

# Startups are Facing an Uphill Future: A Critical Study on the Unicorns of India, Reasons and What is the New Normal

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**Abstract:** *The paper researches the reason why India has become the 3<sup>rd</sup> largest home for unicorns (startups valued at a minimum of one billion dollars) during the Covid-19 pandemic. India, being an extremely technologically savvy economy, took adequate advantage of this knowledge, to attain large gains with respect to the startup industry. The problems that these industries face as well as the issues that develop when they decide on an Initial Public Offering (IPO) are discussed in detail.*

**Keywords:** Unicorn, Startup, Initial Public Offering (IPO), Watchdog, (SEBI), Bootstrapping, Ownership Pattern, Promoter Investment

## Research question

The paper will attempt to analyze the path that startups take to become unicorns (startups valued at a minimum of one billion dollars) and further decide on an Initial Public Offering (IPO). It has been seen that in the recent past, there have been several obstacles that these new unicorns have faced in the economy. The reasons could be both internal and external as well as the changing environment for such companies. An in-depth analysis will be attempted on the reasons for the new norm. Questions like what the way is forward, what steps must be taken, and how can the profit margins be maintained will be studied in this paper.

## 1. Introduction

In the world of increased globalization and liberalization, the opportunities for starting a new idea or a new venture becomes accessible. The availability of technology and knowledge are within the easy reach of the entrepreneur. The basic problem that exists is the availability of finance. There are several ways where finance can be made available

both within the country of origin of the startup as well as from outside that region. All this has been made available due to the increasing speed and access to information. The world is truly indicated in which the speed of knowledge and all other factors reach all parts of the world.

The fact that the world is changing at a phenomenal pace, results in the development of ideas, products, processes, etc. which helps in ease of doing business. It is this endeavor that led to the research and development of various new ideas and the culmination of a product/process/service. This is the basis of a 'startup'. It is not necessary that all these startups become commercially viable ventures. It is possible that the entrepreneur continues to try and research various ideas/products/services before they achieve success.

In the process of achieving fulfillment, there might be several failures and disappointments which they have left by the wayside. The culmination of the startup into a unicorn and then the unicorn entering the Initial Public Offering (IPO) space is the ultimate dream of an entrepreneur.



Figure 1: Picturization of the concept of a startup

Source: Google Image

## 2. Definition

The action or process of setting something in motion is called 'startup'. These are normally companies that have the ambition of making it big and are focused on a single product or service that the founder or entrepreneur might want to bring to the market. It is likely that they may not have a fully developed business model and the finance to move to the next stage of business. A startup is also a company that is in its initial stages. Most of the founders put in their own money or generate money from their close associates to begin their venture.

The aim of these entrepreneurs is to attract finance so that they can adequately justify their products. Many times the funding that they themselves can generate is inadequate to showcase the full potential of the commodity. It is likely that what they start with may be the absolute basic model of what they want to achieve. For the entrepreneur, the basic model itself is a discovery, an innovation, and an invention. The fact that they can see their 'baby' on the drawing board and may be in the physical space gives them the satisfaction that they are moving in the right direction.

For all this many finances are required and often it is the lack of finance that leads to setbacks and eventually shelving the whole idea. This is why one says that 90% of startups ultimately disintegrate. The ones that succeed are likely to have a strong business plan as well as the right product at the right time at the right place, which also indicates that a huge amount of 'luck' may be attributable to the final success of the venture.

### 2.1 Startups

There are six main types of startups:

- Lifestyle Startups

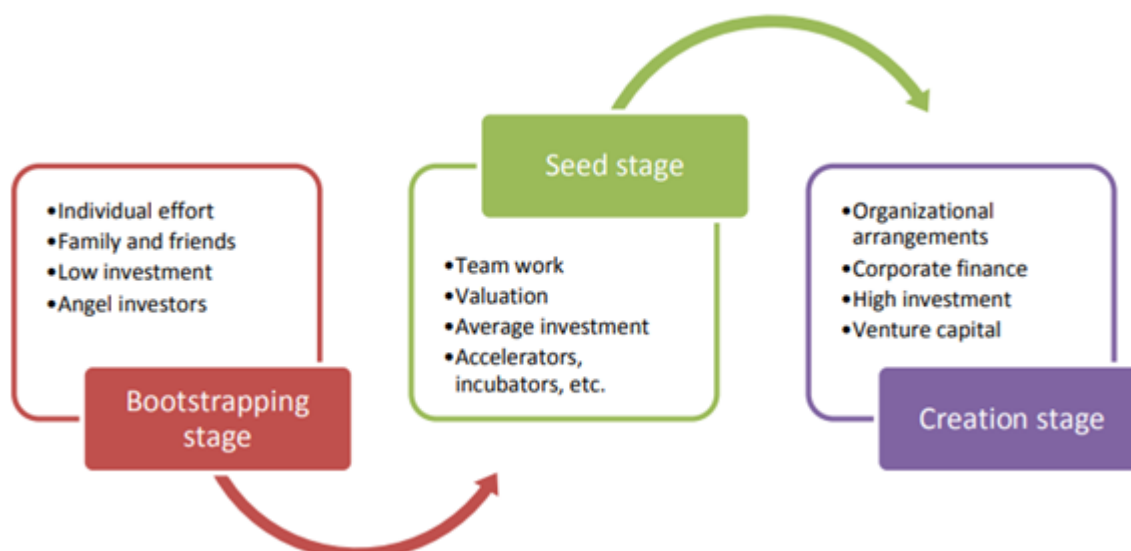
- Small Business Startups
- Scalable Startups
- Buyable Startups
- Large Company Startups
- Social Startups

There are many startup theories that are the basis of any new idea or entrepreneurship activity. The above-stated types all follow the same principle with respect to:

- Organization
- Management
- Entrepreneurship

As far as organization is concerned there are no set theories that can explain the startup evolution, indicating that the path that should be followed is not an adequately foolproof setup. The relevant theories just attempt to answer various organizational configurations, resource dependence theories, etc.

As far as management theories are concerned this may be more specific in the form that it describes the relationship among organizational characteristics. These may be more general rather than specific references to startups. The entrepreneurship theory, on the other hand, does indicate that the founder is important and looks at it from the point of view of both the micro and the macro level. This deals with ideas, creativity, innovation, new product, service development, opportunity, etc. These essentially refer to the early stages of a business organization. Secondly, this aspect also refers to managing people and organizations. The third is the most important where an idea gets converted into a business venture.



**Figure 2:** Illustration of the path followed by a startup

Source: Salamzadeh, A., & Kesim, H. K. (2015b). Startup Companies: Life Cycle and Challenges. *Social Science Research Network*. <https://doi.org/10.2139/ssrn.2628861>

Studies have indicated the concentration of startups in various economies of the world, for example, sustainable agriculture is stronger in South America and Africa,

Pharmaceuticals in North America and Europe, and Education and Platforms that sell good quality, at lower prices cosmetic products are a forte of India. There has been

an extensive increase in startups and venture capital activities since 2009.

In 2015, Chinese companies were operating in the field of Artificial Intelligence. India, on the other hand, was third in the world in 2023 with respect to startups. The status as far as unicorns is a different story. Many a time there are strongly overlapping areas within the same startup description for example the field of Fintech startup companies. These include an overlap of financial, technology services, transfer, and science. This is a serious threat to the traditional system of finance namely the banking sector. The fact that they are regional-wise specifications showcases the expertise and knowledge in that sphere.

## 2.2 Unicorns



**Figure 3:** Image of a Unicorn  
Source: Google Image

The image that has been indicated above is a picture of a fictitious animal that looks like a white horse with one horn. This really means something that is rare and highly valued. It also indicates purity, innocence, and power. The definition of a unicorn with respect to companies is a startup valued at a minimum of one billion dollars. It is a privately held startup company and it was first coined by the venture capitalist Aileen Lee in 2013, indicating the statistical rarity of such a situation.

The whole idea of unicorns started in The United States of America, especially limited to San Francisco, but suddenly there was a big burst of several such companies where the market capitalization increased to two billion dollars. What was more dramatic was that firms that were founded between 2012 to 2015 had a market capitalization of more than twice that of firms that were founded between 2000 to 2003, indicating that the firms today are growing twice as fast as they did earlier.

## 2.3 Unicorns moving towards an IPO

'Getting big fast' has been the new mantra for the startups that started in early 2000, and many venture capitalists tried to grow very fast such that they could raise as much capital as possible. The main question that arises here is how long a company should wait before it decides on an IPO. Is there any relationship between the number of years that a

company is privately held and the time before it enters the public domain?

There are different views on the above statement. It is possible that many unicorns miss their chance as they stay private too long. They prefer to grow with the infusion of funds from hedge funds, mutual funds, and corporate venture capital funds. The downside of this was that when the company was growing there was a large infusion of funds from the above sources. Is it that when it decides on an IPO, the growth phase of the company is over? Has the firm achieved the highest rate of growth when it was a privately owned one? These and more are the questions that come up in deciding the right timing of an IPO.

Often it is also external factors in the sense of the regulatory authorities of the country, the bull phase of the stock market, as well as the government policies at that time which just might be a major contributory factor in deciding on the success of a particular IPO.

The different perspectives that one must consider are:

- The financial profile of a unicorn
- The financial efficiency of a unicorn
- Financial efficiency based on the region of origin.

The above indicates the number of aspects that a unicorn investigates including the region of origin and the financial aspects.

India today is in the top three countries with respect to the number of unicorns in the first half of 2022. The US tops the list, China, and then India.

The issue of how startups become unicorns and when they follow the IPO route has led to several researchers understanding the different regions and sectors in which they have mushroomed. The trend is that many startups achieve a lot of success but there are equally many of them which face failure. The reason for this failure is primarily financial. There is no set formula that these startups can follow to become unicorns.

The reason that these unicorns move to the next step of an IPO is that all the shareholders believe that there is further scope for growth and business development of their product or service. There is also the possibility that some unicorns do not do too well after the IPO. America is the foremost with respect to unicorns and the majority of them are in Silicon Valley. It is possible that Silicon Valley has the right ecosystem that leads to it being called a startup city. To be a successful entrepreneur the primary aim is financial efficiency.

Some research does indicate that the unicorns are not profitable, and it is possible that their returns vis-a-vis the rate of interest at which they have borrowed money are negative. Research in such areas has indicated that 85% of the assets are financed by investors, but it is also clear that they have short-term assets to pay short-term debts. It is this working capital that is used to generate revenues several times a year. The entering of such companies into the IPO market reduces this loss. The area in which the largest number of startups are known to be seen are:

- Healthcare
- Product and services
- Internet
- Technology
- Software

Amongst the above stated, the most successful one is in the healthcare area. As far as India is concerned, the other area which is extremely important is the education sector.

Especially during the times of the pandemic, the education and health sector reached phenomenal growth levels. Examples of successful unicorns in the health sectors were various online laboratories. If one looks at sector-wise entry of unicorns/startups one finds that the healthcare industry seems to be quite profitable.

‘According to Fior Markets reports, the global at-home diagnostics market will register a value of over \$6 billion by the end of 2026 and a CAGR of over 3 percent during the forecast period of 2019-2026.’<sup>1</sup>

Home diagnostic kits are now entering the market with sophisticated technology like Artificial Intelligence (AI), The Internet of Things (IoT), and The Internet of Medical Things (IoMT). The pandemic crisis increased home diagnostic testing as a result, manufacturers are investing in highly sophisticated technology. The Indian diagnostic industry was pushed to invent new and innovative methods, but the bottom line was quality control, affordability, and accuracy.

### 3. Contrast of Unicorns from the period from 2019 to 2022

India ranked second in innovation quality. These startups are not only dynamic in nature but are generating large-scale employment. The year 2019-2021 saw the birth of the maximum number of unicorns. The world was going through a crisis, but during this period Indian entrepreneurs have contributed to a large extent to the economy. Bangalore, Delhi (NCR), and Mumbai are the three largest places where unicorns have emerged. The traditional sectors are E-commerce, Fintech, supply chain and logistics, internet software, and services. The unconventional areas are content, gaming, hospitality, data management, and analytics.

#### 3.1 Ownership Pattern and Promoter Investment

Secure Capital, Tiger Global Management, Kunal Shah (founder of Cred), Better Capital, Inflection Point Ventures, Lets Venture, Accel, Bloom Ventures, 9 Unicorns, and Alpha Wave Global are some of the most prominent investors. The type of funding has changed from personal finance to:

- crowdfunding
- revenue-based financing.
- venture debt
- bank loans

Zerodha has been bootstrapping (using only existing resources such as personal savings, personal computing equipment, and garage space to start and grow a company) since inception and they have changed the funding norms and have promoted independence and revenue generation right from the beginning.



Figure 4: Examples of boot-strapped unicorns in India  
Source: Google Image

Bootstrapping, of which Zoho, Zerodha, and Mu Sigma are the famous startups, entails profitable unicorns with no venture capital or private equity investors and that are entirely owned by promoters or promoter groups. They use their personal finance or their operating revenue. It means that the business is built in a lean manner so that it can grow internally without the help of external capital.

The basic advantages of such a unicorn are:

- No dilution of ownership because they are not giving up their equity to outside investors.
- The promoters have complete control over the operations as they are not depending on outside funding.
- They work on a realistic business model.

#### 3.2 Pattern of seed capital for Startups

A lot of startups in the real world are based on unrealistic business models. That is the reason they are looking for professional funding to build and sustain the business. They do get a few rounds of funding from various angel investors, but once they get into the IPO sphere their value tends to drop. Over time investors have realized that several startups are selling rose-tinted dreams and they go ahead with spending a lot of money to capture the market and acquire more customers. But, when the time comes for their product to face the competitive market, many of them fail.

However, there are cases when startups have achieved accelerated growth with fundraising. The decision to go in for fundraising/bootstrapping would depend on the following points:

- The uniqueness of the product
- Maturity of the market
- Pace of growth
- Length of the opportunity window
- Types of growth challenges and limitations.



### Stages of Venture Capital

Stage	Business Activity	Funding Sources
<b>Pre-Seed</b>	<ul style="list-style-type: none"> <li>Developing a business concept</li> <li>Working on any partnership agreements</li> <li>Getting any patents or copyrights</li> <li>Creating a pitch deck</li> </ul>	<ul style="list-style-type: none"> <li>Self, family and friends</li> <li>Micro VCs</li> </ul>
<b>Seed</b>	<ul style="list-style-type: none"> <li>Creating a product or prototype</li> <li>Getting business running</li> <li>Fundraising</li> </ul>	<ul style="list-style-type: none"> <li>Self, family and friends</li> <li>Angel investors</li> <li>Early VCs</li> </ul>
<b>Series A</b>	<ul style="list-style-type: none"> <li>Researching industry and markets</li> <li>Writing a business plan</li> <li>Marketing and advertising</li> <li>Generating revenue</li> <li>Planning to scale into new markets</li> </ul>	<ul style="list-style-type: none"> <li>Accelerators</li> <li>Super angel investors</li> <li>Venture capitalists</li> </ul>
<b>Series B</b>	<ul style="list-style-type: none"> <li>Expanding consumer interest</li> <li>Establishing a commercially viable product or service</li> <li>Scaling production, marketing and sales</li> </ul>	<ul style="list-style-type: none"> <li>Venture capitalists</li> <li>Late-stage venture capitalists</li> </ul>
<b>Series C &amp; beyond</b>	<ul style="list-style-type: none"> <li>Building new products and markets</li> <li>Establishing a strong customer base</li> <li>Acquiring other companies</li> </ul>	<ul style="list-style-type: none"> <li>Late-stage venture capitalists</li> <li>Private equity firms</li> <li>Hedge funds</li> <li>Banks</li> </ul>
<b>Mezzanine</b>	<ul style="list-style-type: none"> <li>Being acquired by another company or SPAC</li> <li>Remaining private using VC funds to grow</li> <li>Making an initial public offering</li> </ul>	<ul style="list-style-type: none"> <li>Private equity firms</li> <li>Hedge funds</li> </ul>
<b>Exit</b>	<ul style="list-style-type: none"> <li>Making an initial public offering</li> </ul>	<ul style="list-style-type: none"> <li>Sale</li> <li>VCs</li> <li>SPAC</li> <li>Public stock</li> </ul>

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Figure 5: Different stages of funding for a startup

Source: Google Image

#### 4. Results of primary research conducted with respect to feedback on a layman’s idea of unicorns

The research paper attempted to use primary data to understand what a layperson thinks of a unicorn. To try and achieve some relevant analysis, a questionnaire was developed and shared amongst 50 respondents. The results indicated that the majority of them had heard of startups.

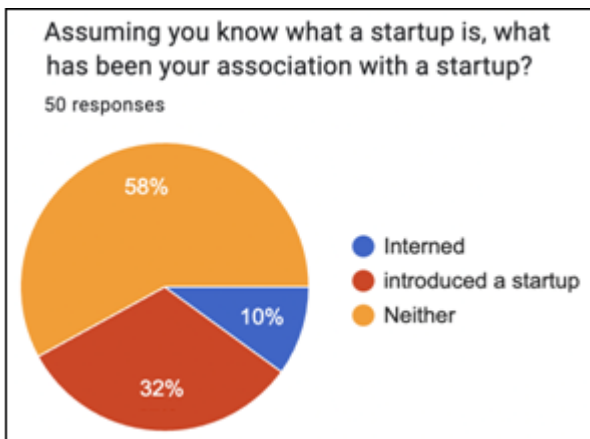


Figure 6: Association of the respondents with a startup  
Source: Own Source

As a response to what is the fundamental role in these types of setups, the main responses seem to be communication, supportiveness, leadership, creativity, and vision.

A majority of them were completely working under rules and were complying according to data protection laws as well as respecting consumer secrecy.

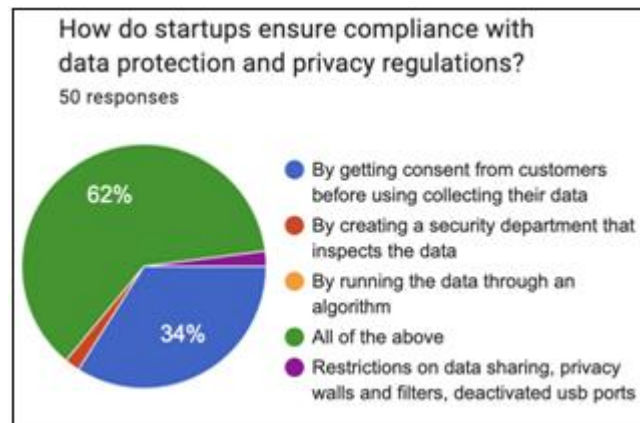


Figure 7: Compliance of startups with regulatory mechanisms

Source: Own Source

As some of the respondents were involved in startups, there were a large number who were not part of this ecosystem.

The ones that were, were concerned with several social issues with respect to women, children, and health, and some were related to sports and improving India’s image in the world.

The education sector seems to have developed at an extremely fast pace during the pandemic in India, examples being Byju’s and Unacademy in this sector, and Cred in the fintech sector.

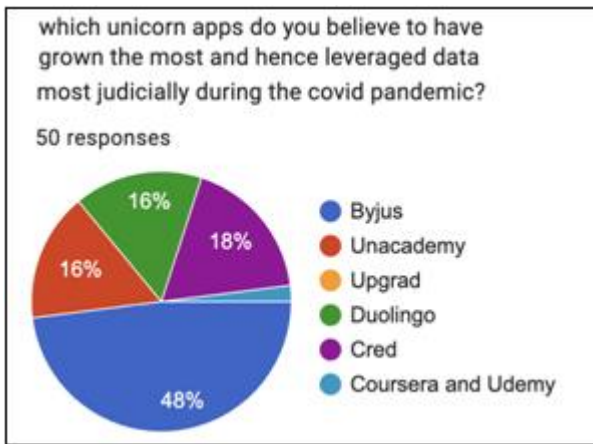


Figure 8: Judicious use of data by Unicorns during the pandemic

Source: Own Source

The reason for their rapid growth appears to be the large amount of money that these startups spent on advertisement. Most of the survey respondents are under the impression that these startups are making substantial profit and they base their assessment on their balance sheets.

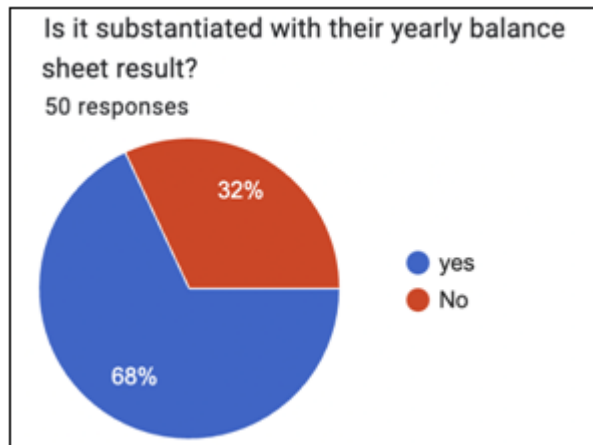


Figure 9: Substantiated results according to the companies' balance sheet

Source: Own Source

A number of the respondents felt that data leveraging may be an answer to increase startups' profits.

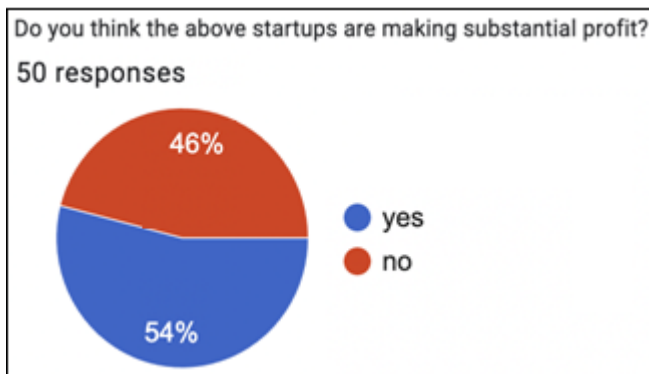


Figure 10: Extent of profit believed to have been generated by startups

Source: Own Source

They felt that personalized interaction with consumers and visibility on social media would increase their efficiency.



Figure 11: Indications of efficient factors responsible for leveraging data

Source: Own Source

In response to what advice they would give to new startups, the responses were varied. There were not a few common suggestions. The advice varied from the cost factors, use of data, the timing of the startup, and importance of consumer privacy.

The importance of data analysis did come up positively with response to marketing strategies, identifying areas for improvement, as well as developing new products and services.

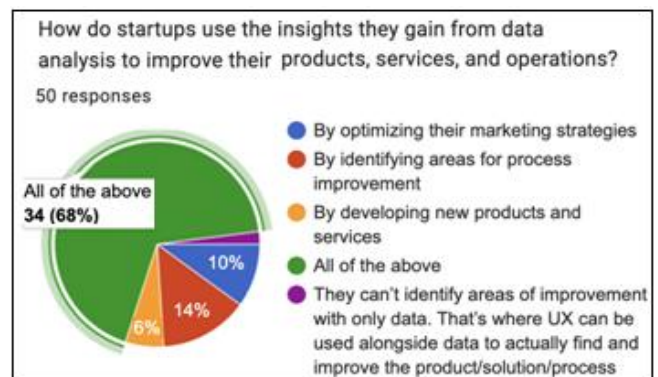


Figure 12: Using data judiciously by the startups.

Source: Own Source

When asked about whether data leveraging would play an important role in a startup, the answers did not point to any one factor. Many respondents thought it would help, while an equal number thought it would be detrimental.

## 5. Conclusion and the Role of Sebi with Respect to Unicorns' IPO

Concluding from the questionnaire, the indications are that the respondents were not too clear on the use of data leveraging as a responsible tool to increase startups' growth. The lacuna of the questionnaire could be:

- The sample size was too small.
- Needed a varied sample of different stages of a startup.
- Different areas in which startups have achieved success. Eg: Pharmaceutical, education, fintech, gaming, etc.

- With respect to the background of existing unicorns in India, the fact that the economy has reached the 3<sup>rd</sup> highest numbers in recent years points to the Indian ecosystem encouraging their growth. Besides the ecosystem, it was the timing with respect to the pandemic which further gave positive thrust to certain areas which flourished due to 'the lockdown' situation.
- A number of these unicorns have attempted to enter the IPO market. The reasons are:
- They require more funds than they have for expansion.
- The seed investors want to exit from these companies and thus want to dilute their stake or give it up altogether. These are those unicorns where outside investment is an important part of the ownership pattern.
- In the case of 'bootstrap' companies, as they do not follow any dictates by investors, they are able to take a call as to when they would like to enter the IPO market. These companies are profit-making companies.

The SEBI, which is a watchdog for the stock index, realized that in recent times the valuation of these unicorns at the time of IPO was extremely high. The moment these companies were listed, besides a few whose share prices spurted in a few days after listing, most of the others opened at lower than the IPO price. Even the ones which had shown an increase in the short time did go back to below-par value subsequently. This raised the question of the valuation of these companies and their IPO price. After this experience, SEBI has framed stricter rules with respect to valuation so that the small investor is not cheated. As a result of this, the number of IPOs has reduced drastically, one of the reasons is a change in the calculation of the valuation of the company and another could be that the company thinks it is 'not the right time.'

This type of continuous regulatory monitoring of the situation goes a long way in helping the small investors and safeguarding their investments, indicating that the Government of India is concerned with the small investors' hard-earned earnings.

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Network.

## Appendix

- 1) Assuming you know what a startup is, what has been your association with a startup?
- 2) Working at a startup, what traits would play a fundamental role towards maintaining a healthy work relationship?
- 3) How do startups ensure compliance with data protection and privacy regulations?
- 4) What problem or research question does your startup aim to solve?
- 5) Which Unicorn apps do you believe to have grown the most and hence leveraged data most judiciously during the covid pandemic?
- 6) Do you think the startups are making substantial profits?
- 7) Is it substantiated with their yearly balance sheet results
- 8) How did you know about these startups
- 9) What is the best path that startups can pursue in order to maximize their input through data leveraging?
- 10) While leveraging data, which factor do you believe can prove to be the most efficient?
- 11) What advice would you give to other startups that are on the brink of starting to leverage data?
- 12) How do startups use the insights they gain from data analysis to improve their products, services, and operations?
- 13) How can startups distinguish between whether leveraging data would play a pivotal role towards their growth or a detrimental role leading to their decline?