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Vikarth has over two decades of experience in Business and Intangibles valuations spread across Grant Thornton, India and another big 4 firm. Vikarth joined Grant Thornton in 2004 and was part of the founding team for corporate finance services initially based out of Bangalore. He leads Valuation Services for North India. He specializes in Business and Intangible valuations and support clients from startups to multi-billion-dollar global conglomerates in their strategic objectives for unlocking value or on contentious matters pertaining to, JV or Shareholder disputes/ litigations or for compliance under statutory and financial reporting regulations. He has undertaken valuations for M&As; corporate restructuring; stock options cross border valuation engagements and portfolio of investments for private equity. He has been instrumental in setting up and driving the Global Delivery – Valuations practice for Grant Thornton, India to offer valuations offshoring services to member firms.

As a board member at International Valuation Standards Council (IVSC), he is involved in developing high-quality International Valuation Standards which ensure consistency, transparency and comparability. Professional memberships and certifications include - Registered Valuer with the Insolvency and Bankruptcy Board of India (IBBI), the ICVS (International Association of Certified Valuation Specialists) MRICS (Royal Institution of Chartered Surveyors), CFA Institute, USA and Indian Association of Investment Professionals (IAIP), Masters in Finance – University of Mumbai and Executive MBA, Indian Institute of Management (IIMB).





THE ART AND SCIENCE OF STARTUP VALUATION IN INDIA

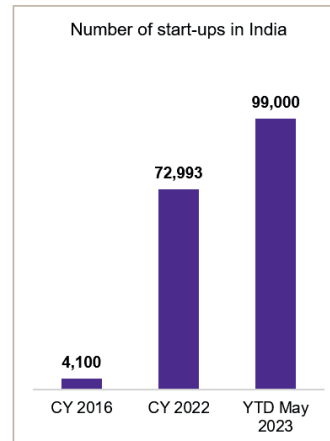
NAVIGATING THE INVESTMENT LANDSCAPE

INTRODUCTION

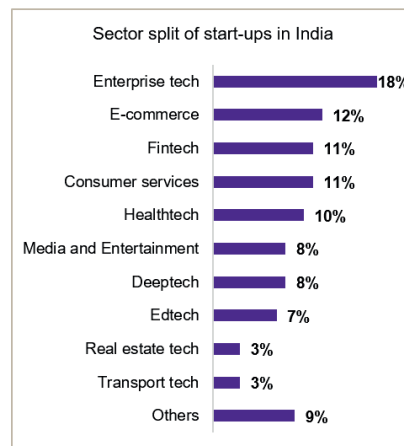
The Indian startup ecosystem has been experiencing a remarkable surge in recent years, attracting global attention and significant investments. As startups continue to disrupt traditional industries and innovate across various sectors, one crucial aspect of their journey is startup valuation. However, the process of valuing these startups remains a complex and often contentious task. Understanding how to accurately value a startup is essential for both founders and investors, as it directly impacts funding, equity distribution, and future growth prospects. In this article, we will explore the art and science of startup valuation in India, shedding light on the key considerations and methods that investors and entrepreneurs must understand in this ever-evolving ecosystem.

UNDERSTANDING THE INDIAN STARTUP ECOSYSTEM

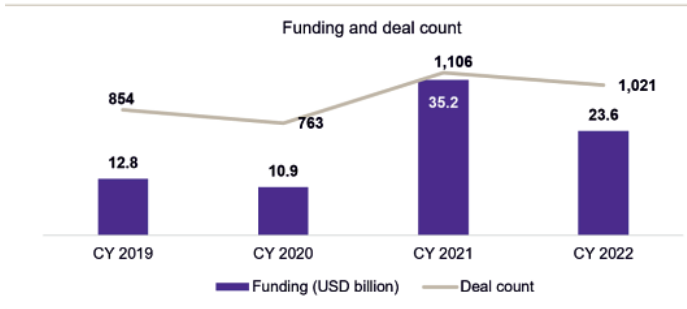
Before diving into startup valuation, it's crucial to understand the context in which startups in India operate. The Indian startup ecosystem has grown rapidly in recent years, driven by factors like government initiatives, a burgeoning middle class, a skilled workforce, and increasing internet penetration. Key sectors such as e-commerce, fintech, edtech, health tech, and mobility have witnessed substantial growth.



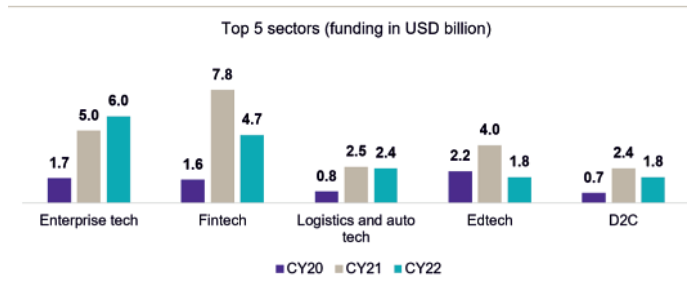
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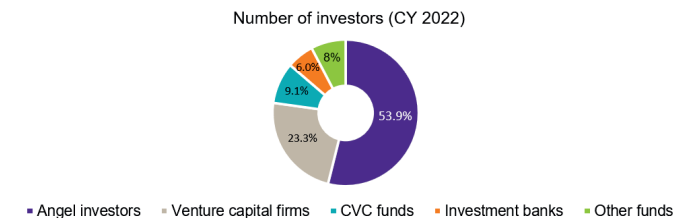
Source: Inc42



Source: Venture Intelligence



Source: Venture Intelligence



Legend: Angel investors, Venture capital firms, CVC funds, Investment banks, Other funds

Source: Venture Intelligence

Investor interest, both domestic and foreign, has poured into India, fueling the growth of startups. This has created a competitive landscape where startups strive to attract capital for scaling their operations. In such a dynamic environment, valuation is a critical determinant for both entrepreneurs and investors.

Major start-up hubs in India



FACTORS INFLUENCING STARTUP VALUATION IN INDIA

1. **Market Potential:** The size and growth potential of the target market significantly impact on a startup's valuation. India's vast and diverse market, coupled with its increasing adoption of technology, offers immense opportunities for startups. Investors keenly assess a startup's ability to tap into this market and its potential to scale.
2. **Revenue Traction:** Startups with a proven revenue model and consistent growth tend to command higher valuations. Investors often look for a clear path to profitability, as demonstrated by increasing sales, customer retention, or monetization strategies.
3. **Team and Expertise:** The quality of the founding

28 yrs.

Avg. age of Indian founders

#20

Bengaluru global start-up rank

~250

Number of incubators

~48%

Start-ups in metros

20%

Women entrepreneurs

Jobs created (2022)

team plays a crucial role in startup valuation. Investors evaluate the team's experience, skills, and their ability to execute the business plan effectively. A strong, visionary team can instill confidence in investors.

4. **Intellectual Property:** Startups with valuable intellectual property, such as patents or proprietary technology, are often considered more valuable. Intellectual property can provide a competitive edge and potential revenue streams.
5. **Competitive Landscape:** The level of competition in the startup's industry and its differentiation strategy influence valuation. A startup with a unique value proposition or a defensible market position may be valued higher.
6. **Traction with Investors:** Building relationships with

reputable investors and securing investments from renowned venture capitalists can boost a startup's valuation. It signals trust and due diligence in the eyes of other potential investors.

7. **Regulatory Environment:** The Indian regulatory landscape can significantly impact startups. Understanding how regulations may evolve and impact a business is crucial. For example, changes in e-commerce rules or data protection regulations or even Angel Tax rules can affect a startup and consequently its valuation.
8. **Economic Cycles:** Like any other country, India experiences economic cycles. These cycles can influence consumer behavior, funding availability, and ultimately a startup's valuation.
9. **Tech Infrastructure:** The state of technology infrastructure in India can be both an advantage and a limitation. Access to technology and the ability to scale digitally can drive higher valuations.
10. **Customer Acquisition Costs:** Understanding the cost of customer acquisition and the lifetime value of a customer is essential. Startups with lower acquisition costs and higher customer retention may be valued more favorably.

VALUATION METHODS FOR INDIAN STARTUPS

Startup valuation in India is often more art than science, given the unique challenges and opportunities in the market. Several methods are commonly used for valuing startups:

1. **Discounted Cash Flow (DCF) Analysis:** DCF analysis involves projecting a startup's future cash flows and discounting them back to the present value. In India, using this method can be

challenging due to the uncertainty and risk associated with startups.

2. **Market Multiples:** Comparing a startup to similar companies who have had recent transactions of investments or acquisitions in the same or similar sector can be a useful approach. However, finding suitable comparable transactions in India can be tricky, as each startup's positioning, business profile, growth trajectory and risk profile may be unique and could differ significantly.
3. **Venture Capital Method:** it is used largely by venture capital funds/early-stage investors for valuing startup ventures. Typically, an investor will either try to obtain a return on his investment commensurate with the risk he perceives in the venture or will seek to monetize his exit at a certain multiple over and above his investment. The method starts by defining the Return on Investment (ROI) on the investment which is generally in the nature of 25-60% because of the high risk inherent in the startup.
4. **First Chicago Method:** First Chicago approach simply does three different projections: Success, Failure and Survival cases and assigns probability estimates to each. This method results in a separate valuation and pricing for each of the three outcomes. The weighted average valuation is determined with weights being the probability assigned to each case.
5. **Risk Factor Summation Method:** This method considers a much wider set of risk factors in arriving at a pre-money valuation giving regard to qualitative factors intrinsic in the start-up. The method starts off by using a pre-determined pre-money valuation number already arrived at for the said startup. Post that there are 12 risk parameters provided to assess the start-up. The parameters are given a range of points from -2 to +2 as shown

below, based on the startup's evaluation of where it stands. The average pre-money valuation is then adjusted by \$250,000 for every "1" point.

6. **Scorecard Valuation Method:** This method involves assigning scores to various aspects of a startup, such as team, technology, market, and competitive positioning. While it provides a structured framework, subjectivity remains in assigning scores. This method gives more weightage to the quality of the startup as of today rather than the uncertain sales that it can generate in the future.
7. **Berkus Method:** The Berkus method is a pre-revenue valuation approach based solely on qualitative methods, much like the Scorecard Valuation Method discussed before. This method is based on five key factors: sound idea, prototype, quality management team, strategic relationships, and product rollout or sales. Each factor has an assigned value, and the total score determines the valuation.
8. **Stage-Based Valuation:** Many investors in India rely on valuing startups based on the stage of development. Seed-stage startups may be valued differently from Series A or Series B stage startups, considering the progress made and associated risks.

CHALLENGES IN VALUING INDIAN STARTUPS

Despite the various methods available, startup valuation remains an art rather than a science. Several challenges complicate the process:

1. **Data Availability:** Indian startups, especially in the early stages, may lack robust financial data. Investors often rely on assumptions and projections, which can introduce significant

uncertainty.

2. **Evolving Business Models:** Many Indian startups operate in sectors with evolving business models. Valuing a startup with a rapidly changing model can be highly speculative.
3. **Regulatory Risks:** Changes in government policies or regulations can swiftly alter the competitive landscape and business environment. Valuation models need to account for these risks.
4. **Market Fragmentation:** The Indian market is highly fragmented, with regional differences that can impact business strategies and valuations.
5. **Access to Capital:** Startups in India often require multiple rounds of funding. The valuation at each stage can be influenced by the availability of capital and investor appetite.
6. **Global Competition:** Indian startups face competition not just from local peers but also from global players. This can influence the perceived valuation of a startup, especially in sectors like e-commerce.
7. **Talent Pool:** The availability of a skilled workforce in India is both an advantage and a challenge. A startup's ability to attract and retain talent can significantly impact its growth and valuation.
8. **Use of Hybrid or Complex Financial Instruments:** Investors often use hybrid or complex financial with complicated terms of conversion or return in order to protect their rights and liquidity preferences. These terms make valuing startups even more a complex exercise and a simple extrapolation of such valuation based on some other round of investment by 3rd party investor without adjusting for rights and preferences held by that 3rd party investor could lead to erroneous valuations for the stake of the investor being valued.

THE ROLE OF INVESTORS IN VALUATION

Investors play a pivotal role in determining a startup's valuation. They bring not only capital but also experience, industry knowledge, and networks. Here's how investors impact the valuation process in India:

1. **Negotiation Power:** Investors with a strong track record or those investing at a later stage have more negotiating power when it comes to valuation.
2. **Due Diligence:** In India, thorough due diligence is essential. Investors scrutinize a startup's financials, legal standing, intellectual property, and potential risks. Any red flag can impact the valuation.
3. **Market Access:** Strategic investors can bring more than just funds; they may offer access to a broader customer base, distribution networks, or international markets, which can influence valuation.
4. **Post-Investment Support:** Investors who provide mentorship, guidance, and operational support can justify higher valuations as they help startups navigate challenges and accelerate growth.
5. **Exit Strategy:** The investor's exit strategy, whether through acquisition, IPO, or secondary sale, can affect the valuation. Startups aligning with an investor's preferred exit strategy may receive more favorable valuations.

Startup valuation in India is not without its risks, and both investors and entrepreneurs should be aware of these:

1. **Overvaluation:** Fueled by the hype surrounding startups, there's a risk of overvaluation.

Overvalued startups may struggle to meet investor expectations, leading to down-rounds or even failure. Often there is a disconnect between "Price" and "Value" of an investment or a startup.

2. **Undervaluation:** Conversely, startups might undervalue themselves, leaving potential money on the table. This can be a concern, especially if they give away a substantial equity stake for minimal funding.
3. **Funding Gaps:** Valuations can be misaligned with a startup's actual financial needs. A startup that overvalues itself might struggle to secure adequate capital to support its growth.
4. **Investor-Founder Misalignment:** A significant divergence between the founder's and investor's expectations can lead to conflicts down the road. Managing these expectations is crucial for long-term success.
5. **Exit Challenges:** High valuations may lead to exit challenges, as potential acquirers or the public markets may not be willing to pay the premium. This can lead to difficulties in realizing returns.

CONCLUSION

Startup valuation in India is a dynamic and evolving field, influenced by a myriad of factors unique to the Indian market. Both investors and entrepreneurs need to tread carefully, balancing optimism with realism. While high valuations are exciting, they must be supported by sound business fundamentals and a clear path to profitability.

Looking ahead, trends such as the rise of deep tech startups, increased government support, and the growth of alternative investment platforms like crowdfunding and angel networks are expected to

influence startup valuations in India. Moreover, as the ecosystem matures, there may be greater emphasis on sustainable business models and social impact, alongside traditional financial metrics.

Successful valuation in the Indian startup ecosystem involves a blend of financial analysis, market understanding, and a deep appreciation of the risks and challenges that Indian startups face. Striking the right balance between growth potential and risk management is key to making informed investment decisions or securing fair valuations as an entrepreneur. However, accurately valuing startups remains a challenge. Founders and investors must work collaboratively to strike a fair balance that aligns with the startup's potential, market conditions, and risk factors. With the right approach, India's startup ecosystem offers boundless opportunities for those who navigate it wisely.

As the Indian startup landscape continues to evolve, understanding the nuances of startup valuation will remain essential for success in this dynamic environment.