress, Grofers, Foodpanda, Shopclues, Pepperfry and Oyorooms who have received funding of more than US$ 100 mn.

Investors such as Accel Partners, Blume Ventures, Tiger Global, Kaalari Capital, SAIF Partners, Sequoia Capital, IDG Ventures, the Indian Angel and Mumbai Angel Network continue to dominate the market.

M&A activity continues to rise in this space with Alibaba acquiring stake in Paytm, OlaCab's acquisition of TaxiForsure, Jasper's acquisition of Freecharge.com, Zomato's acquisition of IAC-Urbanspoon etc.

2015 saw a new class of investors which were attracted to this asset class. Interest shown by corporate icons such as Ratan Tata and Aziz Premji in the consumer tech space is an encouraging trend. Firstly it lends the much needed credibility to a startup business for it to not just attract other investors but it also strengthens their customer and vendor relationships. Corporate bigwigs are expected to have a long term horizon for their startup investments which will give the companies the required space and opportunity to grow without undue pressure on early exits. Corporates such as Reliance, Wipro, Infosys, RPG, Jindal etc. are also setting up their own venture capital arms.

Also successful startup entrepreneurs such as Snapdeal's Kunal Bahl and Rohit Bansal, Flipkart's Sachin Bansal and Binny Bansal are have now become angel investors; they bring valuable experience and network apart from the financial support to the startup community.

Conclusion

Slight pessimism had started setting in the second half of 2015 with startups shutting down and retrenching employees. However, in 2016 we expect that new innovative startups will continue to attract investors' interest. There will be increased rationality in this ecosystem, funding may get tougher and focus will increase to fundamentals, justification around valuations and scalability. There may be a fewer number of unicorns in the making as a result of this. Consolidation will be on the rise and valuations in this space may still be aggressive. An investor's ability to mentor and nurture a startup idea will attract young entrepreneurs compared to pure financial investors; this will also be a win-win situation for both.

Kinnari Gandhi

Director

Grant Thornton India LLP

2. Opportunities & challenges facing startups

As the Indian startup space goes through its own economic cycle, opportunities abound, however with a set of challenges. Here is a set of opportunities and challenges:

Opportunities

Policy initiatives

Indian government aims to build an ecosystem that promotes entrepreneurship at the startup level and has taken a number of initiatives to ensure that the startup businesses get appropriate support of higher involvement and interest of larger and established businesses. Some of these schemes include Make in India, Stand-up India, Digital India, Mudra Scheme, Set up exchange, SETU, Etc.

Increasing presence of global incubators

Startup incubators are companies that assist new startups in their initial phase of development by providing various services. Incubators share both tangible and intangible resources such as equipment, office space, services such as accounting, computing and legal services. They also assist startups in raising startup capital and perform various networking activities to reduce the financial burdens and resource issues. Incubators help entrepreneurs in building sustainable business environment while benefiting the broader corporate communities.

Growth in the level of venture capital and seed funding

Although we see a growing trend in terms of venture capitalists and angel investors providing funding to startups, there are still a large number of startups which still find it difficult to get funding. The challenge faced by startups to acquire funding is not limited only to seed rounds, but is also faced in the Series A and B rounds. Unfortunately not a lot of investors are there in India and of the ones which are there too; not a lot invest very large amount.

Focus on ease of doing business in India

- Single online clearance system: The Prime Minister is planning to bring an online approval window which will provide over 200 permits required by different industries from various government divisions.
- Simplification of regulatory regime: The PM aims to bring India ranking on the ease of doing business to 50 from the current ranking of 142 by the World Bank's index and is working on simplifying business processes and regulations.

Demographic dividend

According to the UN, India has the largest youth population even though it has a smaller population as compared to China. The youth is usually the driving force behind innovation and also is responsible for a growth in demand and consumption. The youth forms the most important part of the workforce which would work for startups and thus present a huge opportunity for startups to grow.

Role of larger businesses

Big corporates generally focus on innovation, performance excellence and risk management in order to compete in the dynamic global business environment. Issues related to tightening of R&D budgets, increasing digital disruption and organisational bureaucracy make it difficult for the larger companies to innovate on their own.

Challenges

Every startup faces problems and so do Indian startups with some problems being unique to the Indian startup ecosystem. The challenges faced by the Indian startups can be classified under the following categories:

Culture

The Indian culture has conditioned people to look down upon failure. For failures, opinions do come by but encouragement rarely so. Entrepreneurship is often about failing and learning from those failures and starting all over again. People need to start accepting failures and allow second chances.

Awareness

People at large are unaware about how they can contribute to economic growth, generate employment and contribute to social development. People are conscious about risk and rewards and India is referred to as a price sensitive market. However, the fact is that people are not price sensitive, but they are value sensitive. People generally tend to have a lot of doubts about what, why and how.

Social issues

- Mentorship/Guidance: Most founders of failed startups feel that the lack of proper guidance and mentorship is a major reason behind their failure. An important factor behind failures and slow growth of some organisations is the lack of quality mentorship, especially in terms of industry knowledge/ support.
- Market structure: Indian markets are largely unorganized and fragmented creating a roadblock for a startup to succeed.

- Consumer behaviour: Behaviour of Indian consumer changes after every 30 to 50 km, which makes it difficult for a startup to create a business or market strategy for their products or services. Most startups generally become stagnant and gradually shut down due to lack of growth.
- Location: Another issue faced by startups is related to the location of their business. India is a place with varied culture and taste and thus every product may not be welcomed equally in every region.

Technology issues

- Appropriate IT-infrastructure has become a need for Indian businesses given the growing number of consumers online.
- Most startups have a B2B business model. This is where cyber risk may rise as they are not aware of potential risks that might exist for their startup business.
- It is absolutely vital for new startups to train their employees for handling critical customer information like that of credit card numbers and related data.
- No back-up plan to keep the startup company running when an accident destroys some key equipment in their data centre.

Financial issues

- Operational finance: Most startups are self/ family funded with limited workforce which makes it difficult to maintain records both financial and operational
- Funding/ Capital deficiencies:
  - Capital and access to capital has been a perennial problem for startups
  - Though government and private sector investors have set aside funds through investment channels but they are not available for all forms of business. The biggest problem for such organisations has been to attract investors and gain their trust with regard to their mode of operations.
  - In the initial phase of operations, startups do not get funding from banks, given no credit history of the firm. In addition, there are limited number of credit rating firms for small and medium sized enterprise.
- Cash flow management
  - Effective cash management is an important factor to achieve objectives both short term and long term. Cash is still a preferred option for payments owing to the fact that electronic payment has not achieved complete penetration to Tier 2 and Tier 3 cities.
  - Gap between burn rate and revenue: Given rising competition from peers both from big as well as small, it becomes imperative for startups to scale up the business and require external funding for the sustainability/ growth in the market.

Sustainability Issues

- The level of knowledge that business advisers have about ecological issues and their willingness to discuss this with their clients is important in creating business ventures.
- Lack of information - provision of more information directly to business founders could help in the adoption of more sustainable business practices.
- Not aware of potential that might exist for their startup business.
- Role of public funding in promoting sustainable enterprises is often overlooked.

Anirudh Gupta
Director
Grant Thornton India LLP

Credits

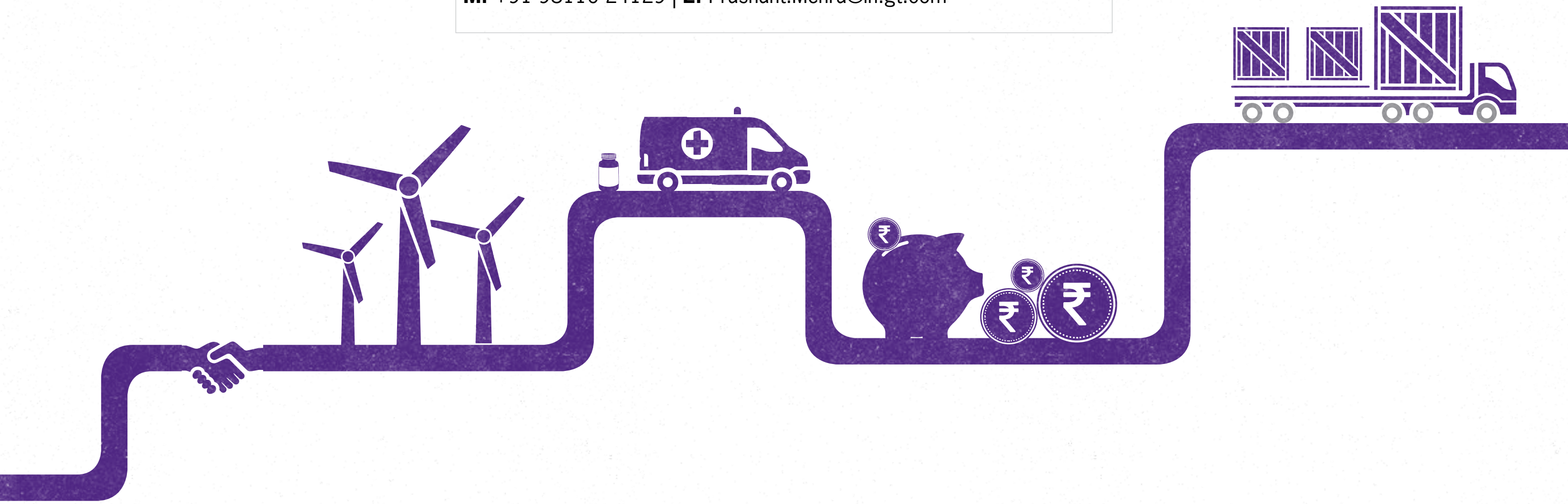
Authors

Harish HV
Prashant Mehra
Kinnari Gandhi
Anirudh Gupta
Divyabala N
Monica Kothari

For further information, please contact our leaders:

Harish HV
Partner
Grant Thornton India LLP
M: +91 99001 12127 | **E:** Harish.HV@in.gt.com

Prashant Mehra
Partner
Grant Thornton India LLP
M: +91 98110 24129 | **E:** Prashant.Mehra@in.gt.com



Methodology and Disclaimer

The deal data for this report has been sourced from Grant Thornton's Dealtracker report. This report includes views from experts. Please note that the views of the experts are personal and may not necessarily reflect the views of the organisation. The criteria used to define start-ups include: a) The Company should have been incorporated for three or less than 3 years as at the end of that particular year. b) The Company is a player in a non-traditional service industry c) The Company has received funding not above the Series B round of funding. Deals have been classified by sectors based on certain assumptions, wherever necessary. If different assumptions were to be adopted, the classification would be different.

Contact us

To know more about Grant Thornton in India, please visit **www.grantthornton.in** or contact any of our offices as mentioned below:

NEW DELHI
National Office
Outer Circle
L 41 Connaught Circus
New Delhi 110001
T +91 11 4278 7070

AHMEDABAD
BSQUARE Managed Offices
7th Floor, Shree Krishna Centre
Nr. Mithakali Six Roads
Navrangpura
Ahmedabad 380009
T +91 76000 01620

BENGALURU
"Wings", 1st Floor
16/1 Cambridge Road
Ulsoor
Bengaluru 560008
T +91 80 4243 0700

CHANDIGARH
B-406A, 4th Floor
L&T Elante Office Building
Industrial Area Phase I
Chandigarh 160002
T +91 172 4338 000

CHENNAI
Arihant Nitco Park,
6th Floor, No. 90,
Dr. Radhakrishnan Salai
Mylapore
Chennai 600004
T +91 44 4294 0000

GURGAON
21st Floor, DLF Square
Jacaranda Marg
DLF Phase II
Gurgaon 122002
T +91 124 462 8000

HYDERABAD
7th Floor, Block III
White House
Kundan Bagh, Begumpet
Hyderabad 500016
T +91 40 6630 8200

KOCHI
7th Floor, Modayil Centre point
Warriam road junction
M. G. Road
Kochi 682016
T +91 484 406 4541

KOLKATA
10C Hungerford Street
5th Floor
Kolkata 700017
T +91 33 4050 8000

MUMBAI
16th Floor, Tower II
Indiabulls Finance Centre
SB Marg, Elphinstone (W)
Mumbai 400013
T +91 22 6626 2600

MUMBAI
9th Floor, Classic Pentagon
Nr Bisleri factory, Western
Express Highway
Andheri (E)
Mumbai 400099
T +91 22 6176 7800

NOIDA
Plot No. 19A, 7th Floor
Sector – 16A
Noida 201301
T +91 120 7109 001

PUNE
401 Century Arcade
Narangi Baug Road
Off Boat Club Road
Pune 411001
T +91 20 4105 7000

For more information or for any queries, write to us at **contact@in.gt.com**

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