INDIAN UNICORNS: GROWTH, CHALLENGES AND IMPACT ON CORPORATE FINANCE

Jesintha Preethi Francena. V
Research Scholar, PG and Research Department of Commerce, Guru Nanak College (Autonomous) Chennai
jesinthapreethifrancena@stellamariscollege.edu.in

Dr. T. K. Avvai Kothai
Associate Professor and Head, PG and Research Department of Commerce
Dean-Academics Guru Nanak College (Autonomous) Chennai
avvai.kothai@gurunanakcollege.edu.in

ABSTRACT
The term 'Unicorn' far from denoting a rare mythical creature, has now become a common jargon in corporate lexicon, referring to technology based private companies with a valuation of $1billion or more. From 2000s' when the first unicorns were sighted till date there has been tremendous increase in the number of financial unicorns. While some beasts like Alphabet (Google) and Meta (Facebook) grew to become super unicorns with valuations of more than $100 billion many others have been lost in the herd of similar creatures or have plummeted to decay. The major reason attributed to growth and decline of unicorns is the rise in the number of tech savvy, new age entrepreneurs with the ability to attract capital and the rise in the number of paper unicorns with low capital efficiency respectively. Several startups generated humungous capital but depleted them very quickly in search for market share. This has affected their valuations and has caused investors to write down their investments in these companies. India too has its share of successful indigenous unicorns. But the year 2016 witnessed the challenges faced by these unicorns in terms of cash crunch, retrenchment and ultimately reduction in value. These challenges notwithstanding the Indian Unicorns have increased in number and size from the year 2021. In this context, this paper seeks to analyze the reasons for growth of Unicorns, its impact on the investment arena, the challenges faced and possible solutions.
Keywords: Technology based Companies, Investment, Capital Efficiency and Market Valuation.

Introduction

Unicorns – the term was first introduced to the Investment Universe by Ms. Aileen Lee a Venture Capitalist through her research article titled "Welcome to The Unicorn Club: Learning from Billion-Dollar Startups". In her paper she analyzed software companies founded in the year 2000 and concluded that only 0.07% of those startups attained $1 billion market capitalization and the ones that reached the valuation was as rare as sighting the mythical Unicorn.

Lee's paper was published in the year 2013 and since then the Indian start up arena has evolved into a sophisticated ecosystem fostering the growth of several successful Unicorns. The success of these Unicorns can be attributed to effective integration of Information and Mobile technology, sustainable business plan, clear blueprint for future development and ingenious ways of attracting private investors for successful rounds of funding.
A Unicorn tends to completely change the landscape of its functional area through disruptive technology that is consumer focused and affordable, as portrayed by the tech firm Uber that has in a short span of time, became a unicorn, and has branched out into new areas with an aim of becoming a titan of transportation and now pioneering in driverless transport.

Review of Literature

Vertua (2021) the objective of this study is to find out the determinants of the prevalence of unicorns per Country. The independent variables used are the GDP per capita, the ease of doing business, the network readiness index, global innovation index and the expenditure on R&D as a percentage of the GDP. The main results were that the expenditure on R&D is, by a large margin, the factor that contributes the most to the number of unicorns per capita. It is followed by the global innovation index and the GDP per capita.

Patil, Wadajkar (2021) have in their paper examined the rise of Unicorns in India from the year 2011 to 2021 and have concluded that the typical time taken by various companies to turn into unicorns is around seven years, which is now drastically reducing because many startup founders are repeaters. They capitalize on the first mover advantage and exploit every opportunity. The reason for the success of these unicorns is their strong executive leadership and consumer focus.

Korreck (2019) this paper analyzes the state of the Indian startup ecosystem to understand the growth drivers and motivations of Indian startup founders; identify challenges and outline the support system. It was deduced that improving general economic conditions and investments in digital and physical infrastructure are expected to benefit startups. Improving the regulatory framework for implementation of existing startup policies and removing inefficiencies within the bureaucracy was considered crucial to ease doing business for startups.
Saumya, Pooja (2018) made a case study analysis of companies that receive huge funding in spite of incurring heavy losses. They examined companies like Naaptol, yaatra.com, Snapdeal, Paytm, Myntra and BigBasket and analyzed the net worth, turnover, and Losses with respect to their funding. The study employed correlation analysis and Multiple Linear Regression analysis to examine the impact of various variables on funds raising capacity of Unicorns and concluded by highlighting a positive significant relationship between the net worth and funding of the start-ups.

Ruyu (2018) has studied the growth of Unicorn enterprises in China. The competitive advantages and risks of unicorn enterprises are discussed using Porter's diamond model from the perspectives of factors of production, market demand, technology, government, strategic structure & similar competition, related and supportive industries. His findings on reasons for growth of Chinese Unicorns are similar to Indian Unicorns such as Technology, Innovation and Entrepreneurship.

Objective of the study

Though many empirical studies are being undertaken in the field of startups, specific studies on private unicorns are limited to case studies and examination of reasons attributed to their growth and funding. Studies analyzing the challenges, valuation models and its impact on corporate finance are areas yet to be explored. Hence this paper attempts to bridge the research gap by identifying the challenges faced by Unicorn enterprises and its impact on corporate finance.

Research Methodology

This paper is an attempt to gain a detailed understanding on the dynamic nature of the Indian startup ecosystem with special reference to Unicorn Enterprises. It is based on secondary data analysis. The data was collected from various websites, annual reports and research articles. Factors such as funding, growth, market capitalization, success of IPOs and valuation challenges were analyzed to gain qualitative insights on the topic. The major limitation of this study is the difficulty of obtaining accurate data as the statistics available online vary across different sources.

Growth of Unicorns

Make My Trip founded in 2000 became India’s first Unicorn in 2010. India currently hosts 115 Unicorns with a collective market valuation of more than $ 350 billion as of January 2023 and is the third largest startup ecosystem in the world, preceded by the US and China. Studies suggest that one in thirteen unicorns worldwide is born in India and many unicorns such as Nykaa and Paytm have had successful Public Listing. Bengaluru is the Unicorn Capital of India with 43 unicorns headquartered there.

The Indian Economy that was used to the addition of one unicorn each year till financial 2016-17 saw an exponential rise in the number and value from the year 2017 - 18 onwards with an astounding 66% year on year growth. The year 2021 could be called ‘The year of Unicorns’ with the emergence of 44 new startup unicorns against a cumulative number of 33 unicorns from 2011 to 2020. Twenty four firms became Unicorns in the year 2022 and according to PwC India report as many as 50 more firms are in line to join the coveted Billion Dollar Club. The SaaS (Software as a Service) sector is the major contributor of Unicorns followed by Fintech, logistics and Edutech. Unconventional sectors such as Gaming, Hospitality, Cloud Kitchen and Data Analytics have also made their mark in the list of Indian Unicorns.

Factors fostering growth of Unicorns in India

Increase in domestic demands, Indian demographics that encourages startups, existence of a robust start up ecosystem, ‘Startup India’ initiatives by the Government, increasing number of Venture capitalists and informed investors with a ‘winner takes it all’ attitude willing to splurge private capital on promising ventures, and shift in global capital now focusing on Indian Unicorns are some of the factors that contribute to the growth of unicorns. The Pandemic that affected every sphere of mankind’s existence was also a boon in disguise to the startup sector globally. It was during this time India saw a phenomenal rise in the number of Unicorns. The Lockdown and Work from Home concept paved the way for many innovative and first of its kind digital business models. Enterprising Indian Entrepreneurs spearheaded these businesses and prevented the economy from going into a standstill. These new businesses were sustained by integrating digital commerce into consumer lifestyle, consistent flow of information via internet connectivity, wide adoption of smartphones, and existence of robust digital payment systems.

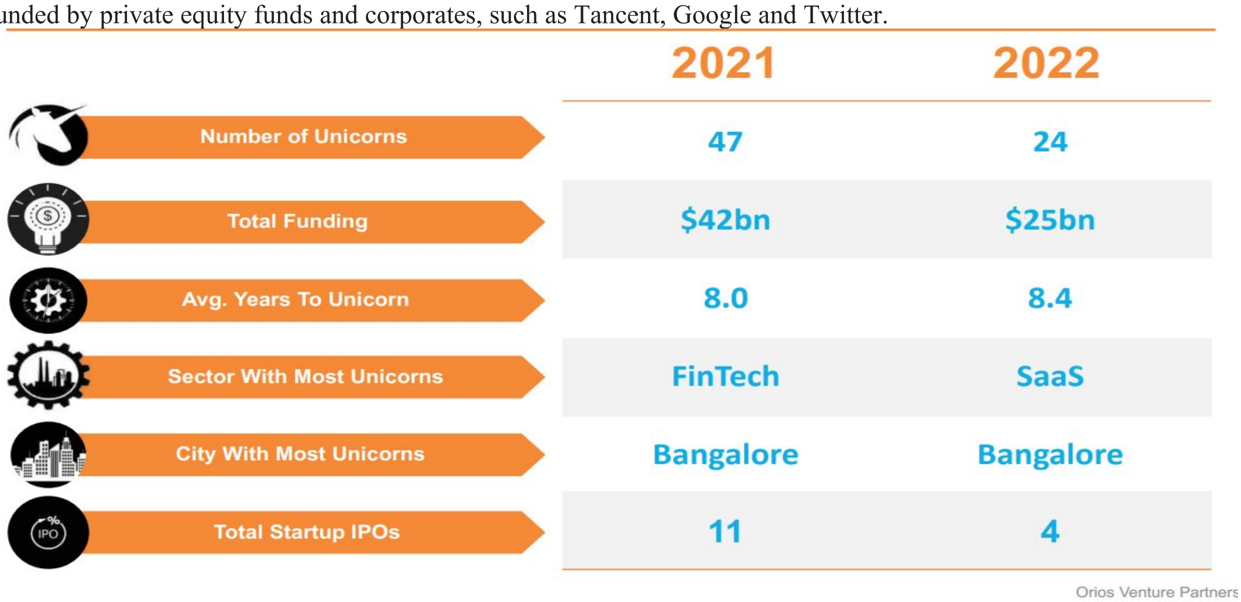
Impact on Corporate Finance

The recession that is descending upon the economy is causing tumults in the equity markets and keeping it highly volatile making investors skeptical when it comes to parting with their money. But it is also an opportunity for the investors to take time and evaluate the investment options in a more realistic way. The economic slowdown has led to fund raising rounds taking longer time to close thereby giving investors ample opportunity to evaluate and choose startups that stand the test of time.

Near Zero interest rate patterns that were prevalent during the pandemic are wanting to pave way for higher interest rates in light of the looming recession. This along with the depreciation of rupee will lead to difficulties in raising funds in dollars and reduction in the valuation of Unicorns. Debt becomes dearer and operational cost will shoot up affecting profit margins. All these will act as catalysts that transform the Investment arena for Indian Unicorns. Ventures with already low valuation will have to depend on non-equity based financing as the venture capitalists will have to prioritize profitability over growth.

This so-called '*Funding Winter'* is expected to turn a number of new entrants to the unicorn club into zombies. Zombie Unicorn refers to a company that keeps operating even after the funds run out without any real growth. In such a climate experts are cynical about the new array of Unicorns catapulting the Indian economy to new heights.

This Funding Winter notwithstanding startups raised $25 billion in 2022, which is 2.2 times the money raised in 2020, though the funding declined by 30% when compared to 2021 when startups raised a massive $42 billion across 1,583 deals. This was three times the investment raised by start-ups in 2020. The year 2022 also saw 229 acquisitions and four techs Initial Public Offering according to India Unicorns and Exits Tech report 2022 by Orios Venture Partners. The key Venture Capitals funding Indian start-ups include Sequoia Capital India, Tiger Global Management, SoftBank, SoftBank Vision Fund, etc. Apart from VC funds, these entities have also been funded by private equity funds and corporates, such as Tancent, Google and Twitter.



	2021	2022
Number of Unicorns	47	24
Total Funding	$42bn	$25bn
Avg. Years To Unicorn	8.0	8.4
Sector With Most Unicorns	FinTech	SaaS
City With Most Unicorns	Bangalore	Bangalore
Total Startup IPOs	11	4

Orios Venture Partners

Source: India Unicorns and Exits Tech report 2022 by Orios Venture Partners

Delhivery (Logistics), Tracxn (IT), Fivestar (Fintech) and Kfintech (Fintech) are the four companies listed on the stock exchange in 2022 and key acquisitions were MX TakaTak acquired by Moj, Blinkit by Zomato, Owndays by Lenskart and Pickrr by Shiprocket. Some of the expected IPOs in the year 2023 are from Flipkart, Byju's, Mama Earth, Swiggy, OLA, and Pharmeasy.

Flipkart, Paytm, OYO, Byju's and Swiggy are the five Indian Decacorns (Companies with valuation of $10billion). Flipkart valued at $37.6 billion is India's most valued Unicorn. Ratio ($120 million) 5ire($100 million) Keka ($57 million) GOAT Brand Labs ($50 million) were few of the companies that had 2022's biggest early stage funding and Verse Innovation ($805 million), Byju's ($800 million), Swiggy ($700 million), Polygon($450 million) were some companies that had biggest late stage funding in 2022.

Criticisms aside, this accelerated pace of unicorn generation is encouraging nevertheless. The number of successful IPOs and M&As are proof for retail investor's enthusiasm in nation building and for the competence of Indian financial markets. It is a positive sign of invaluable economic growth towards India's vision of self-reliance.

Challenges faced by Unicorns

The biggest challenge faced by Indian Unicorns is attracting compatible investors with similar expectations about growth and exit strategies. There is a mad rush of global capital chasing successful enterprises at present but the tables may turn in the face of the recession and geopolitical situations.

Many of these global investors desire speed and hunt for unicorns that scale up at exponential pace. This leads to fast depletion of capital in search of market share. Another major problem is the credibility of market valuations of these unicorns. Private companies have the advantage of nondisclosure and the lack of liquidity of shares aids in contorting its value. Irrational exuberance of the investors and entrepreneurs also hype the valuations.

These valuations are not justified by the business model or future blueprint for profitability. Therefore it is imperative for the unicorns to prove its market potential over time and not just fall under the category of 'paper unicorns' sheltered by optimistic private markets. Unicorns with unrealistic valuations will have to face the hard reality when they come to public listing. The Business Times Research Bureau suggests that investors lost 9% – 71% of their wealth in the year 2022 by investing in such firms such as Paytm, Policy Bazar and Zomato.

In order to succeed in the crucial later stage funding, entrepreneurs are forced to give in to the demands for 'favorable terms' of the investors such as liquidation preferences. It dilutes the valuation of common stocks held by the employees who become the biggest losers in the deal.

It is clearly established that innovation is the key to success for any business and quintessential for Unicorns. Innovation is not a Big Bang idea that just occurs to entrepreneurs. It is about sustaining a culture of innovation in all aspects of business with benefits that accrue over time. It also involves aligning the aspirations of all stakeholder groups with different priorities.

Investment in tech innovations is risky and synonymous to the popular acronym VUCA (Volatility, uncertainty, complexity and ambiguity). This makes it very difficult to predict the outcome of an innovative effort and even on successful implementation it may be short-lived due to the waves of disruptive innovations that are hitting the Unicorn shore.

Unicorns will have to build a supportive environment for technology adaptation. Resistance to tech based business was very high before the pandemic. Now the situation is better with many users continuing to patronize the online businesses that they relied on during the pandemic. The Edutech sector had its major breakthrough during the pandemic when learners and teachers alike switched to online classes.

Global inflation was at 9.8% in 2022 according to Bloomberg Economics estimates. It has brought in problems such as unemployment, ever increasing cost of living and difficulty for policy makers on one hand and massive layoffs and cost cutting on the other. Attracting, training and retaining the right talent is a huge challenge for unicorns and issues like lack of employee engagement, demand for bigger salary packages, and attrition are hurdles to be crossed.

Majority of the startups cater only to urban India and most of the rural India and small town customers are yet to be targeted. A regulatory bottleneck is also a challenge to the establishment and growth of unicorns. The government is taking measures to ease regulatory compliance. It is evident from India's rank in ease of doing business as per the World Bank report that it has improved from 142 in 2014 to 63 in 2022. But there is still a long way to go.

Other problems such as lawsuits, controversies and negative publicity add to the challenges of Unicorns. The Paytm data privacy issue, failure of merger talks between Flipkart and Snapdeal, Sachin Bansal's exit and Binny Bansal's resignation from Flipkart in 2018, and recently filed lawsuit against Bharatpe's cofounder Ashneer Grover by Kotak Mahindra Bank are scandals that are testimony to negative media stories about companies trying to get too big too fast.

The Way Forward

Unicorns must position themselves strongly to send signals attracting the right investor fit. They must aim for attainable growth objectives with credible valuations models and stock market outcomes. Exit plans must be formulated precisely considering the welfare of all stakeholders. Innovative business culture must be fostered with adequate research and training. Adequate investment in employee engagement initiatives is also necessary. Resistance to change can be addressed by understanding the product/service sold, the motives of the user and the internal business operating thereby gaining holistic knowledge on the business environment that can lead to better planning and executing projects successfully.

Conclusion

India is the fifth largest economy in the world and has become a force to reconnect with in the global economy. It has developed strong business infrastructures, strengthened security framework, expanded its digital transaction/payments base and engaged in strategic tie ups with other countries in the interest of nation building. It is scaling higher in the ranks of countries for ease of doing business and has reached the 46th spot in 2022's Global Innovation Index. As India marches forward towards attaining Sustainable Development Goals, the startup ecosystem will continue to flourish in conventional and non-conventional sectors producing highly valuable unicorns that uplift the nation and its investors.

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