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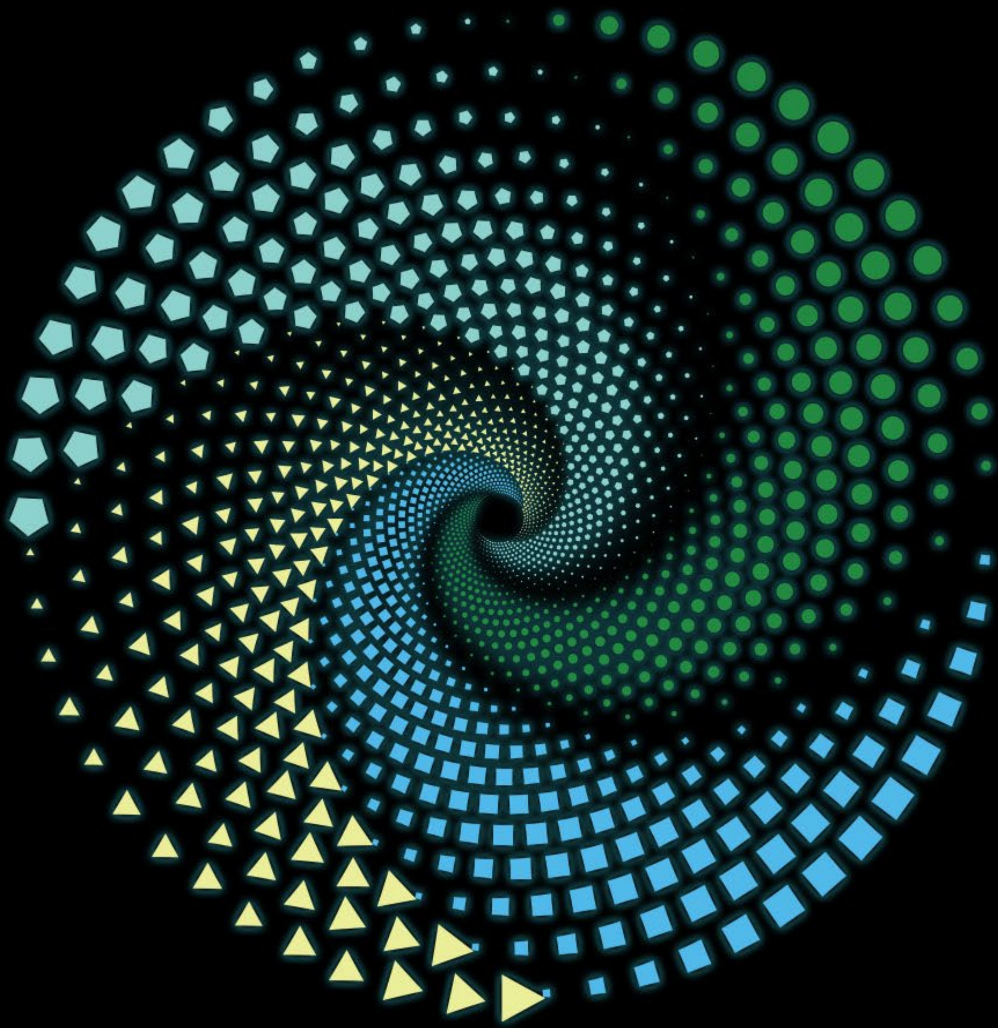

Deloitte Deal Dynamics

Unveiling M&A trends in India's entrepreneurial landscape

August 2024

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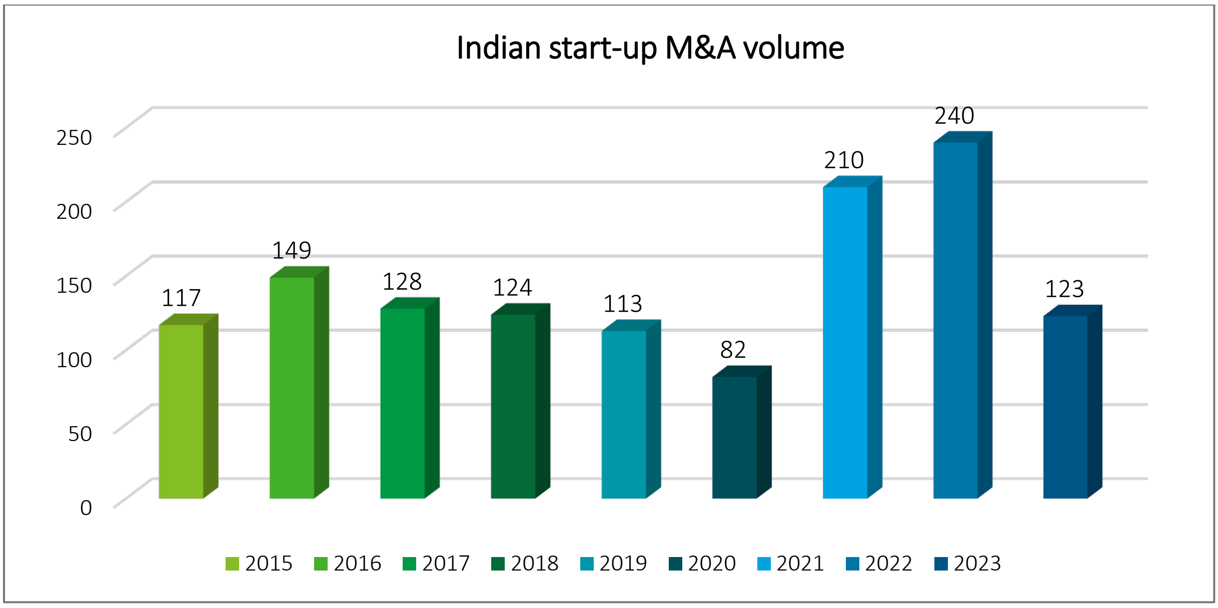
Introduction

Imagine the Indian start-up scene as a constantly evolving chessboard. Here, start-ups use strategic moves, including Mergers and Acquisitions (M&A), to reshape the game. There has been a fascinating shift in M&A deal patterns in recent years. In 2023, a strategic pause was observed due to valuation mismatches, geopolitical uncertainties, financing constraints and regulatory hurdles.

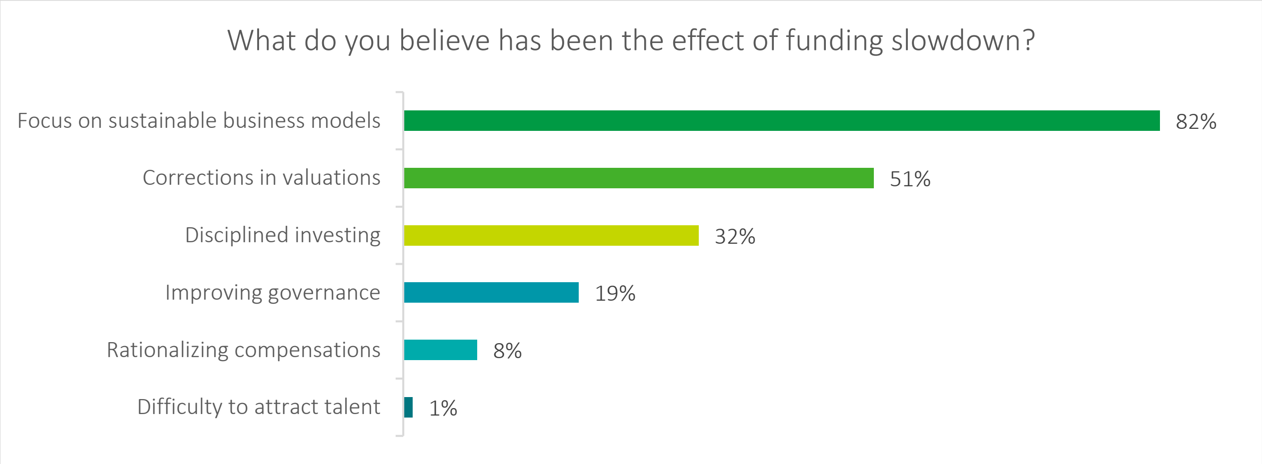


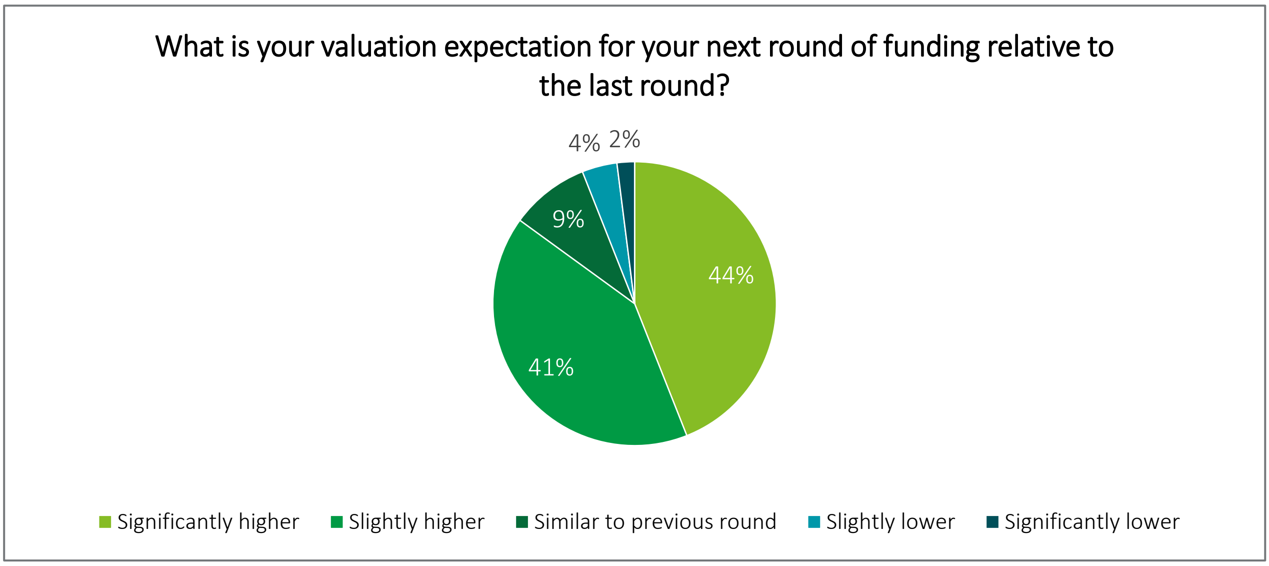
Note: M&A data is for the period between 1 January and 25 December 2023
Source: Inc42

What caused the shift in 2023?

There was a two-thirds drop in funding last year for Indian start-ups, much steeper than the 36 percent drop for the US and 42 percent for Chinese start-ups.[1] In January and February 2024, Indian start-ups raised about US$900 million—a pace that signals another slow year after a six-year low of just US$8 billion in 2023.[1] Start-ups in India secured a mere US$2 billion in funding during Q1 2023. This represents a significant decline of 75 percent compared with the corresponding period in the previous year, marking the lowest quarterly figure in almost three years.[2]

That is a significant drop from the US$36 billion raised in 2021 or even US$24 billion in 2022. In contrast, India's stock market (BSESN) surged 19 percent since the beginning of past year, hitting a record high this month.[1] This increase is spurred by more than 8 percent economic growth. The following infographics highlight the significant drop in start-up valuation.





Source: Innoven Capital

In India, there were sectoral differences in M&A activity. Retail, Fintech and IT were the top-performing sectors. In Q1CY24, two new unicorns emerged, boosting India's tech landscape. Additionally, IPO numbers surged, with 8 tech companies going public, reflecting investor confidence in the sector.[3] Late-stage funding grew 2X in Q4CY23 over Q3CY23 and accounted for more than 70 percent of the overall funding in CY23. Retail-tech, health tech and automotive emerged as the top sectors, accounting for 80 percent of the late-stage funding in CY23.[4]

A combination of factors contributed to a shift in M&A activity in 2023

Strategic investment as a lifeline

Start-ups facing financial challenges actively seek strategic investors to mitigate and reduce risks and build a resilient approach to navigate challenging market conditions. Companies focus on integrating specific capabilities or technologies through smaller deals for quicker talent and technology assimilation. This is essential for staying ahead in a rapidly changing industry.

The risk aversion observed last year was apparent in the average deal size of the top 10 deals, which dropped significantly from US$237.5 million in 2022 to US$26.2 million.[5]

Focus on consolidation strategies

Well-funded start-ups are eyeing smaller businesses with specialised expertise, distinctive offerings and innovative technologies. This strategic move would allow them to rapidly expand and innovate within the start-up ecosystem. Sectors with high cash burn, such as e-commerce, ed-tech, content and media, health tech, B2C lending and fintech payments, are likely to see a surge in M&A activity as these.

Traditional players embrace digital disruption

Earlier, traditional companies refrained from investing in new-age start-ups. However, with the recent drop in valuations, they now view it as an opportunity to embrace digital transformation. This move represents a business diversification strategy and signifies the recognition of the ongoing digital revolution. The constructive interaction between traditional and start-up cultures paves the way for unprecedented collaborations.

Global funds are increasing their presence in India to scout more assets in the IT/IT enabled services segment. In the past 18 months, growth funds, which were more active in the e-commerce and new-tech segments, have started tracking and scouting for opportunities in the IT/ITES segment. These funds are typically looking to invest US$15–40 million in companies specialising in hyper-scalers, data analytics, digital engineering, and ER&D.

Rise in cross-border ventures

Inbound deals from global investors in Indian firms rose 35 percent in 2023, faster than the previous year's growth rate of 25 percent.[6] This growth is spurred by cross-border investments, especially in key sectors, such as fintech, IT services, media and entertainment, and new retail.

The total value held by PE firms in the sector quadrupled from US$13 billion in 2013 to US$55 billion in 2023.[6] Indian IT firms are trading at a premium to their global counterparts for the first time in five years due to their growth performance and potential. Industry executives cite this as one of the reasons for the PE interest.

The 2024 outlook

In the Indian start-up ecosystem, more than 110 unicorns spearheaded over 400 acquisitions between 2014 and 2023.[7] Companies must remember that M&A is more than just transactions. It opens new possibilities for Indian start-ups to create value, achieve sustainable growth and dominate market share. However, companies may want to stay aware as they proceed.

According to a report, 64 percent of investors stated domestic IPOs to be their mode of exit in 2024, whereas only 22 percent said they would take the M&A route.[8] Investor preference for an IPO exit has increased over time due to all-time high benchmark indices (Sensex and Nifty50). Various unicorns have been successfully listed, and many more are anticipated to join the list soon. VCs are readying up their dry powder to make a run at start-ups looking at public listings. Instead of creating unicorns, the focus is on backing start-ups that are closest to offering the best exit opportunities, posing a challenge for M&A activity in the start-up space. Another prominent trend could be reverse flipping or redomiciling Indian start-ups after their headquarters were shifted overseas. This is intrinsically linked to the growing reliance on public markets to raise funds. Several unicorns plan to relocate their headquarters back to India. Many of these are eyeing IPOs in the near future due to the positive signals from the Indian stock exchanges.

Companies with a cash shortage are exploring down rounds that involve raising funding at a lower valuation than the previous funding round. Although India's economy remains robust against geopolitical uncertainties, substantial foreign investments in Indian start-ups have made them vulnerable to macroeconomic shocks.

Regulatory changes may also affect M&A activities. In 2023, the Competition Amendment Act introduced the concept of deal value threshold and expanded the review scope of the Competition Commission of India (CCI).[9] The update requires CCI approval for deals exceeding US$245 million (~INR2,040 crores) to ensure large deals do not have an unfair advantage over smaller companies.[10] This is likely to be detrimental for start-ups as early-stage investors (from tech giants to smaller investors) may have to go through the CCI approval process. This could hinder substantial investments.

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Contributors

Rohit Mahajan
Partner
South Asia One M&A Leader
Deloitte South Asia
rmahajan@deloitte.com

Anil Talreja
Partner
Deloitte India
atalreja@deloitte.com

Deloitte.