



RISK ADVISORY UPDATE

RISK MANAGEMENT IN START-UPS

START-UPS & THEIR RISKS

Startups are the brainchild of creative and ambitious entrepreneurs whose innovative ideas translate into new products and services.

The concept of startup primarily originated from semi-conductor producing technology companies situated in the Silicon Valley. Post the Dotcom boom of late 1990s, people realized that technology and internet will reach unimaginable heights and as result technology startups like Microsoft, Google, Amazon, etc., rose substantially. Ever since there has been continuous multiplication of startups in diverse sectors.

India and Indians are significant contributors to the global economy. With a sizeable young population and supportive government policies, India has had and continues to have a leading run in the Startup arena.

Startups are appealing when one comes across success stories but in reality, not all startups are successful. Startups of all types are vulnerable to a number of risks and have to operate in a highly competitive and uncertain environment.

While risk taking is an inevitable part of an entrepreneur's journey but a smart business person will adopt solutions in advance for those risks which are not worth taking. **Weighing the outcomes, having awareness and managing the risks timely, will help take the Startup journey towards success.**

Risk management helps you identify and address the risks approaching your Startup and in doing so increases your success likelihood by manifold. Hence, **Risk management should be the central piece of the strategy of every Startup/New venture.**

INSIGHTS

ABOUT 90% OF STARTUPS FAIL WITHIN 5 YEARS OF INCEPTION.

-CB INSIGHTS

INDIA STANDS AT THE **THIRD** PLACE FOR HAVING THE LARGEST NUMBER OF TECH START-UPS IN THE WORLD.

THE INDUSTRIES WHICH WITNESS THE MOST NUMBER OF START-UPS ARE THE FINANCE INDUSTRY, INSURANCE AND REAL ESTATE.

THE **TIME OF YEAR** YOU PITCH, THE DETAILEDNESS OF **YOUR DATA**, AND THE **VALUE OF YOUR PITCH DECK** ARE A FEW OF THE STRONGEST FACTORS AFFECTING THE AMOUNT OF FUNDING A BUSINESS RECEIVES.

-FORBES

VARIOUS TYPES OF RISKS FACED BY START-UPS

PRODUCT RISK:

Finding your product-market fit is challenging. Startups gather a lot of intelligence, test several products but they face difficulty in translating that intelligence into a scalable market opportunity — forever being stuck in a consulting model.

You've got to focus on these critical parameters of the business you're trying to build:

- Your customers' need
- Translating needs into tangible solution
- The Product market fit
- Start small, validate and prepare to pivot
- Using lean approach

FINANCE & MARKET RISK:

Domestic and international funds have had trouble raising capital, with investors rethinking financing commitments due to concerns about high valuations, lack of profitability and increasingly demanding stricter investing discipline.

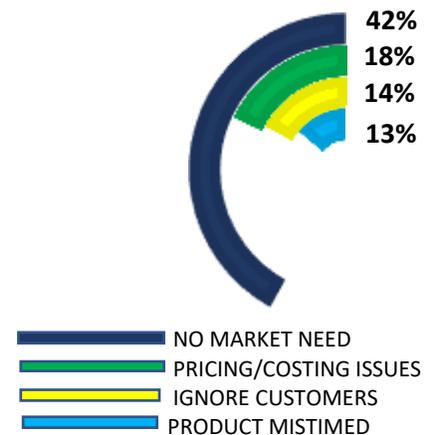
Key financial & Market risks faced by a Startup are:

- Running out of cash
- High cash burn out
- High valuation
- Lack of profitability

Financial risk can be managed by following ways:

- Focus on long term viability with profitability
- Reducing & outsourcing non-core business expenses
- Evaluate cash burnout rate
- Planning of Funds within response time
- Proper valuation & exit strategy

STARTUP FAILURE DUE TO PRODUCT RISK



SOURCE: FORBES

Ola, Unacademy, Meesho, Cars24, MFine, and Vedantu are some of the most well-funded digital startups, have resorted to layoffs to get through the funding crunch, which is expected to endure through 2022. **[Source: Business Insider]**

SoftBank-backed payments app Paytm crashed 27% at its debut, triggering criticism it had overvalued the company without prioritising profitability. Paytm has plummeted a further 62% since. Indian food delivery firm Zomato and beauty retailer Nykaa had blockbuster listings, their shares are down 45% and 38% from their peaks, respectively.

November 23 2021

Social commerce startup Meesho is finalising a financing round of nearly \$1 billion that may take its valuation to \$8 billion.

[source:TOI]

June 2 2022

The SoftBank-backed company is targeting to cut its monthly cash burn to \$25 million from about \$40 million. Its new policies come at a time when Meesho has put its fundraising plans on hold over a valuation mismatch after setting out to raise at least \$500 million.

[source:Economic Times]

PEOPLE RISK:

People are the most crucial and least predictable element of any business. Disagreements over goals and visions, possible employee lawsuits against managers who aren't conducting themselves properly, even the added salaries and distribution of equity can pose a new set of risks.

As per CB insight research, **Startup failure due to People risk is 23%**.

This includes both Founders and Performers.

People risk can be managed by:

- Clear contractual deals with co-founders
- Choosing co-founders with skills complementary to your own
- Training employees to overcome skill gap
- Implement appropriate incentives & retention strategy

COMPETITION RISK:

According to CB Insights, competition is the fourth most common reason for the failure of a startup. **Competition was the main cause of failure for 19 out of 101 analyzed startups in their dataset.**

The interesting contradiction is that for new and innovative Startup ideas, a total lack of competition might be a bad sign because it could be an indicator of lack of market need, which as mentioned is a significantly bigger danger.

Competition risk can be managed by:

- Creating unique high-quality product
- Considering competitive advantages (SWOT analysis)
- Registration of Intellectual property rights
- Strategy for Agility to pivot

PEOPLE & LEGAL RISK

Facebook paid up to \$65m to founder Mark Zuckerberg's ex-classmates .



Facebook paid up to \$65m - \$20m cash and a 1.25m shares – to end a lawsuit in which Mark Zuckerberg, now its chief executive, was accused of stealing the idea for the social networking site from a company called ConnectU. **[SOURCE:THE GURADIAN]**

LEGAL RISK:

In the Startup journey, Entrepreneurs must look into the legal risks that may pose some threat to company issues. The commonly faced legal risks are:

- Complication in Incorporation documentation, Taxation etc.
- Disputes arising from poorly structured contracts
- Lawsuits filed by a competitor alleging misuse of trade secrets

Legal risks can be managed by:

- Constructing a legal risk framework and process.
- Insurance
- Smart contracts
- Regulatory review
- Knowing the law

The above risks are major risks that a startup faces but the list is not exhaustive. There are variety of other risks too like Country risk, Technology risk, Environmental risk, Reputation risk etc. that may be faced by Startups.

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