Source : www.thehindu.com Date : 2022-02-25

IS THE NEW ECONOMY CREATING NEW JOBS?

Relevant for: Indian Economy | Topic: Issues Related to Poverty, Inclusion, Employment & Sustainable Development

Varun Alagh, founder, Mamaearth, which became a unicorn this year. | Photo Credit: SOMASHEKARA GRN

India has added over 10 unicorns (privately held startup companies valued at over a billion dollars) so far this year, which is a rate of nearly one every five days. This comes after a record year of new unicorns (44 in 2021),which pushed India up to the third place globally, after the U.S. and China, in the Hurun Global Unicorn Index 2021. But what exactly does a unicorn valuation mean for the larger economy, and how do these technology-driven startups influence the employment scenario in the country? Thillai Rajan, Professor, Department of Management Studies, IIT-M, and co-founder, YNOS Venture Engine, and P.K. Jayadevan, author and former startup founder, discuss this question in a conversation moderated by ***P.J. George****. Edited excerpts*:

Thillai Rajan: I was looking at the unicorns that have emerged from India so far, and the number seems to be 91. The first unicorn emerged in 2011. From 2014, the number started to grow. In 2020, we had 10; and in 2021, there were 44. I'll give another example here: In 1953, two people climbed Mount Everest. Today, we have 500 to 600 every year. Becoming a unicorn is, in some cases, like scaling a summit.

The first unicorn in India was InMobi. It took the company about five years to achieve unicorn status in 2011. The second unicorn was Flipkart. That company also took about four to five years to achieve unicorn status. Hasura, which is the latest unicorn, also took about five years. Hence, the process of becoming a unicorn has not eased. But it [unicorn status] has become a big motivator for entrepreneurs, and it's a summit that they would all like to scale. More and more entrepreneurs are aiming for unicorn status and this is one of the fundamental reasons, from the demand side, for the higher numbers.

Now, look at it from the supply side. Unicorns are essentially venture capitalist-funded companies, which have reached a $1billion valuation. If you look at the growth in venture capitalist funding, between 2011 and 2020, the compounded annual growth rate was 76%. Over 10,000 companies were funded in those 10 years, and people expect this number to grow because of the potential in the economy. The growth might taper off over a period of time, but it is going to be there. A proportion of these companies are going to become unicorns. Hence, when the base is increasing, the number of unicorns is also going to be increasing.

Now, let's look at the environment. January 16 has been named as National Startup Day. If there is national priority in terms of identifying, sustaining, supporting and recognising startups, that is going to lead to an increase in numbers; more unicorns are going to come.

However, the growth rate in the number of unicorns between 2020 and 2021 was in excess of 300% and that is unlikely to be sustained. In the financial markets, everything is in terms of cycles. We had the largest number of IPOs in 2007, that is 108. In 2010, there were 66 and in 2021, 63. In between these years, there were some very deep valleys. The same is going to be the case with unicorns as well.

If you look at the number of industry classes that we have in India, there are about 302 as per company registration. These industry classes represent very strong areas of economic activity. If on an average we take that there is a potential for three unicorns to emerge in each of these industry classes, we are talking about 1,000 unicorns. That is a strong potential for the growth to continue. It may not be the strong growth that we see today, but there will be growth as long as the country's economy is growing and venture capitalist funding is growing.

P.K. Jayadevan: When Professor Rajan was talking about Mount Everest, it reminded me of an example that we used to talk about at Freshworks, the Chennai-based company that went for IPO last year. We kept talking about how Roger Bannister ran the first four-minute mile many years ago and then we saw many more people do it. Now, you have more experienced coaches, and the ecosystem is more supportive. That is pretty much what is happening now in the startup space. Companies that are solving real problems with real customers should be the real winners. As for the unicorn valuations, they are outcomes of bets that venture capitalists submit, and they understand the risks involved. The valuations can go up and down since they have a lot to do with macroeconomic factors, cost of capital, demand, and supply. But fundamentally, good companies are being built out of India, and that's why you will see valuations going up, and when it is north of a billion, we have a unicorn.

I just want to add a few things to what Professor Rajan said. First, India is an open market with a fairly stable democracy, and having startups as a national priority is a big headwind. There are some kinks that need to be ironed out, but the fact remains that it is one of the largest markets in the world. Second, we have great data penetration. The cost of accessing the Internet is very low these days, and the consumer base has become very big. The hope is that someday, all of these consumers will add up to a domestic market, which is big enough for these startups to make windfall returns. It means the startups will essentially tap into that consumer base using digital technologies. Third, we saw some really good IPOs in the last few years. Zomato and Freshworks are great examples. Underlying all these companies is great talent building high-quality technology products that are being adopted by enterprises and consumers. So, a huge amount of venture capital will come into India. In 2006, there were maybe three or four funds, which would hesitantly back some companies after due diligence of six months or eight months. Nowadays, you see cheques being cut over WhatsApp messages.

I'm not an economist, but the view is that there was a little bit of quantitative easing in the U.S. and interest rates have been kept low. Liquidity in the market led to asset price inflation and stocks went up. Even cryptocurrency, a risky asset, went up. As the cost of capital became cheaper, more venture capital happened. 'What do we do with these funds? Hey, here is the great Indian open market with support for startups, and great talent. Let's deploy it here.' In India, I suspect there is a little bit of a race [among venture capitalists] to provide funding for good companies, and that's probably why the valuations are sort of being pushed up.

P.K. Jayadevan: Directionally, it is true that startups have created jobs. Freshworks started with a few dozen employees and by the time it went public, there were 3,000. With that IPO, about 500 people became 'crorepatis'. I personally know of dozens of people who have gone out and started their own companies with team sizes of five to 10. Many of them have enough capital and they understand the market. So, the hope is that they will create high-quality jobs and it will become a virtuous cycle. These are niche, high-paying jobs and in the larger scheme of things, the numbers may not be high. But these are high-quality jobs which have a flywheel effect, which means employees will start their own companies or invest in newer startups and riskier ideas, and make bolder bets on innovation.

The question of mid-level, white collar jobs has been around for a long time. Automation will shift some of these jobs elsewhere, but I wouldn't say it's killing those jobs. In a country like India, which has access to the Internet and the global market, it is a net positive as we can participate in this labour market as it becomes more and more remote.

TR: What is the mandate for startups? It is essentially innovation and growth. Through innovation and growth, they are able to create an impact. To achieve this growth and ability to innovate, startups take the help of technology or people. There are some startups which will really take the help of a lot of people, like food delivery aggregators. There are certain startups where growth will result in substantial job creation. There will also be certain startups which are largely technology-driven, where the employment opportunity might not be very high, but if the startups are going to result in growth, this can, as Jayadevan put it, have a flywheel effect, which can create a lot of employment either directly or indirectly.

But the mandate for startups is not really in terms of creating jobs unlike what the government does or a public sector enterprise does, where job creation is an important metric. For a startup, it is a metric that is useful but it's probably not a target.

Having said that, we also need to see where the requirement is. Job creation is an important requirement for economic growth. Jobs are like a pyramid, which is always broader at the bottom. We need to be creating more jobs at the bottom so that the pyramid is stable. If startups are creating more jobs at the base of the pyramid, they are then catering to the requirement of the hour.

Thillai Rajan: In financial markets, asset prices are very dynamic and sentiments can play a very important role in valuation. When sentiments are good, the valuation seems to be on the higher side. There is a dominant view that asset prices today are inflated, not just for startups but in the overall stock market. I think I would subscribe to this dominant view that the asset prices today do not reflect true values, but then that's the nature of the financial markets.

I think angel investors and high net worth investors looking to invest in startups are very aware of the risks and cycles of the stock markets and these valuations and will be able to bear it. They will understand the risks of these valuations because many of them are knowledgeable investors.

P.K. Jayadevan: I think there is froth in the market. But venture capital is risk capital, and people who allocate a portion of their wealth into venture capital understand the risks well. I think we also underestimate the genius of the markets. They know exactly which companies are just fiction and which companies are actually churning out profits and having good cash flows. Companies that don't have great fundamentals will be weeded out. There are no two ways about it. If there is no path to profitability, if there is no cash flow being generated, then you are looking at companies that have not fundamentally discovered a business model or a problem that they really want to solve, even after being in existence for many years.

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