Bet on Indian startups now. Here's why.

VENTURE VERSE

by

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Startup valuations & VC investments are a lot like Ouroboros, an ancient symbol of a snake eating its own tail, representing a cycle of continuous renewal. Venture capital boosts growth, creates value, and attracts more investments, perpetuating an endless cycle of growth and funding.

This phenomenon is apparent in India, where the past 15 years have witnessed a surge of entrepreneurs and tech adoptions driving economic growth. Despite occasional funding challenges, the startup scene has flourished.

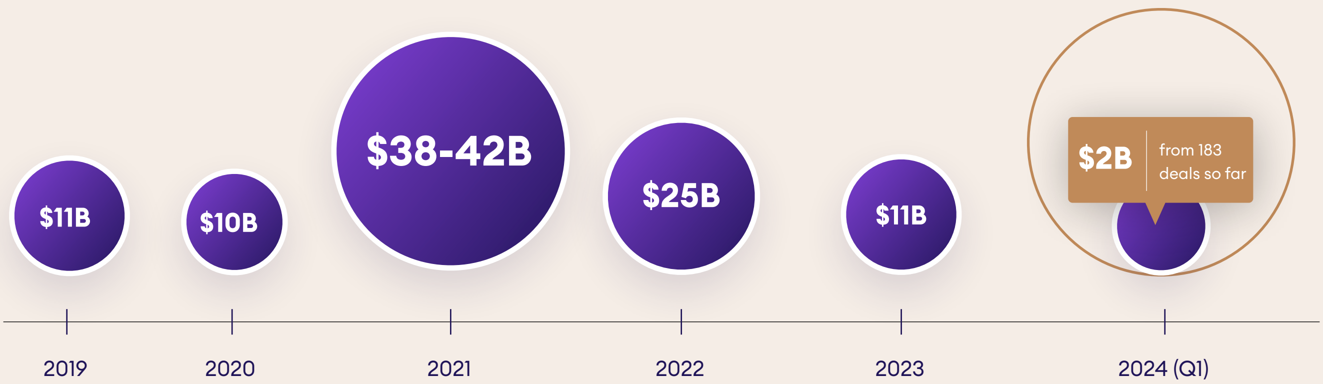
Having observed the Indian startup world for over a decade, I believe there has never been a better time for investors to participate and ride the economic growth wave of the decade to come.

Hear me out.

The Indian startup ecosystem, having witnessed the birth, growth, and demise of thousands of startups, is now maturing and stabilising. Both international and home-grown VC funds and angel investors have seen substantial returns, despite some losses. Government initiatives have made it easier to start and grow businesses. improving India's rank in the **World Bank's Doing Business report** from 142 in 2014-15 to 63 in 2019-2020.

Despite the slower growth over the last two years, Indian startups are coming of age. They are based on innovative ideas, solid fundamentals, and realistic valuations, thus presenting significant opportunities for investors, especially in the growth-stage.

VC funding in Indian startups in the last 5 years



(Note: The numbers are approximated according to data from different reports)

From imitation to innovation

There was a time when Indian startups used to copy business ideas from the West and paste them in India. The poster boys of the Indian startup world, Flipkart and Ola, were modelled after Amazon and Uber respectively, while Paytm took after PayPal and Zomato followed Yelp's and Doordash's path. To be fair, 15 years ago, startup investors were conservative as well, and **preferred proven business models to invest in.** But these business models had to be tweaked quite a bit, and such efforts led to innovations like cash-on-delivery and localised platforms tailored for the Indian customer.

Over time, a new generation of young entrepreneurs - empowered by adapting ideas that went on to succeed in the Indian market - were backed by investors who were willing to take risks. They dared to think outside the box and the Indian startup ecosystem moved on to bigger, better things. Today, home-grown tech startups have produced unique business models like social commerce, hyperlocal delivery, pay on delivery for services, daily subscription for essentials, and many more, putting India on the world map of innovation.

India now boasts of the third largest startup ecosystem in the world after the US and China. More than 1 lakh **startups** have been launched in India and **they have raised an amount exceeding $146 billion** in funding since 2014. **India also ranks third** after the US and China in the number of unicorns. The combined valuation of Indian unicorns crossed **$350 billion in 2023.**

Many promising startups, regrettably, have died prematurely due to poor management and strategic mistakes. During the low interest rate and capital-rich period of 2021, startup founders were like bull in a China shop. Since money was pouring in from all directions, they forgot the first principle of capital raise - Efficiency i.e. focus on Return on Investment (ROI).

The easy availability of capital led to excessive spending on marketing for rapid customer acquisition and hiring new employees at unreal salaries which at times were 4 times the last drawn salaries. This was primarily to present impressive growth to secure subsequent funding, often at the expense of long-term sustainability and profitability.

But soon, reality struck and how.

Winter came, and the monies which were freely flowing till then dried up. It saw the untimely death of many capital-starved startups and this has now led to a renewed focus on financial sustainability. By prioritising ROI, startups are learning that they need to ensure that each dollar spent contributes to profitability.

What Growth-stage startups in India are offering investors today:

Driven by original ideas and business models, startups are now balancing innovation with solid financial practices. Both B2B and B2C models strive to assure sustainability and scalability.

For example, food delivery and restaurant discovery platform Zomato has shown how a startup can build a robust revenue-generating business model by tapping into multiple revenue streams. This approach has attracted significant investor interest, evident in its successful IPO and returns. Also, by expanding into international markets, Zomato has highlighted the global potential and competitiveness of Indian startups.

In another promising development, grocery delivery startup Zepto - valued at $3.6 billion - has raised $665 million in 2024's largest fund raise so far, and is **reportedly preparing for an IPO** this year.

Of course, not everything is perfect. The collapse of titans like Byju's shows that high valuations don't guarantee success. But our entrepreneurial ecosystem is resilient. Doom of some doesn't spell doom for all. Despite the funding winter and mass layoffs in the last couple of years, or perhaps due to those circumstances, startups in India have matured with stronger business fundamentals and focus on revenue growth. Recruitment approaches have also changed with experienced hands from traditional industries being hired at the helm to achieve business metrics conducive to profitable growth and sustainability.

Profitable progression

What happens when startups mature? Stability - not just for entrepreneurs and employees, but for investors too.

Financially sustainable startups are a sign of a healthy ecosystem. **Increase in profitability** indicates a growing pipeline of companies that are ready for an IPO. Backing growth stage startups in a mature, stable, and **profit-oriented ecosystem** means lower risks compared to early-stage investments. It significantly enhances the value proposition for investors. This is how:

Market validation: Profitability demonstrates that the startup has found product-market fit and is addressing real market needs, making them safer investments.

Scalability: Profitable startups can scale operations, expand market reach, & increase revenue potential, attracting investors seeking high-growth opportunities.

Diversification: A mature startup ecosystem allows family office investors & VC funds to diversify their investment portfolio with proven market winners.

Networking: A mature startup ecosystem attracts experienced entrepreneurs, mentors, & advisors, creating valuable networking opportunities that benefit investors.

Existing infrastructure: A mature ecosystem offers established infrastructure like mentorship networks, regulatory frameworks, & support services for startups.

Potential for quicker exits: A profit-oriented ecosystem enables quicker VC exits through acquisitions or IPOs.

Luck by chance

The dip in funding and the instability in startup valuations in the last few years have laid the red carpet for investors today.

The reason is obvious: Lower valuations often reflect broader market conditions where the capital available for investment is limited. When startups compete for a **scanty pool of resources**, investors have more leverage in negotiations and can demand better terms such as larger equity stakes or more control over the company's decisions. It offers more control over the company's decisions. It offers more reasonable investment prices, leading to **greater returns** when the market rebounds.

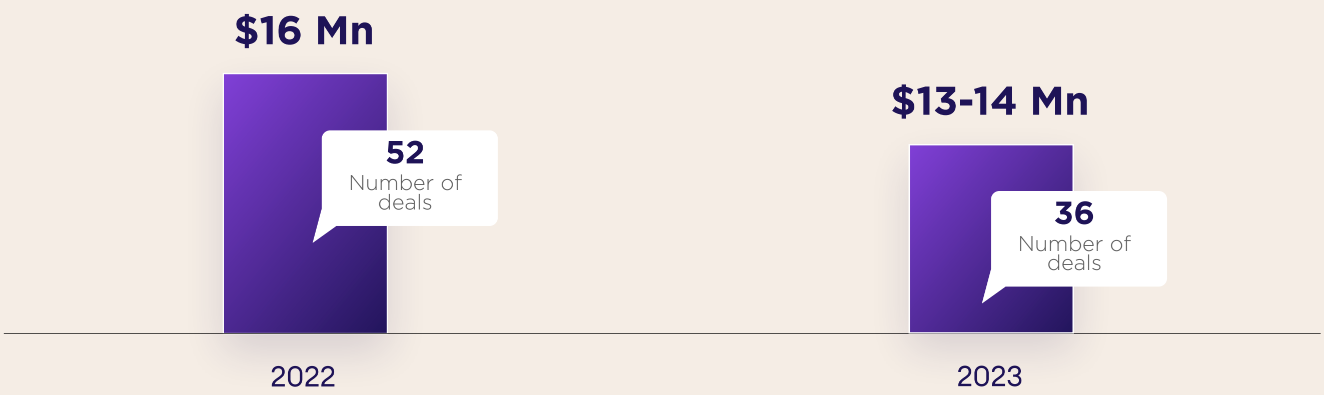
Funds launched in 2023

Startup stage	Number of funds	Total capital
Early	31	$1.8 Bn +
Early to growth	14	$1 Bn +
Growth	5	$331 Mn+
Growth to late	7	$1.7 Bn+
Late	2	$161 Mn+
Agnostic	5	$496 Mn+

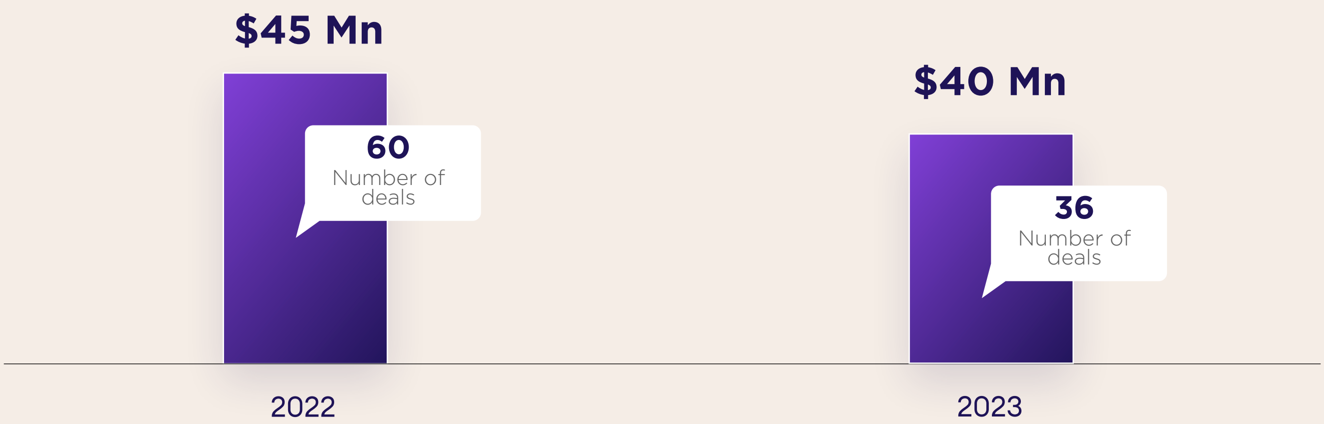
(Source: Inc42 2023 report)

On the other hand, during periods of high investment activity, startups tend to receive inflated valuations based on future growth projections rather than current financial performance. This creates **a disconnect between a company's actual value and market valuation.** It also pressures startups to achieve unrealistic growth targets and leads to unsustainable business practices. This is what led to **startup valuations peaking during 2020-2022**, with **44 Indian startups achieving unicorn status in 2021.** A necessary valuation correction has begun, with new unicorns dropping to 26 in 2022 and just two in 2023. Three more have emerged this year so far. This decline indicates a more realistic growth approach, forcing unicorns to better manage their cash reserves due to smaller investment amounts.

Series B funding rounds



Series C funding rounds



According to a recent **report by the Economic Times,** 11 out of the 112 unicorns in India have reported profits for three consecutive years. The FY23 financials reveal reduced losses and growth, with a quarter of them making profits and a 54% increase in profitable unicorns compared to the previous year. (At least 10 unicorns are likely to be added to the list when the FY24 financials are out.)

Unicorns that went public - such as Zomato, Policy Bazaar and Mamaearth - have already reported profits for FY24, as did **Oyo which reported its first profitable year** with Rs.100 crore net profit.

Is there a scope for more unicorns? Probably.

Is there scope for profitable, sustainable startups? Definitely.

The magic of growth-stage startups

Growth-stage startups of today can be the unicorns of tomorrow - if, and only if, their fundamentals are strong. Last year, we saw that investors were cautious with growth-stage startup deals. In 2022, there were 357 growth-stage deals totaling $7.1 billion, while 2023 saw 192 deals with a total of $2.9 billion, according to *Inc42*. However, the first half of 2024 saw a recovery with 74 growth-stage deals **$1.87 billion** in January-March, and the month of May witnessing 39 growth-stage deals amounting to $1.19 billion as per ***Entrackr***.

However, let's not forget that growth-stage startups offer a balanced investment opportunity with proven concepts, scalable operations, reduced risk, and significant growth potential. It is only when startups perform poorly in profitability, revenue growth, and customer acquisition costs that the valuations drop.

Operating profit is the key metric to focus on for growth stage startups in FY25. It shows business efficiency, sustainable profitability and operational health - all crucial for scaling. Amidst economic uncertainties, showing a path to profitability sets a startup apart and ensures long-term viability.

The Indian startup ecosystem is on an exciting trajectory, driven by original ideas, revenue focus, investor appeal, and global expansion ambitions. This phase represents a significant shift from the past, where startups imitated successful models from other markets.

A striking indicator of this transformation is the number of new startups launched each year. In 2015, over 8,000 startups were established, but by 2023, this number had **decreased to 489.** This reduction signals a shift away from copycat startups, as the market now favour ventures with innovative ideas and solid business models.

Entrepreneurs no longer take VC investments for granted and are vigilant on **optimising resources**. Founders now better understand market traction, team scalability, competitive positioning, and business sustainability.

Recently, Infosys founder & chairman NR Narayana Murthy said that India can surpass China by creating a favourable environment for entrepreneurs. Investor support is critical for building such an environment. Significantly, the growth potential in the Indian startup ecosystem offers lucrative opportunities, **ensuring that investments are both impactful and highly profitable**. A recent **report by *Inc42*** states that 56% Indian startup investors recorded portfolio exits, with 34% achieving 2x-5x Return on Exit in 2023. It adds that 95% investors believe 2024 will be a good time for startups to IPO, and 55% believe it will be a good time for exits.

Also, even if only a small number of unicorns come up in the near future, a recent report by CII and McKinsey claims that **new unicorns are likely to add $1 trillion to the Indian economy**, which would reach $7 trillion by 2030, and create 50 million jobs. Suffice it to say that investing in a growth-stage startup today presents a unique opportunity to be part of disruptive innovation and contribute to the nation's economic future.

After all, as Warren Buffet has said, the best investment you can make is in a company that will continue to grow and innovate - or, in this case, a nation that will grow and innovate.

Bio

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108 Capital a growth-stage venture fund for digital-first, scalable, sustainable businesses in India. He is an alumnus of Harvard Business School and a Chartered Accountant with more than 2 decades of experience in banking and financial services.

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