Note by EIC

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Stop hesitating: Learn how to invest on startups like a pro

Highlight

- Startups in Asia, particularly in China, are the new investment opportunities that may soon outpace market leaders like those in North America, given the rapid and continued surge in funding they attract. This funding has mostly flowed in Internet and Mobile & Telecommunication startups. However, many of Thai startups are still in the explore stage and encounter ecosystem constraints.
- Although startups can generate tremendous returns for investors when they become successful, only a few of them can become unicorns. Notably, as much as 95% of them fail, mainly because their products and services fail to satisfy market demand, their business models cannot generate sustainable income, or they lack sufficient financial management expertise. Thus, when considering investment in startups, investors ought to examine these potential problems carefully. At the same time, the government should promptly develop a supportive ecosystem by improving regulations and providing incentives for high-potential startup enablers.

Startups in Asia, especially in China, are the new investment opportunities that may soon outpace market leaders like those in North America. Among the key features of startups that distinguish them from SMEs are their high growth and their roles in bringing about disruptive technology. Because of these strengths, during the previous years, startups have been able to attract funding from across the globe. Although in their early stage, these businesses may not yet generate income or sizable profit, but their ideas and potentials to replace traditional businesses already help them attract a tremendous amount of investment. In 2014, 375 billion USD were invested in startups, a 72% increase from the previous year. Then in 2015, the figure reached a record-high 505 billion USD. The sum has clearly skyrocketed from between 2011 and 2013, when investment in startups averaged at 204 billion USD and grew on average by only 9% each year. Also, the size of investment per deal has risen from an average of 6.9 million USD in 2013 to 12.5 million USD in 2015 (Figure 1). Moreover, eventhough more than half of the investment is concentrated in North America, the dominance is declining, from 77% in 2011 to 59% in 2015. Meanwhile, startups in Asia are drawing in significantly larger investment, from around 10% in 2011 to 25% in 2015, suggesting a growing trend of investment in the region. China has been a major beneficiary of such trend, taking in approximately 70% of investment in Asia. Also, the size of investment per deal in China is as high as 80 million USD, or 8 times of other regions. This is thanks to its strengths in the size of market , human resources, and capital.

A massive amount of investment from across the globe is flowing in startups related to internet, mobile and telecommunication businesses, given their high growth potential. Tech startups promise high growth potential, because technology can aid repetition and expansion. They, therefore, attract more than half of total invesment. The majority of tech startups are in internet or mobile and telecommunication businesses. Most popular among investors, internet startups are mostly internet software developers, such as Sprinklr, a provider of social software platforms. Others are internet service providers, such as Dropbox, an online file storage that allows users to access data anywhere with an internet connection. There are also tech startups in E-Commerce, such as Jet.com and Snapdeal, which provide marketplaces where buyers and sellers can transact online. Also gaining popularity among investors, mobile and telecommunication startups saw the fastest investment growth of 57% between 2011 and 2015. They include mobile software startups, such as IronSource that provides platforms and tools for application developers, and mobile services startups, such as Garena that offers several services on mobile platform such as mobile games and chat messenger application (Figure 2).

The growth prospect of startups may seem splendid and appealing, but investors should keep in mind that only a handful of startups will grow to be unicorns. Startups like Airbnb are among only a few highly successful ones considered as unicorns, or companies with more than one billion USD in value. An online platform that connects renters and owners of private accommodations, Airbnb raised 2.3 billion USD in funding, but is currently valued at as high as 25 billion USD. With more than 2 million listed accommodations, it serves over 60 million users worldwide. One of the factors that drive Airbnb's success was the timing of its launch during an economic downturn. At the time, the Sharing Economy business model offered additional income for owners of private accommodations. Moreover, it provides a great variety of alternatives for people looking for places to stay. But unlike Airbnb, a majority of startups have gone bust. According to a study by Shikhar Ghosh of the Harvard Business School, most startups fail once investors pull out their investment. Also, Ghosh found that over 95% of startups are unable to generate returns for investors, and within this group, as much as 30% cause investors to lose all their funds.

However, startups can avoid failure and boost their funding opportunities by developing products that satisfy market needs, building business models that ensure sustainable income, and paying close attention to financial management. The leading cause that jeopardizes startups is the inability to develop products or services that fit the market needs. Take Better Place as an example. A manufacturer of electric car, the company was able to raise 775 million USD of funding, but was eventually forced to shut down because the cars were unpopular. That is, only 1,400 cars were sold, a far cry from the target of 100,000 cars. This was because Better Place cars were not user-friendly and suffered from a number of usage constraints. For example, they can be charged with specific Better Place chargers only. Also, battery replacements can only be done at the battery replacement station. The next factor that causes startups to fail is the lack of business models that ensure sustainable income, leading to liquidity shortage. For instance, daily deal business models of Groupon and Ensogo may not attract customers returning to the shops if they have to pay full price which causes a decline in the number of partner businesses and sales of website. However, the causes of failure can vary from business to business. For example, startups in E-Commerce mainly face problems with liquidity shortage, along with price and cost management. Meanwhile, startups in internet software and services usually lack the business models that generate sustainable growth and income. Also, they are often unable to develop products and services that satisfy market needs.

However, many of Thai startups are still in the explore stage and encounter ecosystem constraints. Investment in startups in Thailand has clearly soared since 2014, when at least 42 million USD was invested, tripling the previous year's amount. In line with the popular global trend, most startups in the country are in the internet business, leading by E-Commerce, which accounts for around 22% (Figure 4) as easily entry a market causing to become highly competitive market with numerous international competitors. Nevertheless, a large share of firms are still in the explore stage, or the so-called "seeds", with merely the founders and his ideas or prototypes. They often receive financial supports from Angels or venture capitals that allow them to advance their business models and products (Figure 5). If they cannot come up with the right products for the market, investors may pull out of the project, resulting in financial liquidity problem that can ultimately force the firms out of business. Furthermore, Thailand lacks an ecosystem that supports startups. The law and regulations are unconducive to investment, and incompatible with the new forms of businesses. For instance, taxes are higher than in other countries, and the existing regulations are problematic for startup operations, as in the cases of Airbnb and Uber. Also, there are not enough qualified mentors and accelerators who can support new startups. This can be an important disadvantage, since business know-hows are as crucial as great ideas for startup success.

Implication

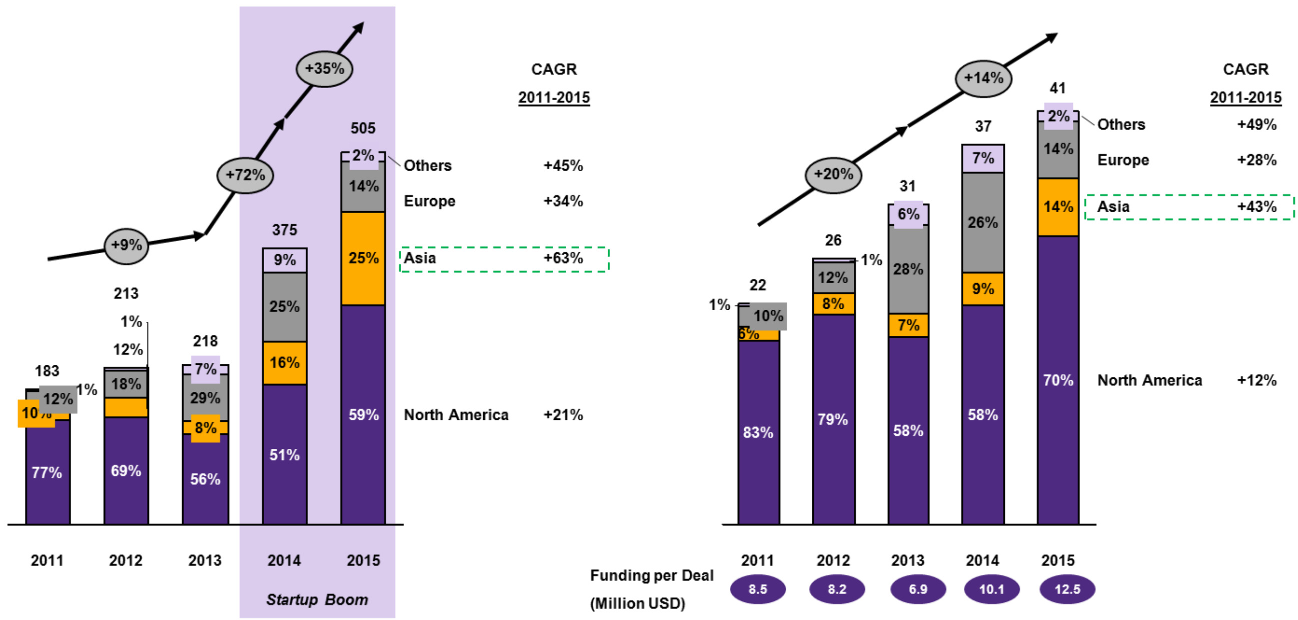
- Investors should diversify their investment to various types of startups. Because not many startups will ultimately become successful, but ones that do will offer huge returns, a diversified and broad portfolio will help both to increase the chance of returns and to diversify risks. Furthermore, investors should carefully examine market demand for startup products, for it is a key determinant of the venture's growth.

- The government should prioritize and step up their support for startups, by creating an ecosystem conducive to startup growth, including improved regulations and incentives to attract qualified mentors and investors. Because most startups involve technology and innovations that can be scaled to the global level, foreign startups will increasingly enter into the Thai market to compete with Thai startups and conventional businesses. The government, therefore, should focus on fixing regulations, such as by making them more accommodative of startup businesses. Moreover, high-quality mentors and investors can be attracted by providing tax incentives and setting up startup incubators.

Figure 1: Investment in startups has grown rapidly, especially in Asia

Size of funding and number of deals by region (2011-2015)

Unit: Billion USD, thousand deals

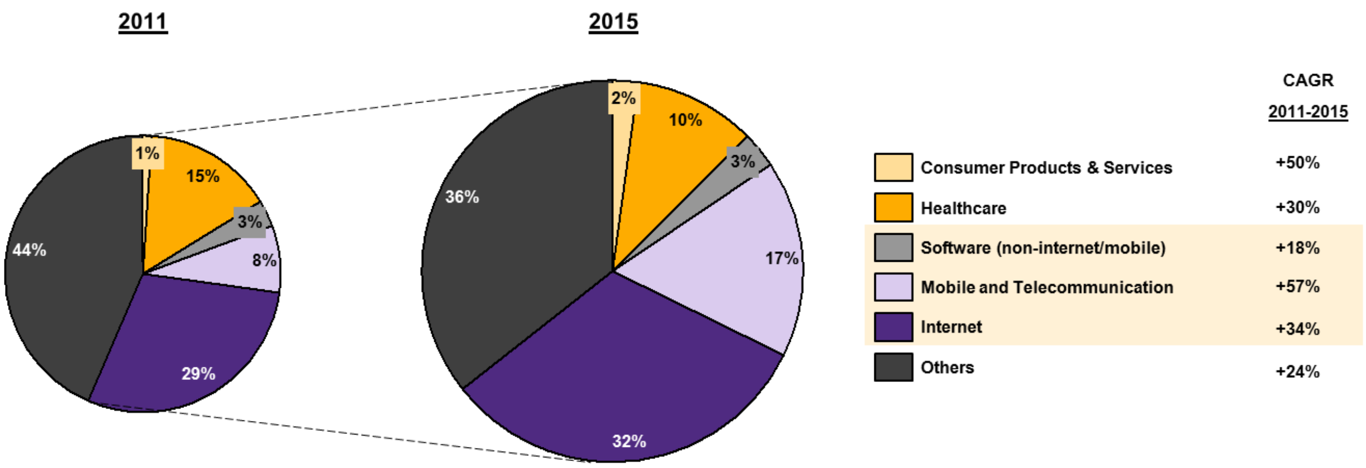


Source: EIC analysis based on data from CB insights

Figure 2: Internet startups in E-Commerce and internet software and services receive the highest share of funding, whereas mobile and telecommunication startups saw the highest funding growth

Size of funding by business types (2011, 2015)

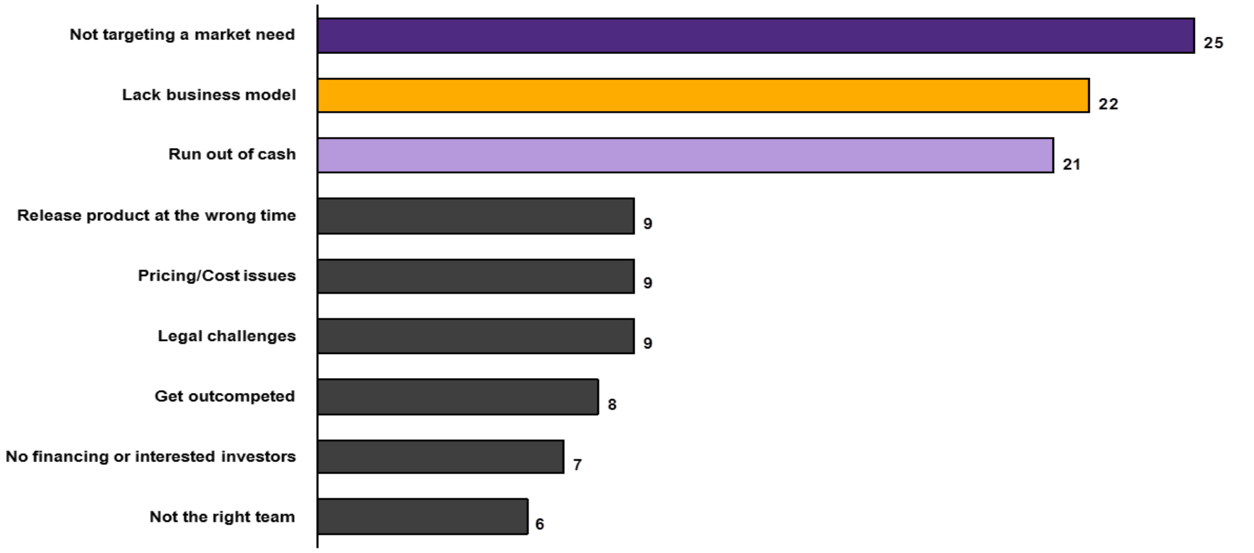
Unit: %



Source: EIC analysis based on data from CB insights

Figure 3: Leading causes of startup failures

Unit: %

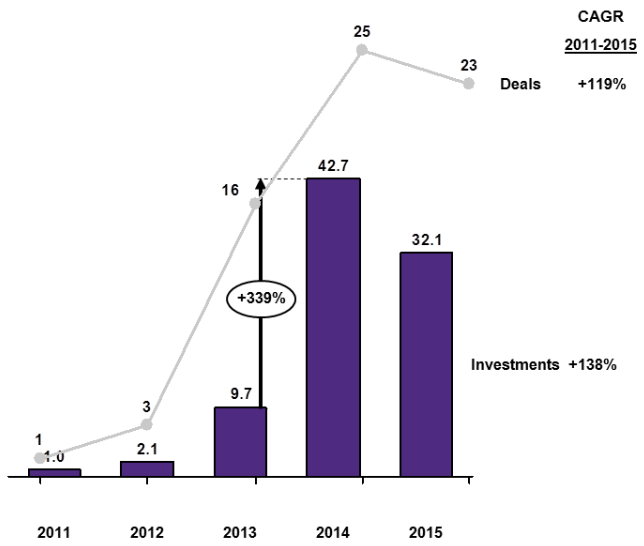


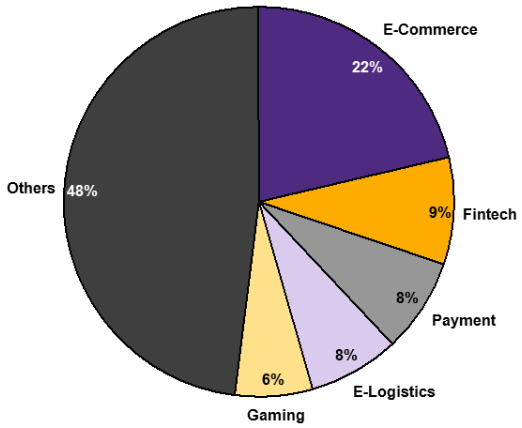
Source: EIC analysis based on data from 103 startups.

Figure 4: Investment in Thai startups, most of which are in E-Commerce, has accelerated clearly in 2014

Size of funding, number of deals in Thailand, and number of deals by business types (2011-2015)

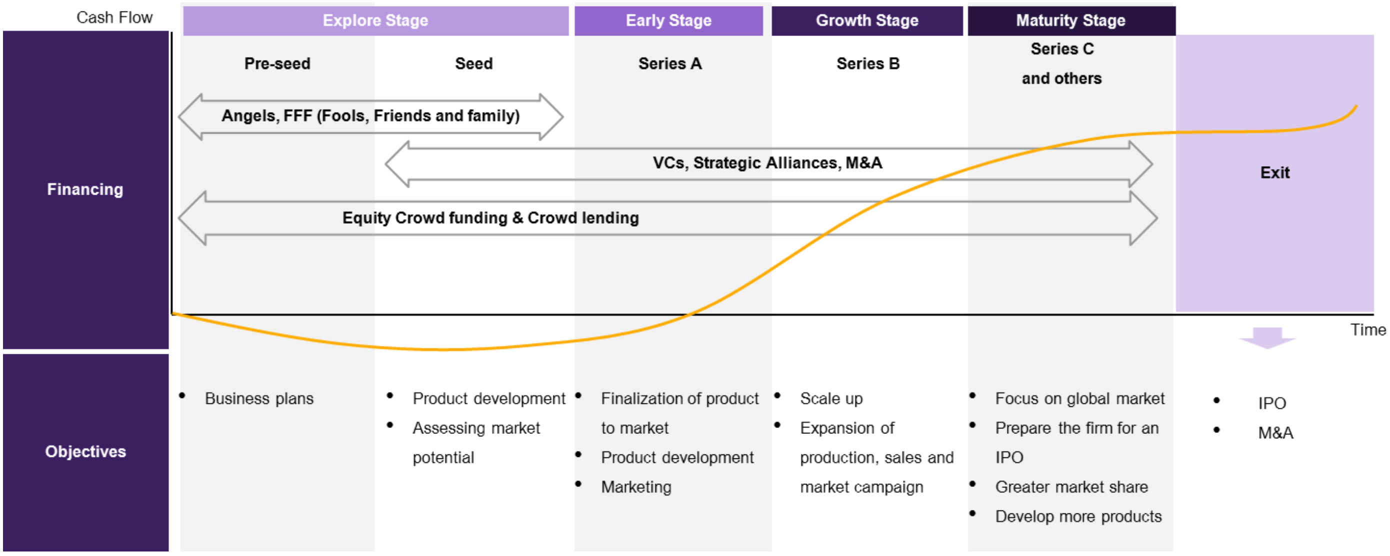
Unit: Billion USD, %





Source: EIC analysis based on data from Techsauce

Figure 5: Startup stage can be classified by objectives



Source: EIC analysis based on data from startupxplore and CB Insights

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