# THE RISE & DOWNFALL OF STARTUPS

**Abstract**

India has 108 Unicorns, CRED, PHARMEASY, BYJU's, MEESHO, GROWW, NYKAA are some examples. It's good for a growing economy like India, but most of these companies are not profitable.

Startup begins with an Idea, with no value attached to it. It grows into a business plan, founders present investors the business plan, investors evaluate these plans, and then they invest money into the company. Funding for startups usually hyped. The value of business is determined by some parameters like

1. Attractiveness of Idea
2. Reasonable nature of Product
3. Appeal of Product in the Market
4. Background of the founders etc.,

Basically all these are subjective aspects and most companies start earning in losses. But that's how the startups are valued. The value is estimated on the basis of future earnings, even though they have no profits to show..

Business valuation is about how much money the company is worth, Unlike in a settled business where financial statements and the actual earnings (metrics like profit after tax, Earnings before interest and Tax) are the basis of valuations, In a startup company there is no such numbers to value the company.

The problem begins when the value is far remote from the reality; this seems to be the case with the lot of Indian Startups. Like BYJUS' Paytm, Bharatpe, Swiggy, Zomato etc.,.

**Authors**

**Nazmal Mohammed**
MBA., LLB., Pursuing LLM : Corporate & Securities Laws,
P.G Department of Legal Studies & Research
Acharya Nagarjuna University
Nagarjuna Nagar Guntur
Andhra Pradesh, India.
Nazmal.huzayl@gmail.com

**Dr. Srigouri Kosuri**
M.A., MJMC., LL.M., Ph.D.,
Assistant Professor of Law
Acharya Nagarjuna University
Nagarjuna Nagar Guntur
Andhra Pradesh, India.

All these are highly valued companies, but in reality they are burning money. It is a huge problem in the Indian startup eco system.

1. 55 Unicorn companies are incurring losses
2. The cost to revenue ratio of startups is 1.2.
3. Venture Capital investments fall by 29% in 2023 compared to 2022.

The Startups are not able to raise money as projected due to Soaring inflation, High Interest Rates, Vary investors. There is no more unlimited capital funding from market.

These companies grew at an unprecedented ways until 2021 they were valued at a sky rocket levels and now they are finally being valued at a more realistic level.

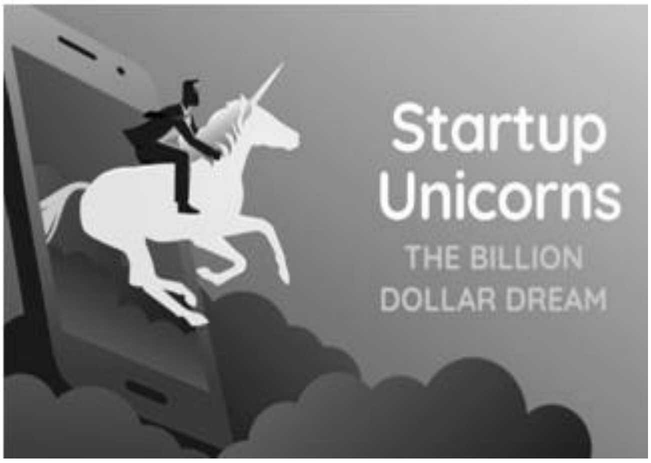
This article explores the factors influencing startup valuations in India with special reference to BYJU's.

Through this chapter, the readers can understand valuation of companies, the emerging trends and the means to incorporate due diligence & shape the realistic value of startups in India.

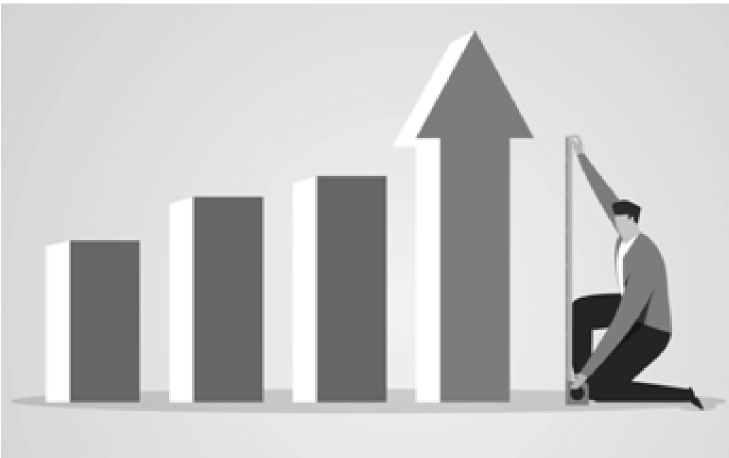
## I. INTRODUCTION

Have you heard of the term **UNICORN**, in the corporate world, A unicorn company is the title given to a privately owned startup company valued at over $ 1Billion. India has 108 Unicorns, to name some CRED, PHARMEASY, BYJU's, MEESHO, GROWW, NYKAA and many more. It's great for a growing economy like India, if they are sustainable and profitable




## II. WHY STARTUP?

Startups are very essential for a country, they are the fuel for its economy, they create employment opportunities and drive innovation. They introduce new concepts in the market through dynamic workplace strategies, techniques and solutions.



## III. THE RISE

In the beginning of the year **2022**, India has reported **more than 61,000 startups**, thus it became the **3rd largest startup ecosystem** after the US and China.

The government of India launched the initiative called **Startup India**, the sole purpose this initiative is to bring about startup culture and create the ecosystem for entrepreneurship and to lead innovation.

1. "Byju's became the India's most valued startup at $16.5 billion." Business Standard, 2021.
2. "Zomato IPO oversubscribed by more than 38 times." *The Economic Times, 2021.*
3. "Paytm now valued at $16 billion." *Times of India, 2021.*
4. "Ola's valuation soars to $6.5 billion amid pandemic recovery." *LiveMint, 2021.*

## IV. THE VALUATION GAME

In pursuit for growth at all costs, many early-growth startups spent significant capital in acquiring customers without paying much attention to monetization and units of economics, often strategized by the investors who knew that if they played the game right, they would have handsome rewards.

The idea grows into a business plan, founders present investors the business plan, investors evaluate these plans, and then they invest money into the company. Funding for startups usually hyped. The value of business is determined by subjective aspects and most companies start earning in losses.

## V. THE DOWNFALL TRENDS IN STARTS UP

1. **Market Potential:** Investors often assess the market potential and the Companies operating in large and growing markets have the potential to command higher valuations. For instance, startups catering to India's massive population or targeting sectors like fintech, edtech, and healthcare are often considered attractive prospects.

2. **Traction and Growth:** A startup's current performance and growth trajectory play a significant role in determining its valuation. Metrics such as revenue, user base, customer retention, and user engagement are crucial indicators of a startup's success.

3. **Team and Talent:** A strong and competent founding team with a track record of success can positively impact a startup's valuation.

4. **Competitive Advantage:** Startups with unique and defensible competitive advantages, such as innovative technology, patents, or exclusive partnerships, are likely to command higher valuations due to their reduced risk profile.

5. **Funding and Investor Sentiment:** The availability of funding and investor sentiment within the market can also influence a startup's valuation. In times of bullish investor sentiment, valuations tend to soar Valuation Game is an unbeatable strategy in a uprising market, this game can also turn disastrous in a dipping market. The growth stage funding will be a big challenge and its even impossible for any company without a clear route to cash-flow management & break-even analysis

***It is essential to remember that valuations are subject to market fluctuations, and the true success of a startup lies in its ability to sustain and grow its business in the long term.***

**Regulatory Provisions of Valuation:** The Companies Act, 2013, along with other securities laws in India, provide provisions and regulations concerning the valuation of companies and the process of raising funds. Some key provisions relevant to valuation and fundraising:

1. **Valuation of Companies [Section 247 of Companies Act, 2013]:** The Act requires that the valuation of any property or stocks or shares or debentures or securities, or goodwill of a company should be conducted by a ***Registered Valuer***. A registered valuer is a professional who is registered with the Insolvency & Bankruptcy Board of India (IBBI) and is authorized to conduct valuations in accordance with applicable laws.

2. **Preferential Allotment & Private Placement [Section 42 of Companies Act, 2013]:** The Act permits companies to issue shares or other securities to a selected group of persons on a preferential basis. The pricing of such preferential allotment must be determined based on the valuation conducted by a registered valuer.

3. **Rights Issue [Section 62 of Companies Act, 2013]:** A company can issue its shares to the existing shareholders through a rights issue. The issue price is determined based on the valuation conducted by a registered valuer.

4. **IPO (Initial Public Offering) and QIP (Qualified Institutional Placement):** For companies planning to raise funds through an IPO or QIP, the SEBI (Securities and Exchange Board of India) prescribes specific guidelines and regulations for pricing and disclosures.

5. **Debt Issuance:** Companies issuing debt securities (bonds or debentures) must adhere to the SEBI (Issue and Listing of Debt Securities) Regulations, which include provisions for pricing and disclosures.

6. **FDI (Foreign Direct Investment) and ECB (External Commercial Borrowings):** For raising funds through FDI or ECB, companies need to comply with guidelines issued by the Reserve Bank of India (RBI), which include pricing norms and reporting requirements.

7. **Takeover and Acquisitions: SEBI Takeover Regulations** govern the acquisition of shares or control in listed companies. These regulations include provisions for pricing open offers and disclosures.

***It is immense for companies to comply with these provisions to ensure transparency, fairness, and adherence to the law when raising funds and conducting valuations. Non-compliance can lead to penalties and legal consequences.***

## VI. TRENDS IN STARTUPS

With funding prospects diminishing, startups are now reducing discounts, their ability to attract more consumers, and shutting down new business lines.

1. **Swiggy** shuttered its meat and premium-grocery delivery service.
2. **Ola** closed its food and grocery businesses.
3. SoftBank-backed e-commerce company **Meesho** stopped delivering groceries.
4. Online education startup **Unacademy** shut down its primary and secondary school business.
5. Food delivery startup **Zomato** closed down operations in 225 Indian cities, citing poor demand.

U.S. Securities and Exchange Commission show that Invesco and BlackRock cut the valuation of **BYJU's** from $22 billion to $11.5 billion and the valuation of **Swiggy** from $10.7 billion to $5.5 billion.

Vanguard reduced the **Ola's** valuation by 35% after which it is $4.8 billion, while financial services startup **Pine Labs** had its valuation cut by 40% after which it is $3.1 billion by Neuberger Berman. Janus Henderson cut up the health care startup **PharmEasy's** valuation to $2.8 billion.

## VII. ROOT CAUSE: OVERVALUATION

1. **Unrealistic Expectations:** Startups receive exorbitant valuations during their initial funding rounds often face tremendous pressure to live up to those expectations. Unrealistic growth targets and profit projections can lead to decisions that prioritize short-term gains instead of long-term sustainability.

2. **Misallocation of Capital:** Overvalued startups may squander their capital on aggressive marketing campaigns, extravagant expenses, or rapid expansion without adequately testing their business models. Such misallocation can lead to financial instability when they fail to achieve the anticipated returns.

3. **Competitive Pressure:** Massive investments and soaring valuations, startups may engage in aggressive competition, leading to unsustainable price wars, loss of market share and erode investor confidence.

4. **Market Correction:** Overvaluation can cause a **bubble** in the startup market. Eventually, market forces correct these **inflated valuations**, leading to a sharp decline in a startup's worth.

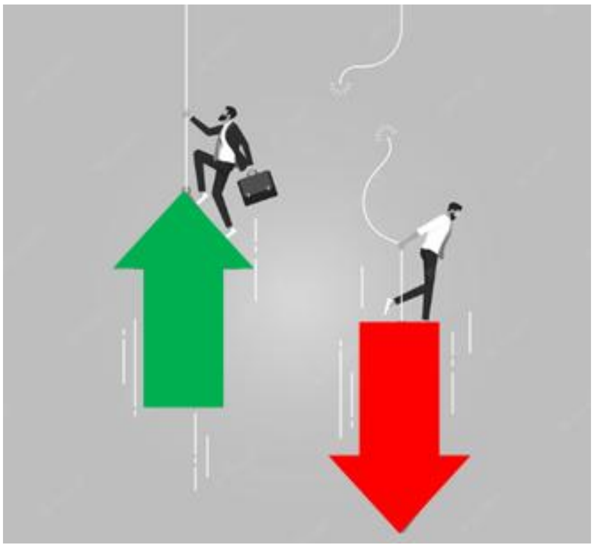
## VIII. BUSINESS CASE

BYJU'S

At one point it was India's most valued startup company, but in the last one year it has seen a most dramatic downturn. Investors no longer believe in its potential, employees are laid off and its owner Byju Raveendran is no longer a billionaire.

## IX. THE RISE OF BYJU'S

BYJU's company started with online videos and preparing students for competitive exams, things took a turn in 2015 when BYJU's launched mobile learning app. By 2018, the app had over 15 million subscribers. BYJU's became a Unicorn, and it was valued over $ 1 Billion. The real boom happened during the pandemic Covid-19, everyone was at home, they were all learning on devices, so BYJU's saw a meteoric rise, and there was exponential growth. It became the growing star of the EDTECH market. The company decided to expand, they acquired WHITEHAT JR for $ 300 Million, then AAKASH tutorial chain for $950 Million and BYJU's kept adding companies to its shopping cart like GREAT LEARNING, TOPPR, EPIC etc., The company scaled up its marketing too. They poured millions into promotions, sponsored the Indian Cricket Team and was the official sponsor of FIFA World Cup.



## X. THE DOWNFALL OF BYJU'S

BYJU's was depending on students to learn online, the world opened up after the pandemic, students returned to schools but BYJU's kept spending, kept growing and investors kept pouring in money, they did not expected the downturn in 2021.

End of the year BYJU's posted a loss of $327 Million, which was 17 times more than the previous year. Subsequently many scandals followed, BYJU's was accused of exploiting its customers. The Layoffs were part of a massive cost cutting exercise. In April 2023 BYJU's office was raided in Bengaluru. In May, 2023 BYJU's lenders filed a suit against company, accusing defaulting payments, breaching loan agreement. In June 2023, BYJU's missed an Interest payment of $40 Million

***In 2022 BYJU's Valuation was its worth $22 Billion, In 2023, this has been slashed to $ 5.1 Billion. Clearly BYJU's lacked sustainable and profitable growth strategy.***

## XI. LESSONS LEARNED AND THE WAY FORWARD

Valuation have no relation to success or profits, it is actually a huge problem in the Indian startup eco system. Lessons learned are as follows

1. **Realistic Valuations:** Startup founders and investors must adopt a more rational approach to valuations, considering the startup's true potential, market conditions, and scalability. Conservative valuations allow room for sustainable growth and minimize the risk of an eventual downturn.

2. **Focus on Profitability:** Startups must prioritize achieving profitability and managing cash flows over unsustainable expansion. A solid business model and a clear path to monetization are vital for long-term success.

3. **Sustainable Growth:** Instead of chasing rapid market share at any cost, startups should focus on sustainable growth strategies. It's essential to build a loyal customer base and offer a unique value proposition.

4. **Investor Due Diligence:** Investors must conduct thorough due diligence before investing in startups. A realistic assessment of the startup's business model, market potential, and competition can help prevent overvaluation.

## XII. CONCLUSION

While the Indian startup ecosystem continues to flourish, the downfall of some startups due to overvaluation serves as a cautionary tale. It is crucial for founders and investors to learn from these examples and adopt a balanced approach, emphasizing sustainable growth and realistic valuations for long-term success.

Indian startups are burning money and they no longer have unlimited capital funding, it may look like a downturn but it's perhaps a RESET for in Indian startup economy. These companies grew at an unprecedented ways and now they are finally being valued at a more realistic level.

**Overvaluation Bubble is bursting and Resetting:** Indian startups have immense potential. The way the startups function should change, and focus on the sustainable, realistic and profitable value of startups in India

## REFERENCES

[1] The companies Act 2013
[2] SEBI Guidelines
[3] The Insolvency and Bankruptcy Code, 2016 (IBC)
[4] Yashil Garg, "10 start ups in India – Everyone should know" published in Knowledgehut.com dated 14 July, 2023 https://www.knowledgehut.com/blog/web-development/top-startups-in-india
[5] "Star founder Byju Raveendran broke down in tears as crises engulfed Byju's" under Most viewed Business news section. Published in Economic Times dated 28th July 2023 https://economictimes.indiatimes.com/tech/tech-bytes/byjusacquires-us-based-learning-platform-epic/articleshow/83278989.cms
[6] Will Poole, Surya Mantha, "Startup valuations: If big deals are overvalued, what about small ones?" published on Nov 18, 2022 02:25:17 PM IST in forbes.com https://www.forbesindia.com/article/startups/startup-valuations-if-big-deals-are-overvalued-what-about-small-ones/81305/1
[7] Neeraj Tyagi : Role of start-ups in the growth of the Economy in India in Section of Voices, Economy, India, Published on December 2, 2022, 10:45 AM IST , in Times Of India(TOI) https://timesofindia.indiatimes.com/blogs/voices/role-of-start-ups-in-the-growth-of-the-economy-in-india/
[8] 7 TOP factors that influence start up valuation, Published in Startuplab.in https://thestartuplab.in/7-top-factors-that-influence-startupvaluation/#:~:text=Startup%20valuation%20is%20the%20process,team%2C%20and%20stage%20of%20development.