NATC IPOs - A Boon or A Bane?

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'New age technology companies' (NATC) - within its name itself lies a herald to a future that is characterized by a transformative way of thinking, an environment that fosters creativity and innovation, and a key foundation for the global ecosystem.

At the time of the (dot).com era, there was a flurry of internet-based companies and a significant change in the marketplace. Life's changed. Value creation took a new meaning. Many companies were formed, many rode the tide, and leaders emerged. Born out of the dot com era, some companies like Google, Amazon and Salesforce changed the status quo of global markets to become multi-billion dollar and trillion dollar companies, thus establishing themselves as global market leaders.

Standing as a testament to this is the evolving presence of NATCs in the Dow Jones Industrial average (or simply, the Dow), an index of 30 prominent companies listed on stock exchanges in the United States. In the past 60 years, NATCs have seen consistent growth in their inclusion in the index from accounting for 0% of the index in 1959 to 10% in 1982, to 16.67% in 2003 and 20% in 2022. This trend clearly places NATCs at a prominent place as the global economy develops.

The growth of this market sector is ever more crucial for a country like India which is taking rapid strides towards a developed and self-sufficient economy by creating employment opportunities and a wider social impact. While India has just taken a step into this market, the global economy has already seen the rise of NATCs and the enormous benefits that they bring with them.

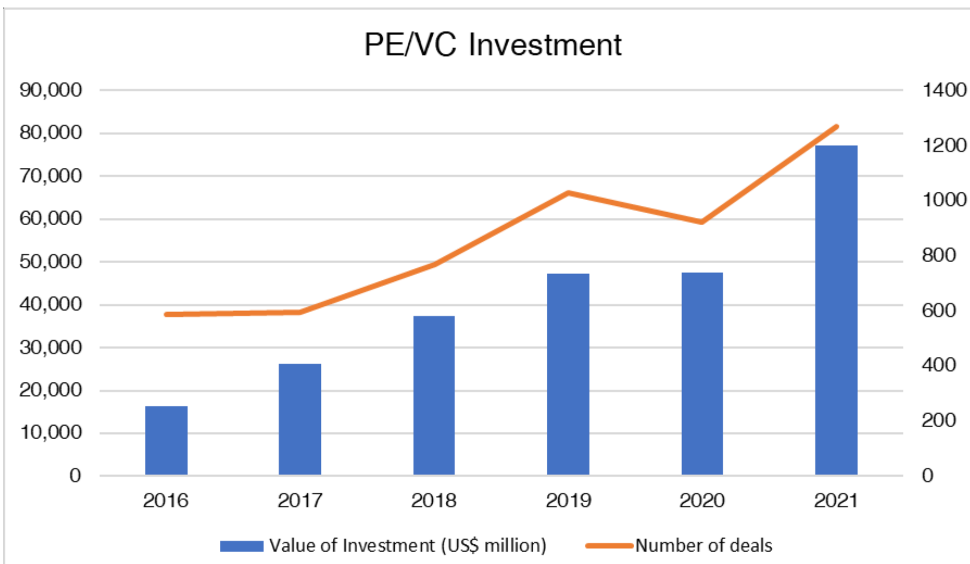

Figure: Total PE/VC investments in India (source: EY PE/VC trends report 2022, VCCEdge, Dealogic)

India's growth in terms of PE/VC investments has been significant over the past several years. As the chart above depicts, the Indian economy has largely seen a positive trend in the growth of investments over the past 5 years. Indian PE/VC investments in 2021 (dominated by start-up investing) closed at an all-time high of US$77.1 billion (62% increase y-o-y). This decade saw PE/VC investments grow at a CAGR of 19% from a base of US$ 8.4 billion in 2010 to US$ 47.6 billion in 2020. The number of deals almost doubled from nearly 600 deals in 2016 to over 1200 deals in 2021. Of the $77.1 billion, technology and e-commerce companies accounted for over 40% of total PE/VC investments by value.

Observing a similar trend, NATCs, in India, with consumer-centric user interfaces, like Delhivery, Zomato, Nykaa (FSN E-Commerce), and PayTM, to name a few, have garnered immense public attention, for varied reasons. The Indian IPO Market in 2021 saw significant activity by such NATCs, accounting for more than 1/3rd of the IPO proceeds in the Indian IPO Market. This is evidence of the large scale of this industry and its high growth potential.

As there are lot of positives emerging out of the start up ecosystem, companies need to carefully evaluate several emerging threats as well to ensure that it's a long term impact which is being considered as opposed to the short term successes which may be measured in terms of unsustainable runaway valuations. Some of the considerations as outlined below are relevant in assessing whether NATC IPO's are a boon or bane?

Boons of the NATC IPOs

Global and Indian opportunities

Many of these NATC companies were rumoured to have engaged in listing overseas. India has risen to become a competitive platform for such companies. Creating employment, attracting talent, obtaining funding, placing India firmly on the global map to innovatively solve problems. Some of these companies may also subsequently list themselves in other exchanges to expand their operations, gain brand recognition and raise further capital.

Consumer-centric value creation

Most of the NATCs that thrive in today's market are consumer centric. The valuation of enablers is higher than those of service providers. For e.g. Airbnb and other technology enabled aggregator platforms are more valuable than some of the largest hotel companies. Innovative platforms have brought ease of doing business, greater connectivity and positively impacted lives. This shows the potential that NATCs have in creating value in the future. The disruptions caused by the technology influenced sector have benefitted businesses/consumers beyond this sector itself, to create value for the whole ecosystem (much of what is not reflected only through IPOs as many companies remain unlisted).

Similarly, green technology is rising to be a prominent industry of its own by using technology to aid in sustainable development and environmental protection. These NATCs use their innovative business models towards achieving the ESG parameters and receive investments from businesses across sectors for the same.

Digital vision - Recognition of unique business models

Due to the innovative business models of these new-age companies, they were able to gain high valuations in the public market. In fact, 6 out of 9 of the companies that went for the IPO in 2021 found themselves being listed at a premium although subsequently, valuations have come under severe pressure. This has laid a foundation to encourage further innovation and domestic recognition, supporting the Digital India programme of the Government of India with a vision to transform India into a digitally empowered society and knowledge economy.

Inspiring a generation

Some of the NATCs find themselves on the Nifty Next 50 index thus making it to the top 50-100 companies listed on the Indian Stock Exchange. While others form a part of the Nifty 200 index or the Nifty 500 index. This clearly sets up the NATCs to be prominent entities. In a country of billion + individuals, some of these companies have created significant employment opportunities and fuelled the desire of the next generation to make an impact.

Attracting capital

Through their novel business models, product offerings and high growth focus, these NATCs attract new foreign and domestic investment in India. This is evidenced by the fact that out of 9 companies, 5 saw QIB subscription rates of above 50 times, 3 companies recorded NII subscription rates above 50 times and 3 companies recorded retail subscription rates above 50 times. This emphasizes the fact that investors viewed NATCs as valuable investment opportunities. Such an outlook surrounding NATC IPOs can further help stimulate the capital markets of India by making India an attractive destination conducive to futuristic companies like NATCs.

Bolster Governance

NATC IPOs have led regulatory authorities to re-evaluate regulations to accommodate the diverse needs of companies and also strengthen and introduce regulatory enhancements to protect investors. For instance, SEBI is currently investigating a more comprehensive inclusion of Key Performance Indicators (KPI) in the DRHP and the possibility of introducing a confidentiality filing option in the IPO process. Both these regulations have significant implications for NATCs due to their loss making and innovative business models while also having wider implications on traditional companies, thus transforming the capital markets process as a whole.

Banes of NATC IPOs

Race to the IPO

Being in a highly competitive industry, companies are in a race with each other to be the first ones to list themselves in the public market. In the pursuit of this, companies may tend to prioritize revenue over profits which may not only hamper the business model of the company but could also present a negative outlook toward social responsibility. 7 out of 9 new age tech companies saw a substantial fall in their share prices subsequent to listing, impacting investors and savings.

Systematic risk

During good times, with liquidity aflush, it can be argued it was easier to fund NATCs. To meet growth needs, higher wages and costs were incurred, in turn contributing to inflation. As the economy cools, there is a risk of unemployment, negative sentiment toward accepting potentially lower paid positions, or lack of better opportunities exacerbated by geopolitical challenges and high rates of inflation.

Evaluating the success of NATCs

NATCs are not typical, and valuation can be a challenge. During the .com era number of clicks on a website, etc. were some of the ways which led to inflated valuation. While accidents can happen and other methods of valuations emerge, e.g. average order value, etc. evaluating the true potential will take time to evolve, let alone the wider socially and consumer-centric positive impact of many of these companies.

What's the verdict?

The year 2021 saw global PE/VC investments decisively gravitate towards technology led businesses as they are involved in the creation of products and services that are ground-breaking, modern, and unique. The true success of NATCs lies not in the financial numbers but within its product offerings and business model that is focused on creating value on a sustainable basis. There is a lot at stake when a company decides to go public, hence when companies choose to go for an IPO, they must ensure that they have the right maturity – the scale of operations, infrastructure, proper governance and the ability to deploy raised capital efficiently.

Leaders of tomorrow are emerging today. The market ecosystem is continuously evolving, it is up to us, as an economy, to support, nurture and develop these companies while being cognizant of the short-term market volatilities. Even if accidents do happen, and they are meant to, what remains important is how strong the ecosystem is to continue the march ahead. There is a tremendous amount of value creation potential in NATCs and paving the way for them to thrive, thereby providing hosts of new growth opportunities for the economy.