India's startup scorecard

Akhil Gupta
Vice Chairman
Bharti Enterprises Ltd.

Startups in India in last decade have been projected and perceived as "backbone of future India". Government of India has labelled "Startup India" as a very significant pillar for India becoming an economic and more important technological force on global map in times to come. Various exhibitions sponsored by industry associations in partnership with relevant Government departments in last one year (like 'Startup Mahakumbh' organized by Assocham with support from Government of India earlier this year) have commendably showcased our startup eco system to the world.

There is no doubt that for good startups with innovative and breakthrough ideas, there will indeed be good potential. However, to ensure that the said potential is successfully exploited, like any project, it is imperative to have a look at the past, learn from the mistakes and shortcomings, if any, and quickly ensure remedial action.

For the startup ecosystem in India, the scorecard so far has been a mixed bag.

On the one hand, it scores highly as seen in the following:

- India had 117,254 startups registered with the department for promotion of industry and internal trade (DPIIT) as on December 31, 2023, according to the Ministry of Commerce and Industry.
- This makes India the third-largest startup ecosystem globally and the second best in terms of innovation quality, according to Invest India.
- Between 2016-2023, startups attracted $133.5 billion investment, according to Forbes. It can be assumed as of today, the total investment in startups will be estimated around $150-160 billion.
- Startups created over 1.24 million direct jobs; indirect job numbers would be significantly higher.
- By October 3, 2023, India had 111 unicorns, backed by around $100 billion investment (of these, six have ceased to be unicorns). In 2024 so far, two more Unicorns added as per DPIIT.
- Of these, 13 were listed by February 2024, with a cumulative market capitalization of $50 billion.

However, on the other hand startups in India face various serious problems, which can be categorised under:

- **Financial performance**
- **Governance issues**
- **Cultural issues**

Financial performance

Financial performance of the 13 listed startups, according to data from ***Fintrackr*** -

- In April-December 2023, six companies were profitable, earning a total revenue and net profits of Rs 7,864 crore and Rs 925 crore, respectively. The highest profit was Rs 435 crore whereas the lowest was Rs 21 crore.
- In this period, seven recorded total revenues of Rs 29,976 crore, with a combined net loss of Rs 5,807 crore. While highest loss was Rs 1,609 crore, the lowest was Rs 137 crore.

  Thus, these 13 listed companies with a market cap of $50 billion had a total revenue of Rs 37,840 crore and an overall loss of Rs 4,882 crore during the nine-month period (annualised loss of over Rs 6,500 crore).
- Among unicorns, the top 10 profitable ones had a cumulative net profit of Rs 6,503 crore (interestingly, of these, two companies with a net profit of Rs 4,843 crore did not raise external capital).

  On the other hand, the top 10 loss-making unicorns had a cumulative loss of Rs 33,496 crore in the same period, with the highest at Rs 7,900 crore and the lowest at Rs 2,014 crore.

  Thus, overall, the top 20 unicorns had a cumulative net loss of Rs 26,993 crore in the nine months (annualised about Rs 36,000 crore).
- Today it is common knowledge that thousands of other startups are burdened with big losses while many are on the brink of extinction due to unavailability of fresh funding to absorb cash burn.

  Overall, for a sector with over $150-160 billion of investments and annual revenues estimated to be in excess of Rs 3 trillion, the overall financial performance is acutely worrisome to say the least.

  Unfortunately, with no signs of most startups achieving self-sustaining cash flows in foreseeable future, let alone the near future, and with funding winter continuing, the looming threat of large-scale shutdowns hangs ominously over India's startup ecosystem.

Governance issues

Several startups, including some very big and celebrated ones, have faced severe scrutiny on governance and compliance issues. Prominent ones in the news are Byju's, Paytm, BharatPe and Zilingo. The jury is still out to find out the reasons, but it is visible that a large number of them failed to produce audited or even unaudited results for FY22/FY23.

The reasons for poor governance/management can be due to one or a combination of factors like:

- Deliberate actions/frauds on the management's part. These could include instances of misappropriation of funds, diversion of funds or adverse related-party transactions.
- Lack of experience of promoters in managing fast scaleups and ignorance of important internal controls, particularly financial controls.
- Lack of clarity on revenue and business model.

Cultural issues

The third reason often seen is due to poor culture on part of the promoters. Sudden availability of large amounts of capital, lack of check on expenditure and cash burned, attainment of celebrity status (often in direct proportion of cash burn achieved) have resulted in many startup promoters becoming too arrogant and unwilling to heed good advice. Unfortunately, this trait is becoming too common; promoters with humility and openness to advice are becoming far and few.

It is easy to blame startup promoters for the shortcomings. However, in my view; the bigger blame lies with investors. Usually they show no interest in governing the companies they invest in, but go ahead with fresh funding rounds, sometimes without checking updated financial accounts, or at least audited accounts for the last financial year. Many new-age investors do not lay much emphasis on discipline, processes and rules of working and instead only encourage topline growth. To achieve that, at times they encourage promoters to even burn cash as quickly as possible. The system of subsequent rounds of investment at exaggerated valuations prompted by ‘liquidity preference’ — where the last investor would get first preference in distribution of proceeds in case of liquidation — has contributed immensely to bad investor behaviour.

To summarise, I do believe that startups can be our valuable assets in times to come. To achieve that, we will have to ensure the following:

- Identify and support ‘real startups’ with innovative ideas rather than merely repackaging standard businesses as “technology driven companies”. A great example is normal NBFCs in traditional lending business rebranding themselves as ‘Fintechs’.
- Percentage of startups failing in India within five years dramatically reduces from 90 per cent predicted by an IBM and Oxford study. No ecosystem with such a failure rate can ever be deemed “successful”. More conservative financing by investors instead of ‘casual’ spraying of investments has to become the rule.
- Ensuring strict discipline, high governance standards with complete transparency must become a collective responsibility of promoters, managers, investors and regulatory bodies like the Institute of Chartered Accountants of India. A culture where promoters willing look forward to advice/mentorship from seasoned professionals rather than considering them as ‘intrusions and interferences’. Investors also need to ensure :
  - Boards have credible independent directors
  - Reports and accountability are sought periodically
  - Resources are provided for responsible governance and analysis of results of investee companies
  - Companies with poor management and/or governance are not rewarded with repeat funding’s
  - Right to change the management in case of poor performance, deliberate misgovernance and repeated non-compliances.

  The Ministry of Corporate Affairs, DPIIT and other government agencies concerned also need to take strict action against startups not providing requisite information and reports within stipulated time.

- Ensure that startups have good revenue and business models, as expected of normal companies.
- And finally the valuations offered to startups are more realistic and sensible.

I feel that time has come that various industry associations, Government agencies and self-appointed champions of startup world, instead of hero worshipping all startups based mainly on their capability to blow up cash with speed, started educating startups that the real glory lies not in the ability to burn cash but in creating real profits and sustainable valuations.