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# Indian Online Start-ups: Can They Stand up Against the World

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***Abstract:** The evolving online start-ups ecosystem in India has created many buzzes. There have been cries that online business start-ups have re-invented the way of doing business in India, it has catalysed the economy growth and business development in India marketplace. Online firms in India have come a long way to become an integral part of the business. When compared with the rest of the world it still lags behind. Though India is a third largest country in terms of internet users, when compared with USD 150 billion sales through internet in USA and China, it lags behind by a far big number. In India, only 9% of its internet users shop online.*

*This study presents a detailed analysis of comparison of Indian start-up ecosystem with the rest of the world. Comparisons have been made with start-up ecosystem of USA, Israel, Singapore and New Zealand. It also compared the initiatives taken by respective Government to boost up the ecosystem. Also analysis of current online start-up trends in India and role of incubators and accelerators. The market segment in which start-ups are investing and gaining success have also been focused. Factors that are hampering its progress and the future road map of online market in India have been discussed at last.*

***Keywords:** Start-ups, incubators, accelerators, seed funding, angel investors, venture capital.*

## I. Introduction

In its 2014 Startup report, NASSCOM unveiled that India is the fastest growing start-up eco-system and with approximately 3100 startups it is third largest ecosystem globally. On average, more than 800 start-ups are setting up annually. NASSCOM projected that there would be approximately 11500 start-ups employing 250k people by 2020. At such a pace, online platform is a gold mine for start-ups in India.

Since 2004, Indian startups have evolved in terms of visibility and market space. Start-ups are more confident in showcasing their product capabilities, activity in the venture capital space and networking platform. However, startup ecosystem in India leaves a lot to be desired in terms of breakthrough innovation. Not to mention there is a gap in the early stage funding in India. This is constraining risk taking ability and innovation of startups. At the same time, the culture of incubators and accelerators has provided some relief to the India startups.

## II. Factors Differentiating Present Online Boom And The Dot-Com Days

From the decade of online booking on IRCTC and voice based services started by Just Dial in '90s, Indian online startups have come a long way. There are many differences between what happened in '90s and what is happing right now. With MakeMyTrip Ltd valued at USD 478 million and Flipkart raising USD 20 million funds from Tiger Global, the face of Indian startups has changed a lot. The three major differentiating factors between the dot-com days and today's online boom are:

### A. Beginning Of Internet Business Era

The internet bubble of '90s was in effect for a long time because the idea of Internet itself was new and alluring at that time. People were betting on the evolution of the internet rather than the business model of the online startups. In 1999, itself 457 IPOs took place, most of them were Internet and technology related.

However, with one year most of these startups shut down. Now, the shift is on the deepening penetration of Internet. In India, 150 million people have access to the internet that is 30 times more that the figure in 2000. 900 million owns mobile phones, and 67 million owns smartphones in India. The belief that the online market is close to an inflection point has changed the online business dynamics in India.

### B. The Missing Business Plan

During the last boom, the biggest driving factor of the bubble was those companies that did not have a business plan but were dear to the investors. The argument goes: Google, for a long time did not have a business plan. Twitter modeled their revenue recently using its sponsored tweets. However, same is not true in the present scenario. Though the numbers of venture capitalist have increased to 300 and angel investors have increased to 225 the priority is still on the business plan. Investors entertain only those startups that have a realistic business plan along with customer validation.

### C. Page View vs. Revenue

During 90s, numbers of pages viewed on the website were the tracking metric for the evaluation of the companies.

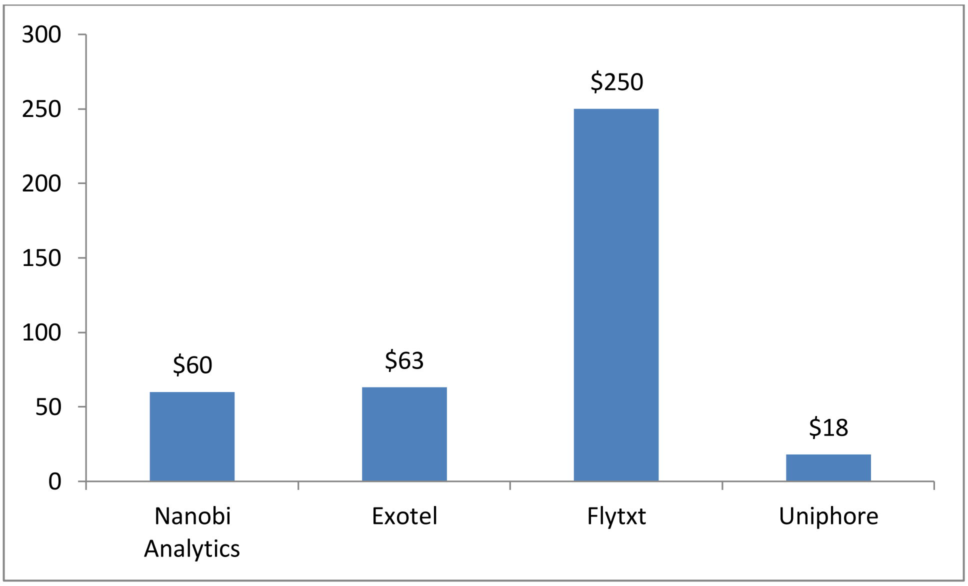



*Figure 1: Top four NASSCOM startups target revenue (in millions), 2014 (Source: NASSCOM Website)*

However, in today's generation where internet has made its status –quo secure, number of pages viewed is no longer the factor for evaluating a company. Now, online companies are evaluated based on revenue. Four start-ups among the top ten selected by NASSCOM have significant realistic target revenue that made them favorite (Figure 1: Top four NASSCOM startups target revenue)

## III. Comparison With Rest Of The World

India is considered to have one of the harshest environments for the startups to grow. Although it is the fastest growing economy, it ranks 140th in terms of nominal GDP per capita. However, being the biggest market provides the foundation for prospering startups. Not to mention the richness of talent base, highly skilled and well-educated web entrepreneurs provides the space for the plethora of startups.

| City/ Indicators | Ranking | Start-up Output | Funding | Performance | Talent | Support | Mindset | Trendsetter | Differentiation from SV Index |
|---|---|---|---|---|---|---|---|---|---|
| **Silicon Valley** | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| **Tel Aviv** | 2 | 2 | 1 | 12 | 5 | 5 | 9 | 17 | 18 |
| **Los Angeles** | 3 | 4 | 6 | 2 | 3 | 13 | 11 | 4 | 11 |
| **Seattle** | 4 | 19 | 7 | 6 | 2 | 4 | 6 | 11 | 14 |
| **New York** | 5 | 3 | 4 | 8 | 12 | 9 | 8 | 7 | 8 |
| **Boston** | 6 | 10 | 1 | 7 | 7 | 8 | 7 | 5 | 20 |
| **London** | 7 | 7 | 5 | 10 | 9 | 2 | 3 | 14 | 17 |
| **Toronto** | 8 | 6 | 9 | 3 | 10 | 3 | 15 | 12 | 5 |
| **Vancouver** | 9 | 13 | 12 | 9 | 4 | 14 | 2 | 9 | 19 |
| **Chicago** | 10 | 8 | 15 | 5 | 14 | 7 | 13 | 18 | 9 |
| **Paris** | 11 | 14 | 13 | 4 | 17 | 6 | 12 | 15 | 6 |
| **Sydney** | 12 | 5 | 14 | 18 | 6 | 12 | 16 | 1 | 3 |
| **Sao Paulo** | 13 | 9 | 10 | 15 | 19 | 11 | 5 | 16 | 4 |
| **Moscow** | 14 | 16 | 19 | 18 | 11 | 10 | 14 | 8 | 2 |
| **Berlin** | 15 | 15 | 11 | 13 | 13 | 20 | 18 | 5 | 16 |
| **Waterloo** | 16 | 11 | 16 | 14 | 16 | 17 | 17 | 10 | 13 |
| **Singapore** | 17 | 18 | 8 | 19 | 8 | 16 | 20 | 19 | 12 |
| **Melbourne** | 18 | 12 | 17 | 20 | 15 | 18 | 19 | 3 | 15 |
| **Bangalore** | 19 | 17 | 18 | 17 | 18 | 15 | 10 | 20 | 10 |
| **Santiago** | 20 | 20 | 20 | 11 | 20 | 19 | 4 | 13 | 7 |

***Table 1: Top 20 global start-up eco-system index (Source: Global Startup Eco-system report 2012 – Startup Genome)***

Compared to Silicon Valley, start-ups in Bangalore are 24% more likely to be monetized. Bangalore has been ranked 19th in global level (Table 1: Top 20 global start-up eco-system index). However, there are far more challenges then support faced by startups in India. The amount of fund raised in Bangalore is 74% less as compared to Silicon Valley. The startups in India are 67% more likely to face smaller market then compared to startups in USA. The revenue stream also has a significant difference (Startup Ecosystem Report Part 2012 – Startup Genome).

***a) Government Policy and Regulatory Environment Across The Globe***

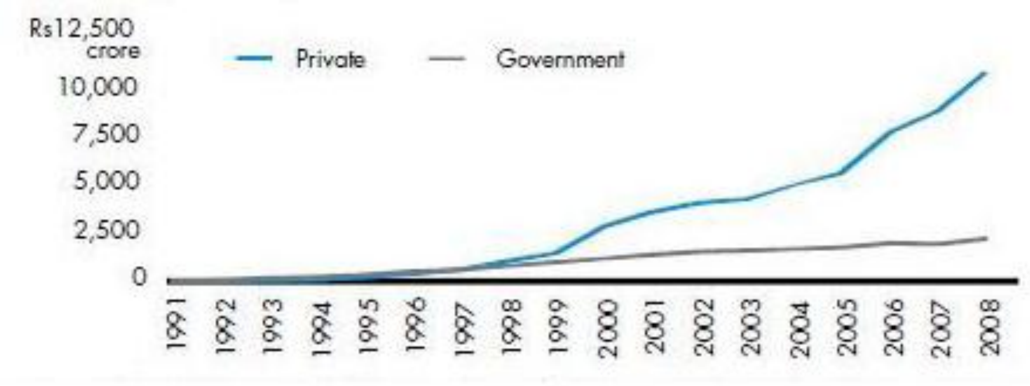
1. *USA:*

In USA, policy and regulatory environment are more favorable to Startups as compared to India. The Small Business Investment Corporation (SBIC) of USA operates as a fund to supply private venture capital for financial growth, expansion and modernization of small businesses. It invests 75% of VC fund capital to boost startups.

2. *Israel:*

The famous Technological Incubators Program of Israeli Government in partnership with the private organization has driven successful incubation for the start-ups. Between 2000- 2009, there were 1600 start-ups supported by Israeli Government incubation program of with 1200 matured. These programs were joined ventured by Government and private sector. The investment by Government was INR 2400 crore and by privates sector was INR 11500 crores (Figure 2: Fund raised in incubator graduated companies, cumulative).

Figure 2: Fund raised in incubator graduated companies, cumulative (Rs Crore) (Source: State of Israel, Ministry of Industry Trade and Labor; Technological Incubators Program)




Israeli Government has framed policies for capital access, tax regime, and use of a debt instrument and exits. Also, the fiscal benefits, Government grants and training support programs have made Tel Aviv one of the favorable destinations for startups.

***1. Singapore:***

Singapore Government provides a tax incentive to angel investors investing in Singapore based new ventures. Under this incentive, angel investors committing a minimum of USD 80,000 are offered a tax deduction of 50% (subjected to max of USD 200,000) of the investment amount with a holding period of two years.

***2. New Zealand:***

New Zealand has New Zealand Venture Investment Fund Ltd (NZVIF) to manage the investment and development of investor networks in the startups. The Government has invested USD 31 million alongside the angel groups over the 12-year period. Per co-investment are limited to USD 3.2 million and each investment per investee can invest at max of USD 200,000.

## IV. Current Trend In Start-Ups And The Role Of Incubators And Accelerators

For a startup to succeed, five resources are required: market, capital, people, culture and infrastructure. The current emerging markets in the online sector in India are:

***A. Mobile Payment Gateways***

Though non –COD captures only 48 percent of the payment option this segment is gaining popularity in VC community. Few startups such as KushCash, Mobilelime and Obopay have built mobile payment gateways with a massive funding backup.

***B. Voice Recognition***

Growing with 3 billion users, this segment is the future. Start-ups such as Mscriber and Ubona have cashed on the demand in this sector.

***C. Micro-financing***

According to Boston Consulting Group, by 2015, the non-banking population in Brazil, India and China have the capacity of USD 85 billion in the banking revenue sector. This sector is one which no Indian startup has tried out. However, it has a high potential.

### *D. Mobile Ad Networks*

Next level of advertisement is a mobile ad. However, the challenge is innovative advertisement model. Startups like mkhoj and dealaajtak have entered this space.

### *E. SaaS Model*

Startups like Vembu and Zoho have acknowledged the potential of this segment fast. These startups have used cheaper, faster and better innovation to optimize their operations and cost.

| Incubators and Accelerators across India | | | | | |
|---|---|---|---|---|---|
| **Mumbai** | **Chennai** | **Bangalore** | **Kerala** | **Ahmedabad** | **Delhi** |
| SINE, IIT Bombay | The Startup Center | Microsoft Accelerator | The Startup Village | CIIE, IIM Ahmedabad | Indian Angel Network Incubator |
| Venture Nursery | RTBI, IIT Madras | Khosla Labs | TechnoPark, TBI | NDBI, NIT Abd. | The Hatch |
| Seedfarm | Villgro, IIT Madras | NSRCEL, IIM Bangalore | TBI, NIT Calicut | Comm. TBI, MICA | TBIU, IIT Delhi |
| GSF | TBI, Anna Univ. | Angel Prime | | | Tlabs |
| UnLtd India | | Kyron | | | GSF |
| | | GSF | | | 5ideas |

*Table 2: List of startups across India (Source: http://inc42.com/resources/50-amazing-startup-incubators-and-accelerators-in-india/)*

Startup accelerators and incubators are the growing trend and provide a significant boost to the startups in India. Incubators and accelerators across India (Table 2: List of startups across India) have helped the Indian startups with resources such as capital, people, culture and infrastructure to grow.

## V. FACTORS HINDERING THE GROWTH OF INDIAN ONLINE STRAT-UPS

### *A. End Consumers*

The diverse population of India offers significant customer base for online Start-ups. It is important for a nascent startup to design a synchronized business model with the idiosyncrasies of this large market. The “Me-too” approach that is copied from successful US counterparts often fail. For example, 58% of online retail business in India has used cash-on-delivery payment option (Figure 3: Different payment option used for online shopping in 2013). This innovation successfully targets the Indian customer segment that has quiet possession of credit cards. However, this approach is not yet adopted by upcoming online startups that are causing early failures of their business models. Not to mention, to build their businesses financially viable and scalable startups should also keep in mind large base-of-pyramid market

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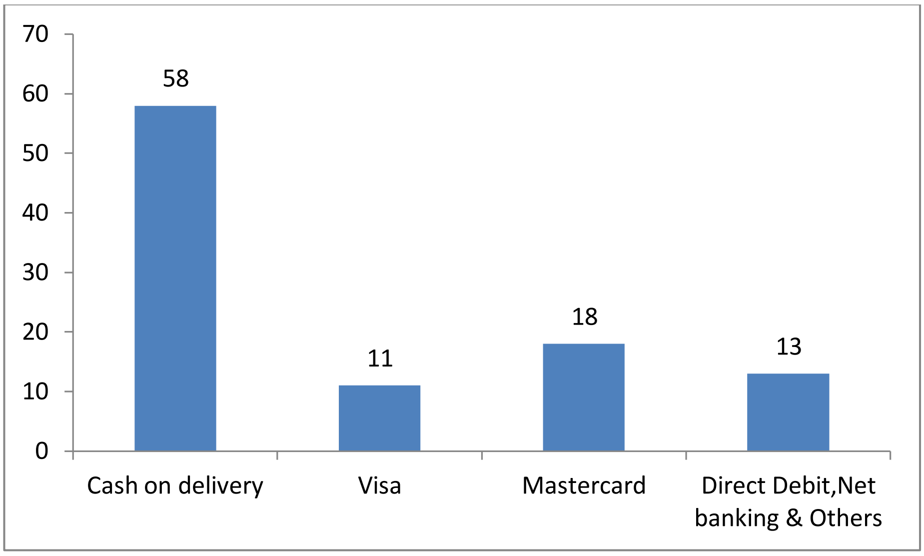


*Figure 3: Different payment option used for online shopping in 2013 (in %)*

### *B. Supply of Risk Capital*

There is a limited flow of capital to startups companies because of the number of factors:

**1. Angel investors:**

Thought the numbers of high net-worth individuals (HNWIs) is growing, angel investments are at the initial stage in India with just 500 investors. The annual total investments in the online startups are approximately USD 22 million. A large chunk of these investments are carried out through angel investment groups such as Mumbai Angel and Indian Angel Network. These investments form only 7 to 8 percent of the annual early stage investing which is negligible in contrast to the annual investment of USD 27 billion of angel investing and venture capital in the USA.

**2. Venture capital funds:**

In last five years, the early-stage venture capital investment in India is approximately INR 5000 crores which when compared to its global counterparts is minuscule. In 2010 alone, venture capital funding in India was INR 1000 crores whereas in UK and USA it was INR 5000 crores and INR 120,000 crores respectively (Figure 4: VC and Angel Investment as % of GDP 2010). For example, during the same period the USA invested twenty-six times the amount that is three times the cumulative GDP rate in that period.

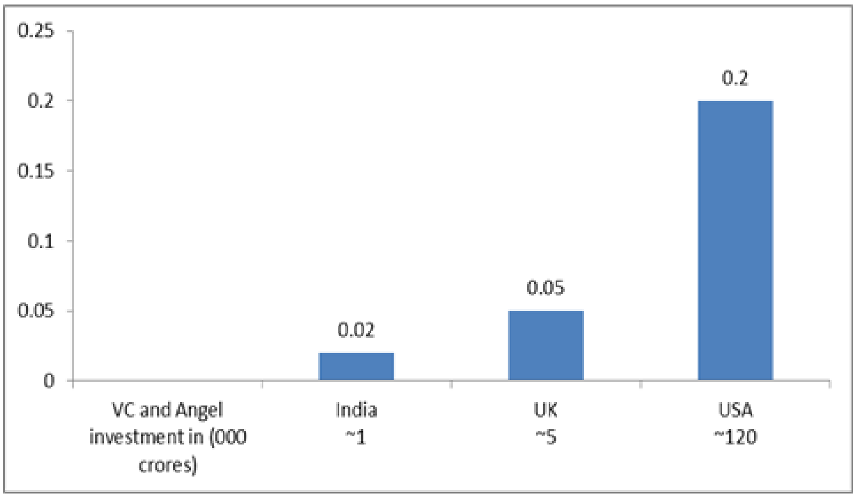


*Figure 4: VC and Angel Investment as a % of GDP 2010 (Source: OECD Financing High-Growth Firm THE ROLE OF ANGEL INVESTORS – 2011; Thomson Reuters; India Private Equity Report 2011; Bain Analysis; Economist Intelligence Unit)*

Though India has an abundance of foreign funds, these offshore funds unquestionably have constrained knowledge of the local market, customer segment, and Indian businesses and hence tend to focus more on growth stage capital.

**1. Fundraising:**

Fundraising is also a factor that is causing fiction to the Indian online startups. In India, fundraising is much lower than the global benchmarks. In last five years, local funds to startups that focus on primary, growth and mature stage funding raised approximately 27,000 crore rupees in India whereas in China, approximately INR 2 lakh crores of the fund were raised. This is more than two times as a percentage of India's cumulative GDP for that period.

**2. Debt:**

In India, access to investment debt for small and early-stage firms is a major concern. Banks and financial institutions are circumspect to lend because of the lack of collateral and credit ratings to these budding entrepreneurs. The culture and skill set required to lend without collateral are lacking in the Indian Banking System. Though the schemes such as credit guarantee scheme introduced by SIDBI have been quite successful, they inefficient in addressing the gap completely.

## VI. Online Market Scenario After Five Years

Though the online industry in India is still in its early days, in past few years, the sector is expected to grow at 50-55 per cent CAGR for next three years (Figure 5: Online market scenario in near future in India). In 2009 where revenue from e-commerce was USD 3.8 billion, it grew to an estimated USD 12.6 billion in 2013. Studies conducted by IAMA indicate that online travel domain has an estimated 70% market share in the e-commerce industry. Also, e-retail is emerging as the fastest-growing segment; its share increased from 10% in 2009 to 18% in 2013.

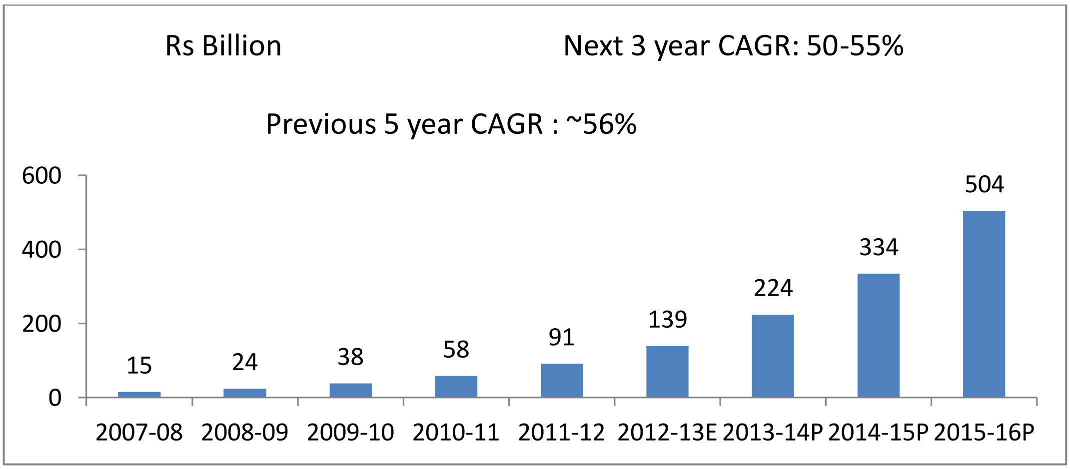


*Figure 5: Online market scenario in near future in India (Source CRISIL Report 2014)*

Research based on e-retail using industrial benchmarks suggests that the number of parcel check-outs on the online portals have surpassed 100 million in 2013. Though this figure represents an infinitesimal proportion that is less than 1% of the total retail market, it is expected to grow continuously in the future years. If this growth continues over the following few years, the size of Indian e-retail industry is expected to between USD 10 to 20 billion by 2017-2020.

This growth in e-retail is boosted by growing startups, internet use, and customer-led purchases. With online startups increasing the domain of e-retail in electronic and durables, accessories and apparels and traditional products such as books and travel services, customer sentiment, and internet usage is expected to grow.

According to CRISIL report, in the fiscal year that ended in March, 2013, the revenue from the online retail sector in India was USD 2.24 billion. Nevertheless, this was just 0.5% of the revenue generated from brick-and-mortar retail sector; the sales of online retail have been growing at a much faster rate. Also, the revenue of the online industry increased by 56% annually from fiscal year 2007-08 and fiscal year 2012-13. As more and more people use the internet, the revenue of the e-commerce industry over next three years could triple to USD 8.13 billion. McKinsey &Co. in its report on Indian internet users (Online and upcoming: The Internet's impact on India, Dec 2012) stated that by the start of 2014, there were 200 million internet users. Also, this figure is expected to increase by 2.5 times to 500 million by the end of 2015. In last decade, dozens of websites have emerged in India that sells everything from baby care products and flights tickets, from appliances to books.

The growth of the online industry in India has been boosted by in large by the demand up surging from tier two, three and four cities. Previously, these cities were neglected as consumer markets but now they are considered as the future of the online marketplace. As per online industry experts, by 2021-23, 30-40 percent of the total retail in top 75 cities is expected to be completed online.

The rural India that constitutes 68.8 % (2011 census data) of the total population has remained untapped in terms of internet technology till now. As this part of the economy also witnessing empowered with the advancement of technology in agriculture and farming increasingly, online portals would be vital for companies trying to access these markets. Also, it is important to note that over 50 percent of total online sales take place in non-metro cities. The spectacular growth in this sector has attracted much interest from venture capitalist and angel investors.

## VII. Conclusion

The analysis shows that online startups in India have come a long way since the starting of Internet technology in India. However, its ride in the last decade has been bumpy because of lack of support from Government, market, and blinded vision of the business aspect. The entry of accelerators and incubators has played a crucial role in shaping the path for these startups. However, it still has a long way to go before it could catch up with its counterparts in other countries.

As of the present scenario, the market segment such as online payment gateways, SaaS model, micro financing, voice recognition, mass reach and mobile ad networks are good for startups. However, before entering into any of these segments, it is important for the startup to have a realistic business plans along with customer validation.

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