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Software Start Up Scenario in India

A Knowledgefaber Article on Software Start Up
Scenario in India

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Knowledgefaber can help you at every step of building and
growing successful software business in India

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In this article the main objective is to understand the ecosystem for software start ups in India:

1. How is the ecosystem for start ups in India?
2. Does India have the right ecosystem for software product companies?
3. How many Indian start-ups have been successful so far?
4. Can India build the next Google or Sales Force or Intuit?

Research Methodology

Knowledgefaber researchers have been tracking Indian start ups across industries like telecom, software, services etc on an ongoing basis

Extensive secondary research including but not limited to company websites, journals, magazines, literature shared by participants, web search, etc. Numerous Interviews (primary research) with key participants from incubation centers, venture capital firms, start ups and other firms like Proto, HeadStart, Silicon India, Nasscom etc who are a part of the Indian start up scenario.

Interviews with experts who have been tracking the Indian start-up scenario

Indian Start-Up Ecosystem

Over the last few years there has been a lot of buzz about evolving ecosystem for start-ups in India. But the big question is has it really evolved? Knowledgefaber has been tracking the start up scenario in India for several years now and we strongly believe Indian start up ecosystem is far from being anywhere close to the ecosystem in US, Europe or even for that matter its Asian counterparts like China. Ecosystem development for start-ups involves two phases. First Phase: The initial phase which lays foundation for a strong industry in the long run with right design, framework, strategy and structure in place. This we believe is largely in place with initiatives from government and private players. Currently there are about 40 incubation centers, over 275 VC's, an estimated 275 angels and about 10 to 12 corporate VC funds operating in India to provide funding support and encourage start ups in India. Every year there are close to two to three start up events where start-ups get a chance to showcase their product capabilities to potential investors and customers. Second Phase: Though India has all the push factors required for innovation but one of the key to building successful product companies **Entrepreneurial Ecosystem** is still missing. Building Entrepreneurial Ecosystem is challenging in India due to lack of funding at the initial stage or seed funding. What we saw in Silicon Valley in late 1960's to the current trend that you see in China today. US Research Triangle Park alone houses 215 companies. Zhongguancun, China's Silicon Valley creates a new company every 4.6 days and is home to a million people. The rate at which new companies are formed in some of the emerging countries is staggering as compared to India. Indian start-up industry is much smaller and this is largely because of the fear of failure, lack of successful customer centric innovation or product capability of Indian start-ups. The Indian startup industry is 1/30th of the size of the US and is following the global recessionary trend of declining capital invested (down almost 30% from 2008 while US is down 50% YOY). In 2008, the amount invested in Indian startups was US\$945million while US startups enjoyed investments of US\$30 billion (30X Indian investments). 13 rounds of investments closed in Q1 2009 in India while in the US 477 rounds closed in the same quarter. The median size of a round in Q1 2009 in India was US\$4.24M while in the US was US\$5.5M. Most start-ups that evolved over last four years have not been able to sustain some have either closed down or got acquired. Till date less than 20 Indian software product companies have gone on to list on Indian stock exchange. These are

clear signs of inherent issues with the entrepreneurial ecosystem which is largely driven by an individual's risk taking capabilities.

Though we do believe that since 2004 it has evolved in terms of visibility for start-ups to showcase their product capabilities, networking platform and activity in the venture capital space. But entrepreneurial & innovation ecosystem leaves a lot to be desired and this is evident from the fact that India has not been able to come up with any breakthrough innovation in the system software space. Most Indian software start-ups are application software or SaaS firms. One of the reasons for this could be the amount of time, money & capability requirement is higher, the success ratio of system software firms is lower compared to application software space. Also there exists a gap in early stage funding ecosystem in India which is restraining increased innovative or risk taking ability of startups in India. Another factor to be considered is that about 90% of the incubation centers in India (About 40 incubation centers) are either academic or government controlled where the time required to get the required capital and infrastructure support for a start up is much higher.

Emergence of VC's, Angel's and corporate VC funds of software firms (Intel, Google etc) led to a boom for start-up industry. Since 2001 number of software start ups has increased enormously to 371 at the end of 2007 to 500 now. Over two-third of these have been formed in the past three or four years. About ~100 companies have started their operations in 2007 alone but this number fell to ~75 in the year 2008 due to global recession and this year we have so far seen ~55 start ups.

However global recession has had a huge impact on start-ups across the world as venture capital firms were cautious while investing in start-ups across the globe and in India as well.

Interesting Facts about VC investment in India (2009)

- The total VC investment in the first nine months of 2009 was \$201 million (across 46 deals) as against the \$709 million (across 124 deals) during the corresponding period in 2008.
- Venture Capital firms invested \$77 million over 17 deals in India during the three months ending September 2009. This was significantly lower compared to the same quarter in 2008 (which had witnessed \$298 million being invested across 55 deals), but higher compared to the immediate previous quarter (\$64 million across 17 deals).
- In Q1 2009, the amount invested in Indian startups was US\$100M down from US\$142M last year
- Of the US\$100M invested in India in Q1 2009, US\$89M was invested in IT companies

Early stage Investment saw biggest drop (90%) in 2008 due to downturn, while the Late stage investment was relatively unaffected. However interestingly early stage investment by VC's in India has gone up. Early-Stage deals (First / Second Round of VC investments into companies that are less than five years old) accounted for 60% of the VC investments (in volume terms) during Q3 '09.

Some of the successful software start-Ups from India include Zoho, DimDim and Tally Solutions etc

Indian Entrepreneur

Our analysis shows that Indian start ups have largely been followers and not innovators. If you carefully look at the Indian start up space over the years you will see that start ups have followed a Herd mentality. This is especially true when a start up gets a substantial funding from VC's. Earliest example of such herd mentality was Shaadi.com

which was followed by a host of many similar matrimonial sites like BharatMatrimony, JeevanSaathi, Badhai, MeraSathi etc. Similar trend was noticed when Info Edge's Naurki.com became hugely popular and successful followed by Timesjobs, Jobsahead, Jobstreet, Shine etc. This trend seems to be continuing with recent examples like mChek, MapmyIndia, MakeMyTrip, Clixflif, Picsquare, Fropper, Guruji and many more who became first companies in their respective domains followed by a host of similar start ups. Though this is a universal phenomenon it is not a good trend for the India as our start up market is not mature enough to accommodate large number of players in these domains. Also herd mentality in India market is driven largely due to funding that the leader gets and not by the innovative product/idea the company comes up with. In the long run leaders (Shaadi & Naukri) become successful as they have a clear vision, technological capability, talent and customer reach. Rest of the players tends to remain in the shadow of leaders and some fail. It is evident from this that Indian entrepreneurs are not creating innovative product companies across different industry verticals but just following the leaders.

Recommendations

Based on current market trends we believe that the following market segments could be hot for start-ups and could generate a lot of interest from VC community.

Mobile Payment Gateways – This segment is gaining a lot of popularity among the VC community especially easy money transfer services over mobile phone would be a big hit in India. A few start ups like Obopay, KushCash and MobileLime have successfully build mobile payment gateways in the US with millions of dollars in funding.

Mass Reach – One of the examples of mass reach was Naukri.com though not high on innovation but it did come as a scalable product with simple UI (User Interface). Very few start ups have been able to replicate similar scalable product capabilities and none have been able to match the success that Naukri.com has achieved. Indian entrepreneurs need to either innovate or target a mass customer segment that they can cater.

SaaS Model – Indian entrepreneurs could also look at better, faster, cheaper innovative SaaS models like Zoho, Vembu and DimDim. These companies have paved way and inspire companies to innovate in SaaS model in many other segments.

Micro-financing – Blow-up of big banks in last few months indicates that a fundamentally new model may be needed and Indian entrepreneurs can aggressively look to tap this huge untapped market opportunity. As per Boston Consulting Group "unbanked" population in China, India and Brazil alone could generate \$85 billion in banking revenue by 2015. May be this is where the next big innovation is likely to come from.

Voice recognition – Mobile voice recognition is a killer application and it is growing at a crazy pace with over 3 billion mobile users currently. Indian start ups like Ubona and Mscriber seems to be cashing on the demand in this space but there seems to be more room for more innovative voice recognition start ups from India.

Mobile ad Networks – Advertising on mobile phones will be a challenge but innovative advertisement model can spell boom in this space. A few companies like mKhoj, dealmaadi and dealaajtak have entered this space. mKhoj has been able to capture the market to some extent.

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