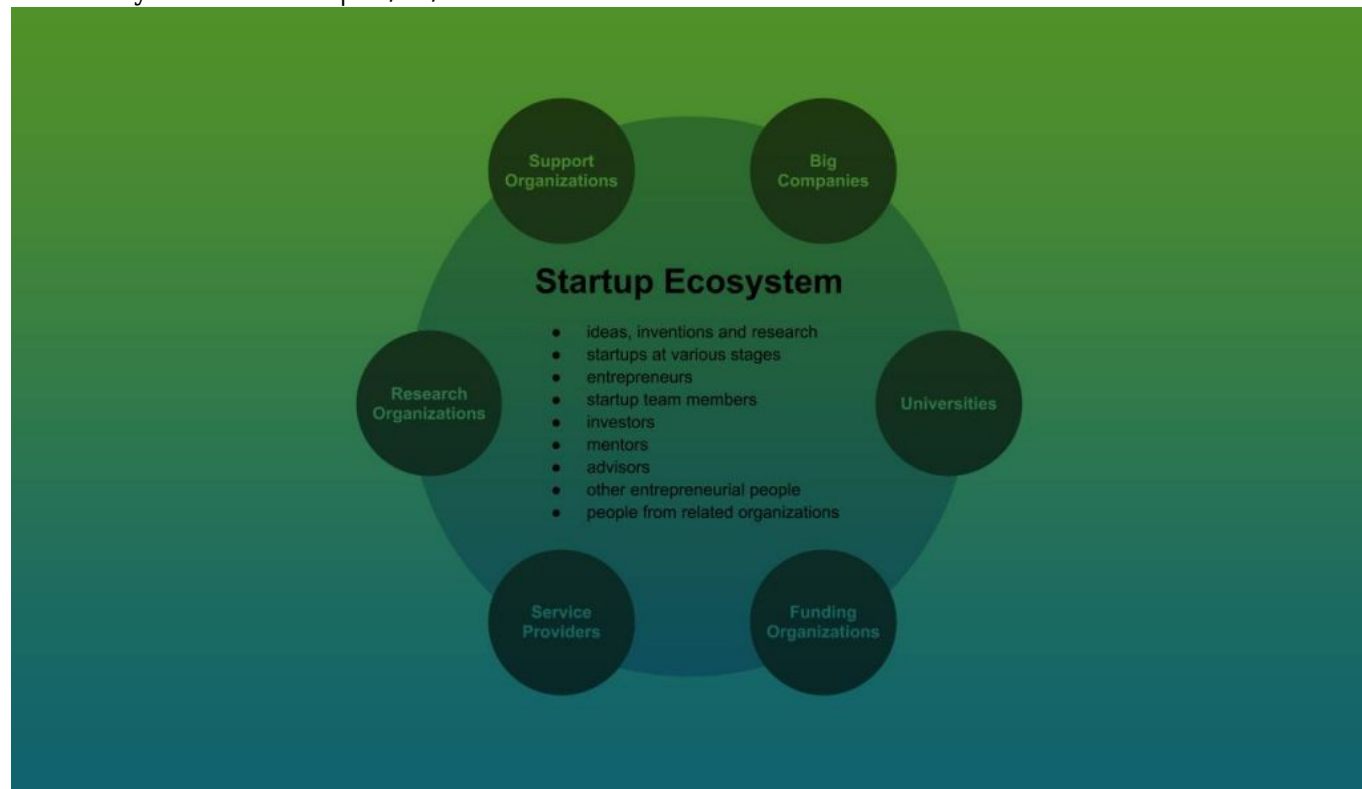


Challenges in Tech Startup Ecosystems

written by iasexam.com | 28/06/2022



[GS Paper 3 - Indian Economy]

The startup ecosystem which has been in overdrive for the past few years — propelled by a combination of factors, but largely, by the era of cheap money — is now showing signs of weakness.

Status of Tech Startups in India

- India has become the 3rd largest start-up ecosystem in the world after the US and China.
- 44 Indian start-ups have achieved unicorn status in 2021 taking the overall tally of unicorns to 83, most of which are in the services sector.
- India has seen such rapid growth in unicorns due to several strategic as well as conditional reasons.

Government Initiatives

- **Startup Innovation Challenges:** It is a fantastic opportunity for any startup to leverage their networking and fund-raising efforts.
- **National Startup Awards:** It seeks to recognize and reward outstanding startups and ecosystem enablers that are contributing to economic dynamism by spurring innovation and injecting competition.
- **Ranking of States on Support to Startup Ecosystems:** It is an evolved evaluation tool aimed to strengthen the support of States and UTs to holistically build their startup ecosystems.
- **SCO Startup Forum:** The first-ever Shanghai Cooperation Organization (SCO) Startup Forum was launched in October 2020 to develop and improve startup ecosystems collectively.
- **Prarambh:** The 'Prarambh' Summit aims to provide a platform to the startups and young minds from around the world to come up with new ideas, innovation and invention.

Factors behind Tech Startup Boost

- With the combination of accelerated financial inclusion (bank accounts), ease of identification (Aadhaar) and connectivity (mobile phones) it was said that it is ultimately a bet on the Indian consumer, and the economy, not on government regulations/policies.
- Low-interest rates: In the era of cheap money and negative real interest rates, uncomfortable questions over the true market size and profitability were swept under the rug.
- Growth fuelled by cash burn: High cash burn rates were the norm as both startups and investors sought growth by subsidizing the customer.

Challenges and Issues

- Lack of profitability: Among the startups that have gone public in recent times, Paytm's losses stood at Rs 2,396 crore in 2021-22, while for Zomato and PB Fintech (PolicyBazaar) losses were Rs 1,222 crore and Rs 832 crore respectively.
- Drying-up of investment: Sure, investors will continue to pour money. Some early age start-ups will continue to be funded, as will some of the more mature ones. But investors are likely to be more circumspect in their dealings.
- Impact on valuation: There are also reports of startups in diverse markets, ranging from Ola to OYO, planning to raise funds at lower valuations. Among those who have gone public in recent times, most are trading much below their listing price. Tighter financial conditions, a re-rating of the market, will impact both fundraising efforts and valuations.

Lack of discretionary spending capacity

- Many numbers were given as indicators of the size of the market or TAM (the total addressable market).
- Smartphone users: One such number thrown around is the smartphone users in the country — some have pegged this at 500 million.
- UPI transactions: The transactions routed through the UPI platform — in May there were almost six billion transactions worth Rs 10 trillion.
- Bank account holders: We have the near universality of bank accounts. But in reality, for most of these startups, the market or even the potential market is just a fraction of this.
- There aren't that many consumers with significant discretionary spending capacity, and those with the capacity aren't increasing their spending as these companies would hope.
- No increase in spending: What is equally worrying is the complete absence of any increase in spending by even these consumers who would have the capacity to spend more.
- While more consumers are on-board digital payment platforms — Paytm has about 70 million monthly transacting users — these numbers suggest that when it comes to consumers with considerable discretionary spending, the size of the market shrivels considerably.

Conclusion

Tech startups are about to witness a tough time ahead. Some startups will survive this period. Many may not. And changes in the dynamics of private markets will also have a bearing on public markets.

The accelerated development of the start-up ecosystem needs significant funding and therefore the role of venture capital and Angel Investors are critical. Apart from policy-level decisions that promote entrepreneurship, the onus is also on India's corporate sector to foster entrepreneurialism, and create synergies to build impactful technology solutions, and sustainable and resource-efficient growth.