



“If the performance of the company is flat, then there is no apparent reason for the valuation to go up. The board, including the VCs, need to justify how the valuations have gone up when the growth prospects have been negative”

SAHIL KANUGA
CO-HEAD, INTERNATIONAL DISPUTE
RESOLUTION & INVESTIGATIONS PRACTICE,
NISHITH DESAI ASSOCIATES

company has turned profitable on an operating basis. However, he did not reveal any numbers.

While surrounded by challenges, and taking various measures to mitigate them, one thing is certain. Start-ups are not giving up the fight just yet. For instance, Gaurav Munjal, Co-founder and CEO of Unacademy, has time and again spoken about how the edtech firm’s senior leadership is taking salary cuts, and they have also cut down on employee costs. All that with a view to turning profitable, a target they expect to achieve soon.

On the other hand, *BT* had earlier reported that Swiggy has closed off all its non-viable businesses in order to cut down expenses. For instance, it had pulled the plug on its pilot programme for premium grocery delivery called Handpicked, which was functional in several parts of Bengaluru. It had also shut down its meat marketplace vertical in January and laid off 380 employees as part of a company-wide restructuring activity in the same month.

Investors, too, have had an epiphany of sorts, and transformed as a result. While initially, their focus on growing the top line was supremely important, conversations are increasingly veering towards balanced growth and profitability now. “Today, investors are placing greater emphasis on finding a balance between growth and profitability when it comes to valuations,” says Lightspeed’s Bhargava. “By considering a broader

set of parameters, including a focus on capital allocation, investors aim to gain a comprehensive understanding of a company’s value proposition and potential for long-term success.”

A top Indian investor who did not wish to be named told *BT* that investors have often been swayed by the charisma of founders. “Investment within the start-up ecosystem was earlier personality-driven. Their start-ups may not have established business models but investors have invested in them because they [the founders] are eloquent and charismatic, invite the top stakeholders for drinks, and organise lavish parties for them. The only chatter during parties is around valuations.”

Investors need to stop getting carried away by the passion of the founders and judge the company by its business model and how it is contributing to the economy, says the investor quoted above.

“I can resonate [with what the investor is saying],” says Singhvi, admitting that he sometimes goes all out when it comes to betting on the founders. “In my eight years of investing, I must have taken a bet on the founders when I know that the business or the plan he is sharing doesn’t make sense. Sometimes founders have proven to be worth the risk, but at other times, they have not.” He adds that while judging the founders now, he has added a few more layers of due diligence, that includes his or her knowledge, attitude, and experience, apart from their passion for their projects. “When things go haywire, your attitude shows a lot about how you handle the situation.”

Kanuga adds that investors, founders, and the board of directors need to come together and handle the crisis at hand. They need to be responsible and make sure that adequate checks and balances are put in place. “If the performance of the company is flat, then there is no apparent reason for the valuation to go up,” he asserts, adding that VCs need to justify how the valuations have gone up when the growth prospects of the company have been negative.

That brings us back to the original question: Is this the end of the era when start-ups were achieving unicorn status almost every other week? “Absolutely not!” says Bhargava. “The era of unicorns is still very much alive; however, the standards for achieving the ‘unicorn’ status may have become more stringent, which in my opinion, is good for the ecosystem.”

Experts believe handling the current crisis with care and foresight can bring the mojo back for start-ups and help strengthen the ecosystem. After all, who doesn’t like a revival story? **BT**

@bhavyakaushal2

much an art as it is a science. “Valuation depends on how we see the future. Many internal and external factors within the company influence it,” says Gaurav V.K. Singhvi, Co-founder and CEO of WeFounder Circle, a community-based investment platform. He adds that many times, with companies that are at an early or growth stage, adequate data may not be available. In such cases, investors often rely on future performance and forecast numbers to arrive at a suitable valuation. There are several methods, a mix of which investors use to determine the value of a company. (See *chart The Valuation Game.*)

Agrees Anuj Bhargava, MD of venture capital firm Lightspeed. He says, the method used by investors also depends on the size and scale at which a company is operating. “The more evolved a company is, the more information you have about its metrics, and you can evaluate the company better.” What makes valuations interesting, and tricky at the same time, is the fact that the concept is extremely subjective. “What may be valuable to one person may not be valuable to another,” says Sahil Kanuga, Co-head of International Dispute Resolution & Investigations Practice at law firm Nishith Desai Associates.

102 |

OVER THE PAST few months, several start-ups have seen their valuations being slashed. For instance, the US-based investment management firm Neuberger Berman marked down the valuations of two of its Indian portfolio companies—Pine Labs and PharmEasy. In its latest regulatory filings, the mutual fund house has reduced the fair values of API Holdings—that operates PharmEasy—and Pine Labs by 21.6 per cent and 39 per cent, respectively, to \$4.3 billion and \$3.1 billion.

Further, investment management firm Invesco also slashed the valuation of Swiggy to \$5.5 billion from \$8 billion in May this year, after it had cut the company’s valuation to \$8 billion from \$10.7 billion in January 2022.

Even travel-tech platform OYO, which has been gearing up for an IPO for some time now, saw its valuation drop to \$2.7 billion—after key investor SoftBank reduced the value of its stake in it—from the initial \$10 billion valuation it had achieved in 2019. Again, there haven’t been any down rounds. But does this mean that start-ups are not living up to investors’ expectations? Partly yes.

Valuations of venture capital (VC) investments are closely tied to the prevailing market dynamics, says Bhargava, whose VC firm Lightspeed is an investor in Oravel Stays—the company that operates OYO. Further, Kanuga says the growth of a company is directly proportional to the increase in its valuation. “There [could be] a time when its performance may not be good,



THE VALUATION GAME

FACTORS THAT CAN RAISE THE VALUATION OF A START-UP

- INVESTORS’ EXIT STRATEGY
- ASSET TYPE
- FUTURE PERFORMANCE
- CASH FLOWS
- FINANCIAL LEVERAGE
- EXPECTED FINANCIAL RETURNS

FACTORS THAT CAN HIT THE VALUATION OF A START-UP

- SECTOR DEMAND
- QUALITY OF STAFF
- CUSTOMER LOYALTY
- ONLINE PRESENCE
- STRENGTH OF BRAND
- SUPPLIERS

SOURCE: DEAL ROOM BY M&A SCIENCE

that’s when the valuation goes down,” he notes.

Experts also point out that valuations are slashed when start-ups find it difficult to raise funds. “Suppose X fund has invested in a company at a valuation of \$100 million but the new investors are not accepting this valuation. The new funds believe the valuation of the company should be no more than \$50 million. In such cases, the existing investors have to go back to the market and say ‘We are valuing the company at \$50 million,’” says Singhvi, adding that VCs also have to inform their LPs or limited partners about the value of their investments.

Of course, such dynamics are bad news for start-ups