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GOVERNMENT AND STARTUP

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# Make In India Vs Startup India

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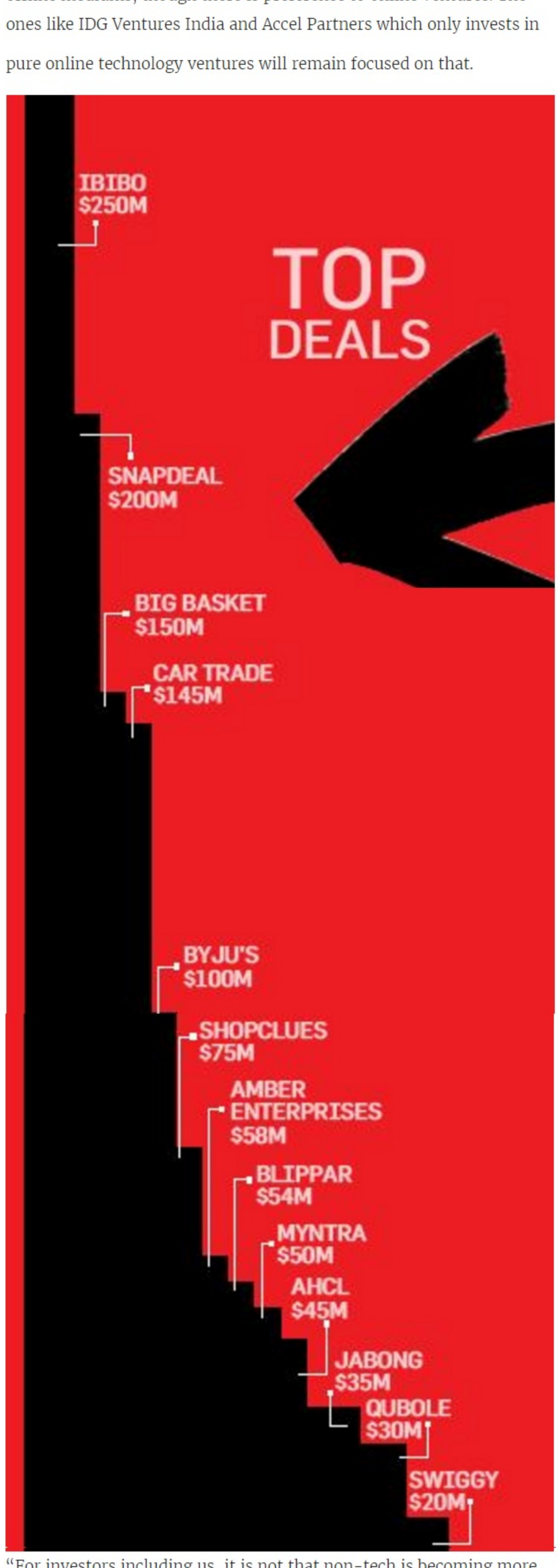
During a networking break at a start-up conference held last month in Gurgaon, I overheard two delegates (assuming they are entrepreneurs) discussing current investor sentiments. A short, shabby young man sporting disheveled hair with an iPad showing some graphs and figures was grudgingly admitting his vain attempts of meeting 13 investors to raise funding for his start-up since last December. "...I am trying to keep things going on my own... These guys (investors) have been hearing me and giving feedback but after that nothing (happens)...What's clicking for them right now?" The other man, probably in his 40s, wearing black suit and sipping tea with a smile sounded little cheeky in his reply. "Hmm...So probably you can look at doing some 'actual' business where you can 'actually' make money...," he said who has been a small wine maker based in Jaipur and is about to raise funding.

Later in the Q&A round post an investor session when the same young man asked panelists (four of the most active early to late stage investors of 2015 and have invested in both online and offline businesses) of a shift in investors' strategy towards offline commerce going forward, the entire panel vehemently denied. "Offline businesses including tech and non-tech certainly are and have always been more investable than online though their runway to growth in most sectors can be long but would remain steady. The permutations and combinations in comparing offline and online in terms of sustainability and unit economics would always point slightly more towards offline ventures even as technology remains integral to both set of businesses. However, to say offline businesses would spoil the party for online start-ups by attracting more investors would be bit farfetched," says an investment banker requesting anonymity. This is barring enterprise start-ups like Freshdesk, Capillary and Druva which haven't seen much frothy valuations.

## True to the Cause

What the investment banker and panelists at the session implies is that hybrid investors like Sequoia India, Matrix Partners India, Saama Capital, Mayfield India, SAIF Partners, Helion Ventures, DSG Consumer Partners which have invested in both online and offline ventures including Kalaari Capital, Nexus Venture Partners and Norwest Venture Partners (NVP) India which also have few offline investments will remain committed to their strategy and that is backing technology and technology enabled scalable businesses irrespective of online or offline mediums, though there is preference to online ventures. The ones like IDG Ventures India and Accel Partners which only invests in pure online technology ventures will remain focused on that.




"For investors including us, it is not that non-tech is becoming more attractive just because there is a cautious approach towards online ventures. Investors would continue to back online businesses. The sentiment is of cautious optimism. We makesix-eight investments a year and have a robust portfolio of 15 non-tech or offline companies," says Avnish Bajaj, Managing Director, Matrix Partners India.

"Startup India would continue flourish since it already has significant traction and momentum coupled with tax exemption on start-ups. This would only going to get more investors funding the Internet businesses. Make in India, on the other hand is likely to be a larger program in the long term but its broad-based execution, where new manufacturing facilities are being set-up by thousands of entrepreneurs is likely to be more medium term oriented," says Niren Shah, Managing Director, NVP India.

Apart from that these investors also opine of Startup India leading to Make in India and not one versus the other. The late stage venture and private equity firm Mayfield Advisors counts beer chain The Beer Café, India's second largest palette manufacturing and distribution firm Leap India and Delhi-based agri-logistics company Sohan Lal Commodity Management which in September 2015 raised Rs 100 crore in pre-IPO round among its strong offline portfolio.

"Online start-ups already help offline businesses grow across sectors by tie-ups or bringing them on their platforms to directly or indirectly attract more customers. So it will eventually help Make in India more robust. Of course Make in India movement has opened up a plethora of opportunities in manufacturing and areas around it for investors. For e.g. early stage offline is an extremely attractive area for us as not many investors focus on that and our offline portfolio companies have grown at comparable rates to online businesses," says Vikram Godse, Managing Partner, Mayfield Advisors.

## Staying Angelic

Though angel investments have more or less remained unfazed but the impact of mid and late stage funding crunch has certainly cascaded to small ticket investments. As per start-up investment tracker VCCEdge, the angel investments went down from around 133 in Q1 2015 to around 115 in Q1 2016.

Nonetheless angel investors would bear the brunt of the slowdown if they see their start-ups unable to raise successive funding from venture capitalists and hence stifling the exit opportunity and eventually leading to either write-offs or backing these startups with more funds until they strike the VC deal. So does that mean angel networks would be backing more offline ideas which can quickly raise next round?

"We look at good entrepreneurial ventures irrespective of whether they are doing businesses offline or online and the sentiments in the market. However if we see a sector where next round of money won't come then it would be not an investment opportunity for us and that can be offline or traditional sectors as well," says Padmaja Ruparel, President, Indian Angel Network (IAN). Asia's largest angel network of over 350 members has over 30 percent of around 80 start-ups that it has backed so far, captured by offline start-ups.

More so, there has been no change in the time taken for the due diligence by angels to understand start-ups' exit capabilities before writing the cheque.

"There has been no changes to our due diligence process. It remains the way it has always been. We look at the scale of the problem start-up is solving as the lines between tech and non-tech businesses are blurring. Businesses today are all hybrids instead of just offline or online. If they are solving scalable problems with unit economics in place then exit won't be an issue. The slowdown is not the reason why they won't be able to raise funding or die," says Chandni Jafri, CEO, Mumbai Angels.

## Bloodbath...Really?

Mark Cuban, 57-year-old serial entrepreneur, owner of the professional basketball league National Basketball Association's team Dallas Mavericks in the US, a 'Shark' at the famous television series of start-ups pitching to investors 'Shark Tank', and known for his bold and unambiguous statements last year in March compared the dotcom bubble burst of 2000 to the presumed current one and explained why it is more devastating than the former on his blog, Blog Maverick.

"...The only thing worse than a market with collapsing valuations is a marketm with no valuations and no liquidity. If stock in a company is worth what somebody will pay for it, what is the stock of a company worth when there is no place to sell it?," said Cuban referring to public market collapse of 2000 where "investors had some liquidity to sell their stocks" vis-à-vis the current privatemarket slowdown where, "there is zero liquidity for any of those investments." Cuban, however, later at a conference retreated saying that current market is not a bubble and that on a macro basis the risk to the economy is nowhere near to the 2000 crash as "there are much smaller number of investors involved".

The 2000 crash saw investors losing gigantic $5 trillion in market value which perhaps is much more than investments made so far in technology and technology-led companies globally, going by Cuban's remarks.

So, 2000 was certainly a bubble wherein nothing was left when it got pricked. Now, we look at the current valuation decline of start-ups which emanated from the US when around mid last year giant mutual funds like Fidelity, T Row Price for the first time marked down their unicorn companies including Zenefits, Dropbox, and Snapchat in theirquarterly mark-to-market valuations marking exercise to their investors. The mark down along with the mid last year fall of Chinese stocks listedglobally reflected on Flipkart's valuation markdown from $15 billion to $11 billion in February this year by one of its minority investors, Morgan Stanley. T Rowe Price was another minority investorwhich chopped down its stake in Flipkart by 15 percent in April this year. The USbased investment management firm also marked down eight of its other companies such as Cloudera, MongoDB, Houzz, Airbnb, and Uber.
Flipkart, being the bellwether of the great Indian consumer appetite is also a great driver of sentiments in the ecosystem. Its valuation correction has further impacted start-ups till Series A level where investors are backing only those which can lead their respective categories (as every category has multiple players) with some bottom line and good amount of stickiness to have returning customers. But that's not the end.

Of course, there would be down rounds, more shutdowns across sectors having multiple players, layoffs, top management exits, desperate M&As being pushed by investors to avoid any distressed assets across funding stages. But what would also happen is real entrepreneurs would be built though with moderate growth this year at least. So, the wheat would be separated from the chaff. And what would not happen is shut down of large unicorns because it is not possible for any of them to see an absolute valuation crash. Again taking Flipkart example, how does that matter if it has to raise next $1.5 billion at the current $11 billion or for that matter $13 billion valuation.

The moment it happens, the entire ecosystem sentiment will take a positive U-turn. For good, investors who only put money to jack up their companies' valuations will be kicked out. Most importantly looking at the broader picture, Indian start-up ecosystem is still nascent as most investors are still sector agnostic rather than going deep into a category and building it up blockby-block. Also, India's fast growing consumer Internet story is a different beast altogether with increasing Internet penetration.

"This is a normal cycle. Whenever any new industry takes off, many players enter the market and it becomes a game of increasing the market share and not about capital efficiency or unit economics. In 2012 also many e-commerce firms got consolidated. This happens in every sector including telecom sector historically when initial licenses came out and there were many telecom players in every region," says Deepak Gaur, Managing Director, SAIF Partners.

So what would you call it? First, a bubble burst which if exists had already bursted mid last year and only got more apparent from October 2015 onwards; second, a bloodbath which would lead to loss of billions of dollars and shut downs (which happens though on a lower scale in every sector unlike online start-ups because of crazy valuations and no profitability) this year or third, a correction with heavy froth?

It would certainly be not a bloodbath where everyone would die except category leaders as that would kill competitionand make ecosystem less robust. Less than a bubble, it seems more of a correction with good amount of valuation froth on top which means when the froth is cleared, a large quantity of real value comes up which will happen probably within next two years. And when that happens, it would mark the beginning of Indian start-up revolution 2.0.

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