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Making sense of the Indian "Unicorns"

- **Dr. Rajnish Karki**[1]

An American venture capitalist coined the term unicorn, not long ago in 2013. The promising start-ups, that will have an estimated valuation in excess of $1 billion on listing in the stock markets, were marked out as unicorns. This was sizeable enough for any new business and a sound endorsement of its success. The term soon gained a life of its own – and became a defining feature of the new venture and private equity investing.

Since India tends to follow and is closely aligned with the American venture capital, unicorns have become a phenomenon here too. There are important differences though, apparent and the real. The rise to a billion dollar value creation in around a decade was conceived as feasible primarily through the disruption of a conventional industry by information technology and its myriad applications. Such IT led start-up disrupters are at play in India too and are commanding over a billion dollar valuations.

Moreover, unlike America where the economy is growing at low real and nominal rates and the product-labour-capital markets are fully catered or at near equilibrium, India provides spaces and opportunities to scale conventionally. Credit Suisse, a brokerage, recently identified 100 unlisted unicorns, of which the disrupters and the conventional enterprises were nearly equal in proportion. Two-thirds of these are under a decade and half old, thus able to set a unicorn-like pace, particularly in the face of global financial crisis and domestic slowdown.

The Indian phenomenon is relatively much bigger than the American, an economy over seven-times in size, where the Economist reported 156 unicorns in April 2019. Domestically, the 100-unicorns with projected $240 billion valuation are already significant in comparison, to India's 338 listed companies having market capitalisation in excess of Rs. 7000 crores. With conceivably much higher

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growth rates, the unicorns could reshape the Indian corporate sector and the economy at large, within a decade.

This game-changing promise, however, needs to be rightly made sense of and calls for careful handling. First, the valuation of an unlisted entity is always a gross estimate and a self-serving number put out by the existing investors. It is based on mostly private information and an outcome of negotiation among investors. A unicorn typically shifts through a few sets of investors and goes through many rounds of investments, in its journey to market listing, and the valuation tends to get hyped at each step.

Leaving apart abject failures, the investors do everything to avoid fall in their enterprise's valuation and the ecosystem of those with stakes around tend to stoke the phenomenon higher and wider. The soaring valuations of unicorns are in the public domain and that the media plays upon. In a sample of dozen prominent and decade-old unicorns across the world, the Economist found eleven had no profits yet and their valuation was five to thirty times the 2018 sales. This is eerily similar to the dotcom boom and bust, a couple of decades ago, and the unicorn can see a similar run and their valuations turn ephemeral.

Second, the unicorns have propagated a long, often unending, investment model. Virtually none of the Indian unicorns, particularly disrupters, are currently profitable or economically viable and in well over a decade. They still need fresh capital to operate, and the strategic sustainability – when a track-record of earning per share will justify their valuation – is nowhere on the horizon. The capital has to be mobilised at increasing valuations, to protect the existing investors, and an ever riskier cycle sets in.

There is little evidence yet of the paying students, market share leave alone profits of Byju in the education sector. In hospitality, there is widespread disquiet among hotel partners of Oyo, as the promised increase in business has generally not materialised. Thus any dislocation in the capital flows or tapering of the investor interest will render them vulnerable, even operationally. Moreover, the unicorns lead a pack of possibly ten-thousand or '100x' similar enterprises in India, claiming valuation in millions of dollars. This is a large ecosystem and it is inherently volatile due to the long investment model.

Third, the unicorns' phenomenon has driven capital investments and entrepreneurship in India, during the past decade. The venture capital with over $200 billion investments during 2010-20, which is more than the entire equity offerings in stock markets, has now emerged as a major if not the leading source of capital for the formation and growth of enterprises. This is a major shift and fills a gap in the Indian economy.

There is palpable spurt in Indian entrepreneurship, and well over a lakh or '1000x' new businesses could have been catalysed by the unicorns. These businesses are formed mostly by professionals. The entrepreneurship has become sought after across and new social classes and has spread geographically, as IT led businesses are generally location agnostic. The venture capital, however, is largely foreign and its drying-up will pose a challenge. This could be taken care of by the entrepreneurial agility and ingenuity and the suitable channelisation of under-deployed domestic capital. The entrepreneurial shift is important enough for any Indian establishment to ignore, and to adequately build upon.

In the 2008 corporate strategy book "*Competing with the Best",* I reckoned the strategic implications of IT on business will be as profound as that on operations. And envisaged redefinition of industry value chains and conceiving of altogether new business and organisation models. The unicorn phenomenon encompasses all of it and on a grand level. However this is not outsourcing alone and cannot be compared with software services on profitability. Their markets are largely within India and will be ultimately supported by the prudently deployed domestic resources. Some Amazons and Facebooks could emerge, but the bulk of them will have to course correct, move away from valuation hype and become real, strategically sustainable businesses soon.

Even if a few of them survive, the unicorns have triggered a new wave of entrepreneurship and investments in India. This will shape the nature of enterprise formation and its growth along the small, medium and large stages, where the linkages have been missing and are much needed. The infusion of world-class technology in small companies, around the core of IT and where India has established advantages, will make for the global play at each stage of enterprise scales ala the German mittelstand. The unintended social and economic consequences of the unicorns, in spite of the dangers of a crash, make them worth its while for India.