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Startup Ecosystem in India

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Why is in news? Why 2023 was a difficult year for Indian start-ups, and why 2024 too looks challenging

If 2021 was the story of India's start-up ecosystem coming into its own and establishing the country as a credible hub for building successful businesses, 2023 was a lot more sobering.

2024 could see founders focus more on essential metrics such as increased profitability and reduced cash burn. But investors believe that the funding ecosystem may not get the same traction as in 2021.

How was 2023 for Indian start-ups?

Indian start-ups raised a total of \$8.3 billion. This is the lowest they have raised since 2016, when there were much fewer of these firms.

Indian start-ups also **saw a decline of 72%** in the compound annual growth rate (CAGR) of funding in the last three years — a signal that the **venture capital-fuelled boom** that followed the Covid-19 pandemic has ended.

In 2022, the country added 23 unicorns, which is the term used to describe private businesses with a valuation of over \$1 billion. In 2023, only two firms could attain that status.

More than 20,000 people working at various start-ups lost their jobs in 2023.

A **report by Nasscom and Zinnov** said tech start-up founders cited cash flow issues, funding availability, and low customer demand as top challenges in 2023.

At the same time, a number of firms cropped up hoping to ride the ongoing generative artificial intelligence (AI) wave — another trend that could see increased traction in 2024 as AI becomes more mainstream.

Impact of the decline in fund raising:

The **older firms struggled more**. The biggest impact of the sharp decline in fundraising in 2023 was **on late-stage investments**, which, according to the Nasscom-Zinnov report, fell to 29% of the 2022 levels.

The decline in late-stage investments is primarily **due to valuation cuts and the shift in the focus of investors** towards profitability. There was also a significant decline in mega deal rounds from 42 in 2022 to 12 in 2023.

As funds struggled and a number of start-ups cut corners on corporate governance, investors became more cautious with their cheques to upcoming businesses. This is crucial because young start-ups depend on initial funding to streamline their processes and to devise go-to-market strategies.

The **Nasscom - Zinnov report** said seed-stage funding struggled in 2023 — Indian start-ups **raised only \$700 million in seed-stage funding** compared to \$1.2 billion in 2022.

Were there any sectors in which start-ups did better?

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Funding in Indian **automotive tech start-ups** grew by **16% in 2023**, resulting in a **4.5X increase in the sector's** share of total funding as compared to 2022, the Nasscom-Zinnov report said.

There was a **57% increase in mega-deal value** in 2023 over 2020, with the deals primarily involving funding raised by **EV manufacturers**.

Start-ups in the **supply chain and logistics sector** also experienced a rise in deal value driven by funding raised by unicorns or almost-unicorns.

Investors are betting on the **growth of the Open Network for Digital Commerce (ONDC) ecosystem**, which they hope will boost the growth of start-ups in the logistics space.

Though 2023 was a difficult year for tech start-ups, these firms increased their focus on business fundamentals, with **nearly 60% of start-up founders reporting an increase in revenue and profitability** in 2023, as per the Nasscom-Zinnov report.

Over 100 generative AI start-ups are now active in India's start-up ecosystem, building horizontal and vertical applications.

How did India compare with the world in the start-up ecosystem?

India was **fourth on the list of countries** where businesses raised money, after the United States (where start-ups scored \$113 billion in 2023), the United Kingdom (\$17 billion), and China (\$9.6 billion), as per a **Tracxn report**.

In 2023, **18 start-ups hit the bourses in India**. On this list were Honana Consumer Limited, the parent company of beauty and wellness brand Mama earth, and drone manufacturer idea Forge.

In the US and China, 34 start-ups each went public in 2023, the Tracxn report said.

About Start Up:

In India, a startup is defined as an entity that is headquartered in India, which was **opened less than 10 years ago**, and has an **annual turnover less than ₹100 crore**.

It is typically characterized by its innovative ideas, products, or services.

Startups often rely on a combination of personal savings, crowdfunding, angel investors, and venture capital to finance their growth.

They are typically funded through bootstrapping, venture capital, or other means.

Bootstrapping: Funding a startup's operations using personal savings, revenue generated by the business, and minimal external investment.

Venture Capital (VC): Funding provided by investors to early-stage startups with high growth potential in exchange for equity or ownership in the company.

Angel Investor: Angel investors are wealthy private investors focused on financing small business ventures in exchange for equity.

Unicorns: Start-ups founded after the year 2000 with a valuation of USD 1 billion.

Overview of India's Startup ecosystem:

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As per the **Startup Ecosystem Report 2023**, in 2021, India minted a **record 36 unicorns** while raising a total of \$72 billion in exits. In 2022, the number of unicorns was down 33 per cent to 24, and exits declined to \$5.5 billion.

The Indian startup ecosystem is **ranked 20th in the world** according to the **Global Startup Ecosystem Index** ranking (Startup Genome, 2021)

Three Indian cities feature in the top 20 city ecosystems of the world— Bengaluru (10th), New Delhi (14th), and Mumbai (16th).

In terms of the number of unicorns (startups with a valuation of \$1 billion or more) produced, **India is the third-largest startup ecosystem in the world** behind China and the United States (US) (Sarkar, 2021).

India has the 3rd largest startup ecosystem in the world; expected to witness YoY growth of a **consistent annual growth of 12-15%**.

India has **about 50,000 startups in India in 2018**; around 8,900 – 9,300 of these are technology led startups 1300 new tech startups were born in 2019 alone implying there are 2-3 tech startups born every day.

Significance of Startups:

Startups have the **potential to generate a substantial number of jobs**, often more than established companies. This is especially significant in developing nations like India, where high unemployment rates are prevalent.

Established companies often outsource certain tasks to startups, allowing them to focus on their core competencies. This **opens up opportunities for investments** into the country.

Startups not only create jobs but also **stimulate economic activity**. As they employ locals and purchase goods and services, money flows into the economy, leading to increased revenue for the government and overall economic growth.

The startup ecosystem **encourages entrepreneurship** and fosters a culture of innovation, contributing to social capital and technological advancements, benefitting the whole economy.

Government Initiatives to strengthen the Startup ecosystem:

Startup India: It was launched in 2016 which intends to catalyze the startup culture and build a strong and inclusive ecosystem for innovation and entrepreneurship.

Faster Exit for Startups: The Government has notified Startups as ‘fast track firms’ enabling them to wind up operations within 90 days vis-a-vis 180 days for other companies.

Startup India Hub: It is one of its kind online platforms for all stakeholders of the entrepreneurial ecosystem in India to discover, connect and engage with each other.

Startup India Seed Fund Scheme (SISFS): The Scheme aims to provide financial assistance to startups for proof of concept, prototype development, product trials, market entry and commercialization.

Credit Guarantee Scheme for Startups (CGSS): CGSS is aimed at providing credit guarantee up to a specified limit against loans extended by Member Institutions (MIs) to finance eligible borrowers viz. DPIIT recognised startups.

Support for Intellectual Property Protection: The Government launched Start-ups Intellectual Property Protection (SIPP) which facilitates the startups to file applications for patents, designs and trademarks through registered facilitators in appropriate IP offices by paying only the statutory fees.

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States' Startup Ranking: The States' Startup Ranking is a yearly capacity building exercise created and released by Department for Promotion of Industry and Internal Trade (DPIIT) that evaluates all of India's states and UTs on their efforts to build an ecosystem conducive to startup growth.

Atal Innovation Mission: Under this mission, the Union Government has set up Atal Incubation Centres (AIC) to incubate startups in various sectors. It has also launched **Atal New India Challenge** that aims to seek, select, support and nurture technology-based innovations.

National Startup Awards: This program recognizes and rewards outstanding start-ups and ecosystem enablers contributing to economic dynamism by stimulating innovation and stimulating competition.

Fund of Funds for Startups (FFS) Scheme: The Union Government has established FFS with a corpus of Rs. 10,000 crores, to meet the funding needs of startups.

International Market Access to Indian Startups: Startup India has launched bridges with over 15 countries that provide a soft-landing platform for startups from the partner nations and aid in promoting cross-collaboration.

Challenges:

Many Indian founders have a **technical background and lack business knowledge**.

Finding the right investor and raising funds is **difficult information gap exists** between those who provide solutions and those who are supposed to use them.

Startups are at a **disadvantage compared to large companies** in terms of market penetration.

The present **regulatory framework** in which startups operate is widely seen as difficult, inefficient and unpredictable.

The **lack of representation of women** in venture capital firms is also a reality in India.

Intellectual property rights enforcement can be complex and time-consuming, which can discourage startups from investing in research and development.

Way Forward:

Policy reforms **improving general economic conditions** as well as **investments in digital and physical infrastructure** can benefit startups.

Indian culture needs to be more encouraging towards people, who take agency and create something on their own. The **willingness to take risks** should be more appreciated and failure seen with less negative judgement.

It shall be imperative to channel investments in education to develop a broader talent pool.

Support must be extended to entrepreneurs in smaller tier 2, 3 and 4 cities.

Fostering a good work culture can be **helpful to attract and retain talent**. This will foster a more inclusive and innovative environment.