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VENTURE CAPITAL FUELING INDIA'S UNICORN REVOLUTION: A COMPREHENSIVE ANALYSIS

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ABSTRACT

As India's startup ecosystem continues to thrive and evolve, the emergence of unicorn startups has garnered significant attention, highlighting the country's prowess in fostering innovative and scalable businesses across various industries. This paper examines India's unicorn revolution and the role of venture capitalists behind their success. Through secondary sources and primary research in the form of interviews, it delves into the impact of Covid-19 on India's start-up ecosystem, and finds that investments had a sharp fall in the early pandemic months with a healthy bounce back due to a shift towards digital consumption. Start-ups with online presence did unexpectedly well and will continue to do so on the wave of a rising economy and growing demand. The vital role played by venture capitalists in supporting these startups during the challenging times of the pandemic underscores their expertise and foresight, positioning them as critical enablers for sustained growth and success in the ever-evolving Indian startup ecosystem.

Introduction

A growing economy like India's requires dynamic and formidable new business ideas. India's biggest advantage is its large knowledge base of trained individuals. Venture capital provides financing and professional knowledge to tether together a new business model to reach a profitable stage and grow optimally. New businesses require funding to give wings to ideas and innovations at nascent stages. People with ideas need people with money to back them. Not only large sums of money are required but also a willingness to take risks by investing in the idea. This is where a venture capitalist comes into the picture. Modern India is the birthplace of 108 unicorn companies, including Nykaa, BharatPe, Groww, Blinkit, and Liscious to name a few. All of them are funded by venture capitalists.

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According to Legal Services India, a venture capitalist contributes significantly to the life cycle of developing businesses by investing in high-risk, growth- oriented projects. (Jain, 2022) It bridges the gap between high-quality ideas and available funding.

The Corporate Finance Institute further explains that a venture capital fund is a type of investment fund that invests in early-stage startup companies that offer a high return potential but also come with a high degree of risk. The fund is managed by a venture capital firm, and the investors are usually high net worth individuals or institutions.

What Is Venture Capital?

Venture capital is a term used to provide funds to companies and entrepreneurs. Venture capitalists can provide backing in the form of capital, technological expertise or managerial experience. Capital is mostly provided at seed round funding or early stages of business, but can also be given at different stages of a company's life cycle. A small business in need for funds with a long term potential of growth are sought after by venture capitalists for investments.

Key Points

1. Venture capital is a term used to describe the monetary fund's given to companies or entrepreneurs.

2. Venture capital can be provided at any stage of business but is mostly given at the early foundation stage.

3. Venture capitalists can provide not only financial help but also expertise in managerial or technological areas.

4. Venture capitalists manage pooled investments from high net worth individuals and further invest the funds in high growth potential companies for the long term.

History of Venture Capital In India

The late 1980s saw the emergence of the venture capital industry in India. 1988 is when the Indian government granted legal status to venture capital. There has been no turning back since then. Technology Development and Information Company of India Ltd (TDICI) was the first venture capital firm set up in India. It was a 50/50 partnership between ICICI BANK and UTI. This was the initial stages of VC in India, at the time investments were made in large industries only. Over the passage of time and the success of liberalisation of the Indian economy, venture capitalist's moved into other sectors like consumer retail (Nykaa) and consumer services

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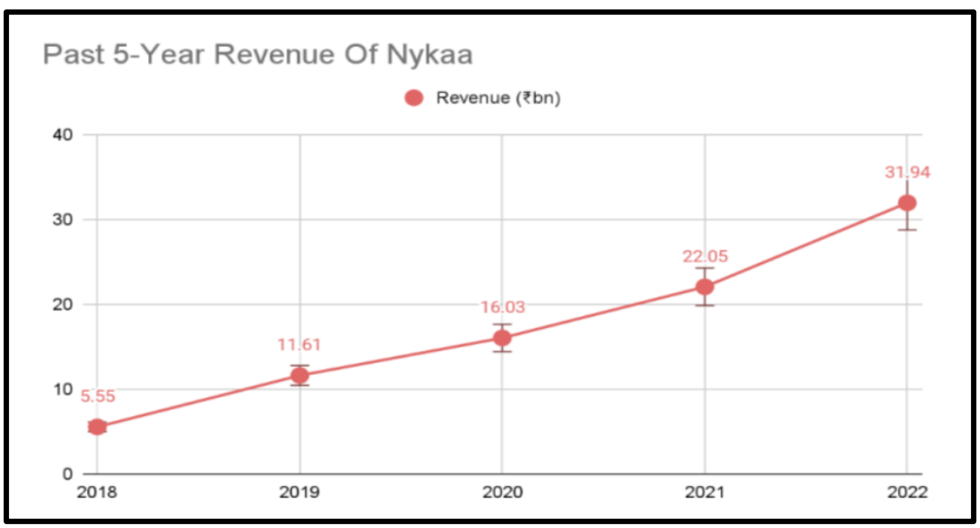
(Blinkit), which now make up 50% of the investments by VCs. Other investment sectors include education (Byjus), IT, media, electronics, pharmaceuticals, etc.

IMPACT OF VENTURE CAPITALIST BACKED COMPANIES

COMPANY	DATE OF INCORPORATION	SALES (IN INR)	EMPLOYEES	MARKET VALUE (IN USD)
NYKAA	APRIL 2012	1230.8CR(Q2 FY23)	1000-5000	5.18$ BILLION
OLA	DECEMBER 2010	(DATA NOT AVAILABLE)	5000-10000	4.8$ BILLION
BLINKIT	DECEMBER 2021	RS 26.2 BILLION (FY22)	5000-10000	ACQUIRED BY ZOMATO FOR 550$ MILLION IN 2022.
URBAN COMPANY	2014	437 CR RS (FY22)	32000	1.86$ BILLION

Source:https://www.statista.com/statistics/1289874/blinkit-india revenue/#:~:text=In%20financial%20year%202022%2C%20the,almost%2026.2%20 billion%20Indian%20 rupees.



Source: https://appicsoftwares.com/blog/nykaa-revenue-and-user-statistics/

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Covid 19 and The Impact On India's Start-Up Ecosystem

According to the Hindu Business Line, the year 2020 began with an Indian ecosystem of over 38,000 start-ups, growing rapidly on the back of a spectacular 2019. However, covid-19 jolted the start-up ecosystem across multiple dimensions and the impact was severe during the lockdown period from March to June.

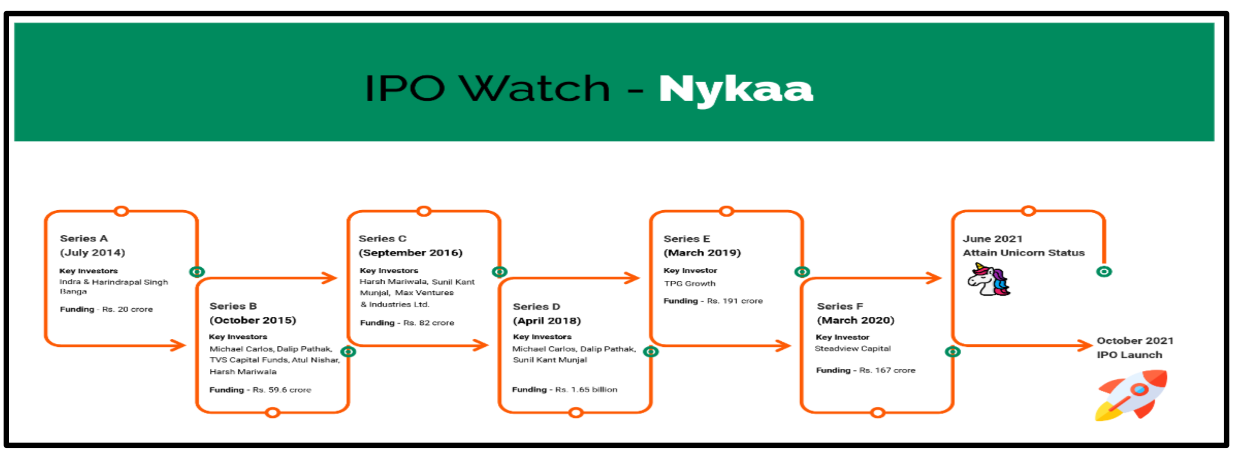
Zinnov published the "Covid 19 and the Antifragility of the Indian Startup Ecosystem", where it mentioned that there was a dip of 50% in overall funding during the lockdown versus pre-covid levels. Around 40% start-ups were negatively impacted, and 15% of the Indian start-ups were forced to discontinue operations due to the pandemic.

However, when the economy re-opened up there was a healthy bounce back of the start-up ecosystem as the demand grew faster than expected. The paradigm shift towards digital consumption provided the necessary push to the stumped start-up scenario of the lockdown period. Sectors such as healthcare, e-commerce, and education saw a boom as the need to go digital became more of a necessity than an option.

By October 2020, four of the Indian start-ups- Nyka, Unacademy, Postman, Razorpay had become unicorns.

Aileen Lee, a New York based venture capitalist coined the term Unicorn, referring to a privately held startup which reaches over US $1 billion valuation. The term was first used in 2013 to represent the statistical rarity of such lucrative ventures, thus comparing it to a mythical creature- the unicorn

CASE STUDY - NYKAA



Source: https://www.podworld.in/pod-cafe/nykaa-investor-list

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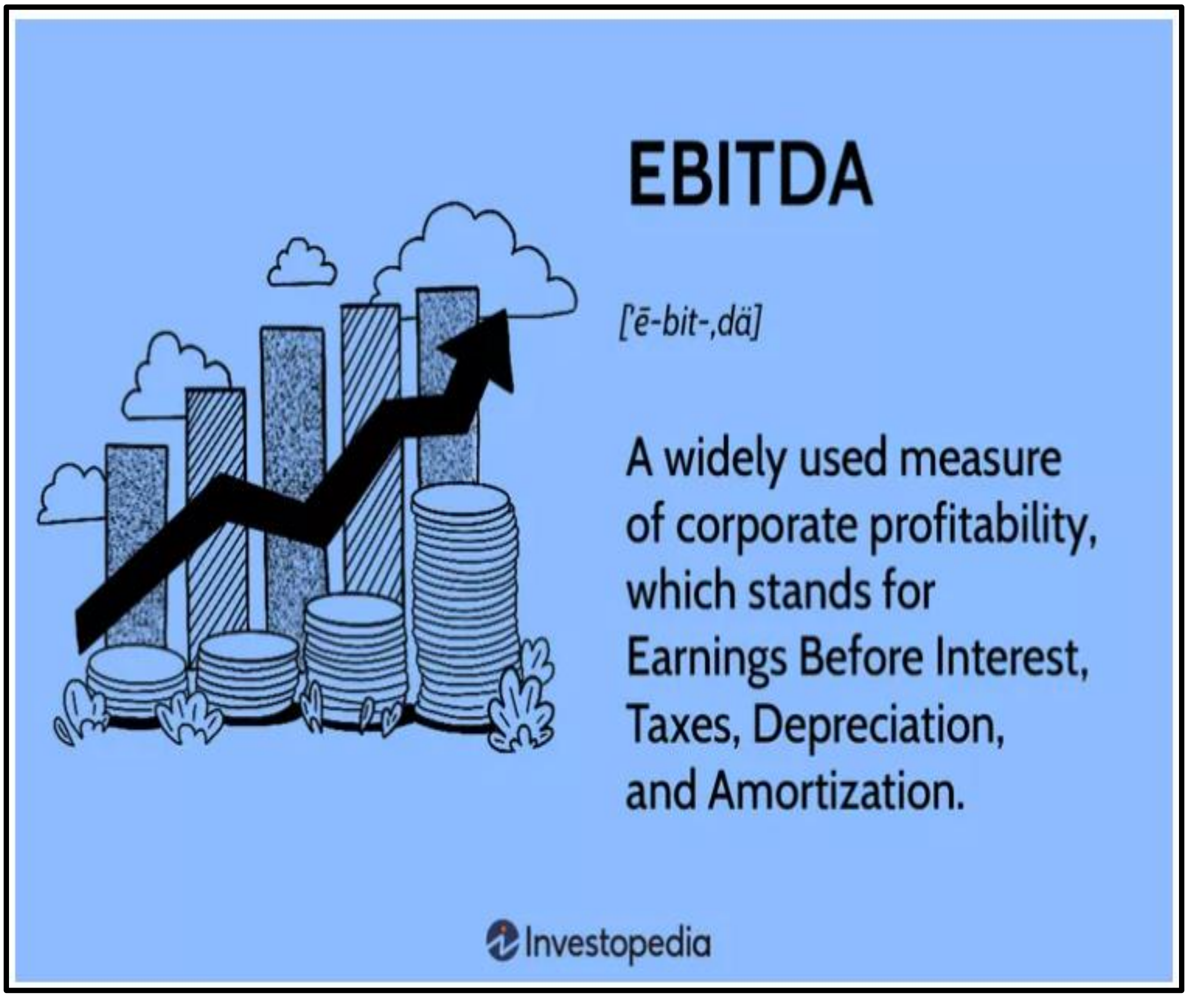
In 2012, Falguni Nayar quit her job of 18 years, as an investment banker with Kotak Mahindra Bank and started Nykaa, an online platform for shopping all things makeup and beauty related. In over eight funding rounds Nykaa could only raise $100.9 million. Year ending March 2020 Nykaa recorded a revenue of 1,860 crores with an EBITDA of Rs 94 crore. The company is worth over $13 billion today.

EBITDA or earnings before Interest, Taxes, Depreciation and Amortisation, is a financial metric. It is used extensively to compute the performance of a business in terms of finances. It is often also used as an alternative to net income.



Source: https://www.investopedia.com/terms/e/ebitda.asp

Amortisation is an accounting technique used to periodically lower the book value of a loan or an intangible asset over a period of time.

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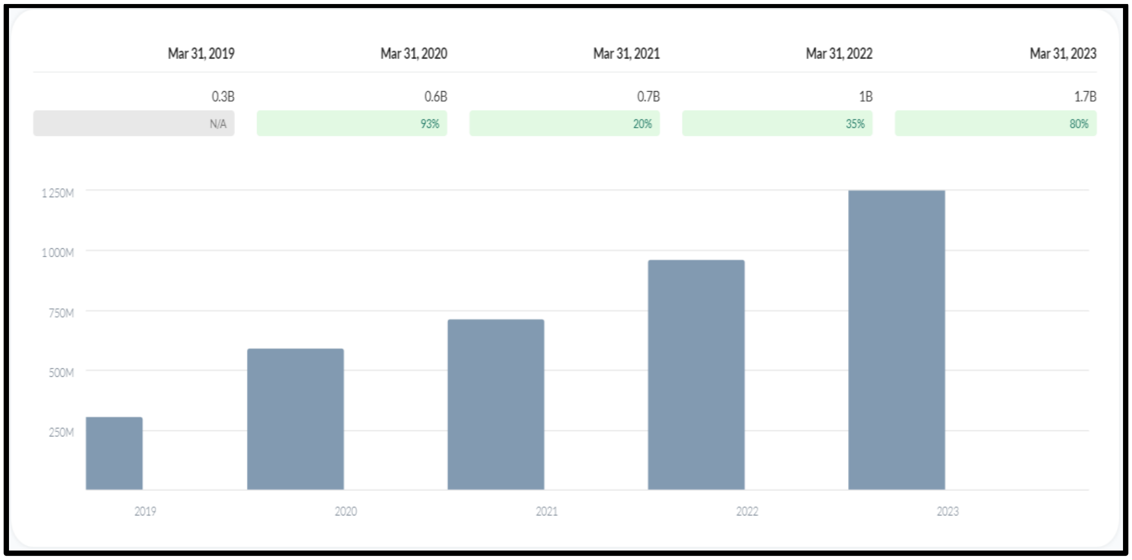

Source: https://www.alphaspread.com/security/nse/nykaa/financials/cash-flow-statement/depreciation-amortization

INTERVIEW WITH ASHVIN CHADHA, ANICUT CAPITAL

To gain further insight into venture capital in India, and its role in promoting Indian start ups to the Unicorn stage, I sought the perspective of Mr Ashvin Chadha, an alumni of Wesleyan University and The London School of Economics. He is a managing partner and member of the Anicut Investment Committee. He is a finance professional with over two decades of experience across investment banking, private equity, angel investments and private credit.

His firm, Anicut Capital, is an investment firm based out of Chennai and New Delhi, India that manages alternative assets. Their fund is called the Grand Anicut Fund (GAF), and it focuses on investing in Indian opportunities with a defined exit in varied sectors.

Interview with Mr Ashvin Chadha:

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START-UP SCENARIO AFTER THE PANDEMIC

- **What changes did you see in Indian start-ups pre and post March 2020?**

March 2020 was an event which was not foreseen by any of us. This event resulted in many startups to tweak and pivot their business models. Before 2020, we saw a shift in the startups from e-commerce based models to Indian made consumer brands. There were many budding brands emerging to cater to the ever growing spending propensity of the Indian middle class. According to a report by AC Nielsen, in 2019, the Indian consumer brand market was valued at $40bn which was to scale to $100bn by 2025. Notably, these brands had an offline first approach to acquire their customers. On the online side, they were present on marketplaces like amazon and flipkart to name a few. What covid did was to make the customers shift from offline to spending online and that's when there was emergence of purely online (D2C) brands. Irrespective of the sector, any business which involved acquiring their customers directly had moved from offline to online first presence. The shift in the customer behaviour to more rapid adoption of online, whether its paying utility bills, shopping for their daily essentials or shopping for leisure resulted in a boom of Indian D2C. As per a 2021 report by Avendus, the Indian consumer brand market was already valued at $100bn which exceeded everyone's expectations. The startups responded by rapidly moving their business models to online first approach. This resulted in many ancillary sectors also emerging which involved asset light models. Some examples are cloud kitchen and gig economy.

Not only on the consumers' side, but the behaviour of the organisations also changed significantly as due to remote working, there was rapid adoption of tech for communication, implementation of workflows. This resulted in the coming of age of startups providing virtual communication for organisations, workflow management-based startups and models that use core tech to determine employee efficiency and mental state.

We saw the emergence of sectors like edtech, mental wellness, online lending and financing startups raising a lot of money as all this was fuelled by customer needs and behaviour whilst being confined indoors.

- **Were you wary of investing during the early months of the pandemic?**

The early days of Pandemic were tough as the investor sentiment was low because of the uncertainty prevailing due to Covid. We as an organisation were of the opinion of continuing the investment process as we felt that that panic will subside, and sentiments will be back. We stuck to our thesis of businesses which were scalable and cash efficient and that helped us in identifying potentially good startups to back. We all know that due to low investor sentiment,

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there were a lot of startups who had good and sustainable business models that were facing financial crunch due to lack of capital and that's where Anicut found its opportunity.

- **What kind of growth did you witness during the pandemic months?**

The global pandemic had brought about a true boom in startups, as the number of new companies not only in India but around the world had significantly surpassed the indicators of 2020. Such a surge in entrepreneurship is being attributed to workers who were laid off and started their own businesses. In the first four months of 2021, Indian startups have raised $7.8Billion. Some examples include 123% growth in Zomato's revenue which coincided with their IPO and about 3X revenue growth on Ed tech startup Byju. As far as Anicut's companies were concerned, our founders stuck to the core principles of running a strong business which was to not to overspend, focus on the customer engagement metrics and continuous product development for a better customer experience. Having said that, the macros during the pandemic ensured that Anicut's companies had healthy MoM healthy growth with solid unit economics.

- **What kind of start-ups did you invest in in 2020- 2021? How was this different from previous years?**

Anicut's thesis for investment rides a lot on the quality of the founders. Any business run by a competent team, with strong unit economics and scalability is our sweet spot for investment. We have followed these principles irrespective of the pandemic. Slight tweaks in our assessment we made during the pandemic and post pandemic are as follows:

- Founder's vision on whether this will be an omnichannel brand or not
- Tech intervention roadmap to make things efficient
- Offline strategy and roadmap for consumer brands
- Unit economics in online and offline channels and the distribution strategy
- Evaluation and investment profile in the SAAs and Deeptech domain hasn't changed much pre and post pandemic

- **There was a boom in online start-ups. What role did the pandemic play in this, and how did that change after recession news started pouring in?**

There were over 15K startups that registered themselves in 2020, which increased to just over 20k in 2021, and there were 25k new-age companies that came into the system in 2022 alone.

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This boom was aided by the pandemic in the following ways. The underlying cause was people confined to their house:

- Lack of offline options for shopping (leisure, home essentials) which spurred the d2c market
- This d2c market resulted in birth of many logistics and fulfilment startups
- Food delivery skyrocketed as there were no options to eat outside
- Work from home which resulted in rise of workflow management and communication tools
- Schools/tuition centres were shut down and online classes came, giving birth to large edtech startups
- Covid diagnostics and healthcare went online hence online labs, teleconsulting and medicine delivery startups gained traction
- Consumers spent much of their time on phones which spurred the content and the gaming sector

If we see from above, all these business models worked on a pure online or an asset light model. Now, after the recession and the change in consumer behaviour to pre 2020 era, the startups are again going back to catering their customers via the offline channels. Hence, now we see a lot of startups stressing two things

- Profitability, as lot of money was lost due to high online customer acquisition costs
- Omnichannel approach- The online trend is here to say but the resurgence of offline purchase has made the startups to pivot to this approach
- What does the future hold for start-ups after the pandemic?

The macroeconomic factors played a major role in post pandemic recession, apart from this, the high spend by the startups to acquire their customers via the online channels and the irrational valuation given by investors during the pandemic years also contributed to the current market scenario for the startups. There is no doubt that the post pandemic recession will test many business models and startups and many of them will die. The ones who will survive, will find less competition to deal with and at the same time will get an opportunity to cater to a larger than before market of consumers. Globally, India is better positioned than its counterparts in terms of

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the economic growth indicators, this will continue to fuel the growth of these startups and renew the investor interest in them.

CONCLUSION

Delving into the intricate relationship between venture capital and the emergence of unicorn startups in India, we can see that venture capital firms provide the necessary funding, expertise, and network connections that enable startups to achieve unprecedented growth and valuation. The Indian startup ecosystem has witnessed a remarkable surge in the number of unicorns, showcasing the potential of the country as a thriving hub for innovation and entrepreneurship. However, it is important to acknowledge the challenges and risks associated with this rapid growth, such as inflated valuations and sustainability concerns. As India continues to foster an environment conducive to startup success, policymakers, investors, and entrepreneurs must work collaboratively to ensure the long-term viability and scalability of these unicorns. By nurturing a supportive ecosystem that emphasises not only capital infusion but also mentorship, talent development, and regulatory frameworks, India can sustain its momentum as a global leader in the startup landscape. Ultimately, the journey of venture capital-backed unicorns in India serves as a testament to the transformative power of strategic investments and entrepreneurial ambition, propelling the nation towards a future characterised by innovation, job creation, and economic growth.

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