SECTOR BRIEFING

number 12

DBS Asian Insights

DBS Group Research • April 2015

Billion Dollar Babies?

Digital Start-Ups in Singapore: Pros and Cons, Challenges and Strategies

DBS

Billion Dollar Babies?

Digital Start-Ups in Singapore: Pros and Cons, Challenges and Strategies

Sachin Mittal
Telecom, Media and
Technology Analyst
DBS Group Research
sachinmittal@dbs.com

Produced by:
Asian Insights Office
DBS Group Research
asianinsights@dbs.com

DBS

04 Overview
Starting Up in Singapore

07 The Breakthrough
Can Singapore be the Next Silicon Valley?
Advantages of Starting Up in Singapore
Challenges of Starting Up in Singapore
The Verdict

10 Where VCs Expect to See Billion Dollar Businesses Arise
E-Commerce
Transport
Consumer Electronics and Robotics

14 What Metrics Do VCs Look for in a Digital Start-Up?
High User Engagement and Growth
Market Dominator, Category Leader
Potential Exit Opportunities
Space for Number Ones Only

17 Paradigm Shifts: Old Versus New
Vicious Cycle of Investing in Value-for-Money Players
Virtuous Cycle of the Network Effect

Overview

Starting Up in Singapore

What makes a city a great place for digital start-ups?

The research group, Startup Genome, asked this question a few years ago and came up with a set of criteria: start-up output, funding, performance, entrepreneurial mindset, trendsetting, support, talent, and differentiation. It then ranked the world's best "start-up cities".

On top was, unsurprisingly, Silicon Valley, with Tel Aviv and Los Angeles coming next. Out of the 20 cities that made the list, four were in the Asia Pacific: Sydney, Singapore, Melbourne and Bangalore.

Since gaining independence 50 years ago, Singapore has worked hard to become the regional hub for Southeast Asia in all sorts of industries from shipping to banking to aviation to petrochemicals. Now, it is pushing to do the same in the digital space.

A milestone was reached last July when Garena, a Singapore start-up, proudly joined the billion dollar internet club with valuation of US$1.2 billion and a massive user following on its global gaming platform. The city-state seems determined to play mid-wife in the births of many more billion dollar digital businesses. Certainly, its start-up ecosystem has been growing and developing steadily over the past five years. To date, more than 80 Singapore start-ups have reached their first significant round of venture capital funding, known as a Series A round.

A standout example has been MyHero. It raised US$10 million in a Series A round for its stock trading gamification app, "TradeHero", in September 2013. This was one of the largest Series A funding rounds for a consumer start-up in the region. (Typically most companies will only get a Series A funding of around US$3 million to US$7 million.) In November 2014, "Paktor", a mobile dating app, raised an estimated US$3.3 million funding led by Vertex Venture Holdings, a wholly-owned subsidiary of Singapore's state investment firm, Temasek Holdings, which has also financially backed GrabTaxi and Reebonz.

Singapore, though, still has a way to go. It needs to chalk up 150 to 200 Series A rounds to be really globally noticed as a significant digital start-up centre. It knows this and has even set its own target of 300 within the next five years.

"The city-state seems determined to play mid-wife in the births of many more billion dollar digital businesses"

This report will examine among other things the pros and cons of starting up in Singapore, what venture capitalists (VCs) are looking for, and how traditional corporates succeed or fail when they try to buy their way into the digital space. It will also identify three sectors most likely to give rise to local start-ups with billion-dollar potential.

Diagram 1: The key players in Singapore's start-up business ecosystem

Source: DBS Group Research

Why start in Singapore?
Money! That's why!

The Breakthrough

December 2010 marked the start of the rapid development of Singapore's start-up ecosystem, when US-based Groupon acquired a local group buying website called "Beeconomic" for around US$24 million. This was part of a broader Asian push by Groupon, which also bought uBuyiBuy (Hong Kong) and Atlaspost (Taiwan). Beeconomic was set up in May 2010 with a reported start-up capital of US$50,000. This created a real buzz in Singapore with hard evidence that internet companies could indeed be built there.

Can Singapore be the Next Silicon Valley?

In the US, there are 320 million people. By-and-large, they share the same culture, more-or-less speak the same language, and use the same currency. In comparison, Southeast Asia has a larger combined population of around 620 million. But its ten constituent countries contain a wide range of cultural and language diversity. Moreover, its consumer class is much smaller than that of the US. Based on scale and reach, it is difficult to imagine Singapore replicating the success of Silicon Valley as a start-up haven.

But in way that is not the point. Instead the focus should be on what can be done here. In this regard, the challenge for business is to develop an idea and build a model that can scale and grow. An example is Reebonz, an e-commerce luxury retail site that enables users to buy and sell a wide variety of new and pre-owned luxury items. Since starting in 2009, Reebonz has expanded its business operations into 8 different countries with over 300 staff members within the short span of 6 years. The founders of Reebonz started this business based on the sharp understanding of a commonality amongst Asian women, the want to own at least one branded designer bag over their lifetime.

Advantages of Starting Up in Singapore

1 Access to Funding

Why start in Singapore? Money! That's why! Available venture capital in Singapore was estimated at US$24 billion in 2013, although only US$1.7 billion was actually invested, according to the Asian Venture Capital Journal. Singaporean investment in start-ups ranks second in Asia after China. Of course, not all is invested in Singapore companies. For example, Thomas Ng, then a partner at the Singapore government-backed Venture TDF, invested US$5 million in Alibaba's first round of financing in 2000. But nonetheless, if you have a great start-up with a compelling and sustainable business model, there is no lack of funding potential in Singapore.

2 Superior Geographic Location

Singapore is situated in the heart of Southeast Asia. A three or four hour flight can get you to any major cities in the region. Six to seven hours flying will get you to all the other

big cities of Asia. Singapore is considered to be central in the start-up ecosystem of Asia, knitting together the huge markets of China, India and Indonesia along with Malaysia, the Philippines and Thailand. In short, Singapore-based start-ups have a geographical edge when it comes to scaling their businesses.

3 Experience and Capabilities

Singapore has a track record of tech success stories and boasts an impressive network of VCs and founders. In Singapore, there are a lot of mentors, who are willing to work alongside start-ups. They are important angels for start-ups as they are able to help build the connections and give advice based off their prior experience in the sector. Furthermore, Singapore is superior in terms of capabilities, offering a good mix of hardware and software capabilities. China has a big advantage in hardware, but not in software whereas India is a direct opposite. Singapore has access to both, as skilled people from India and China work and live in Singapore, bringing in their network of connections from their respective home countries.

Challenges of Starting Up in Singapore

1 High Costs

A key pushback against the Singapore option is the higher costs.

But these need to be weighed up against Singapore's advantages. If a start-up is not located in a conducive ecosystem, it is unlikely that the business will have good access to required capital. Moreover, despite the increased costs, many investors and VCs prefer to stay in developed countries, due to the many natural benefits that arise from it. Thus, even with the higher initial cost, Singapore is still a prime location with the concentration of resources within its borders.

2 Talent Shortage

There are concerns that Singapore, being a small market, represents only a small talent pool. The Singapore government needs to be very proactive in this regard with the right policies to attract foreign talent and retain local talent. The ultimate aim is to create a brain gain.

The Verdict

In conclusion, Singapore's highly business-friendly policies, such as low tax rates, grants and proactive initiatives in building up Singapore's talent pool, allay such worries. These benefits are rarely available in other start-up ecosystems. Hence, when one looks around

regionally, without a doubt Singapore stands out as the superior place to kick-start your start-up.

Singapore's Biggest Success Story So Far

Last July, Garena, a Singapore start-up, proudly joined the billion dollar internet club, with a valuation of US$1.2 billion. Garena is a five-year-old online gaming platform, with a strong user base of more than 100 million gamers worldwide. It works on a freemium model. It is free to join, but users can also purchase various in-game options, such as cosmetic and costume features for their in-game avatar. Or they can buy items that influence game-play, like weapons and armour. The winning formula for Garena's popularity is its sustainable business model, which is built on a commonality ingrained in Asian gamers. That is, the desire to be recognised in the community and to play with like-minded people.

In a fragmented in-game community, gamers all too often have to operate individually as it is difficult to find other gamers and form teams. However, Garena is a platform that interlocks gaming and social networks. As such, it creates an independent community that connects everyone who plays the game on the Garena platform. This allows gamers to easily join teams, and to create buddy lists for chatting and tracking each other's progress. Gamers scattered across the globe can share the same gaming mentality needed to play together. It is no wonder Garena, a category leader, is a proud member of the billion dollar internet club.

Where VCs Expect to See Billion Dollar Businesses Arise

Some VCs have kindly shared their insights on which digital sectors show the most promise and where start-ups have greatest potential. We have compiled their various insights and consolidated the results into the top three responses.

1 E-Commerce

Why it this space hot? Less than 4% of retail sales in Singapore are made online compared with 10% in China. Of course, this might be due to the many shopping malls in Singapore's heartland communities. And, the absence of a dominant local e-commerce player might also be a contributing factor. Nevertheless, it also suggests there is much untapped potential in Singapore's e-commerce market. There are many proven cases of e-commerce start-up success worldwide – China's Alibaba, India's FlipKart, Japan's Rakuten and Amazon in the US. To succeed, it is critical that entrepreneurs innovate and provide unique customised solutions catered for the consumers' needs, for a model that works in another country might not necessarily work here. Singapore certainly has the ability to serve as an e-commerce hub for Southeast Asia.

Case Study: Reebonz

Reebonz was founded in 2009 and is now a Singaporean e-commerce success story. Its vision is to make luxury accessible and to build a billion dollar internet group in Southeast Asia. It was valued at more than S$250 million in June 2013. Reebonz targets the region's growing middle classes who are looking to own luxury goods. Reebonz sales events are consistently modelled around the concept of 'accessible luxury', offering members up to an attractive 70 percent discount.

Reebonz constantly innovates and so differentiates itself from potential competitors. An example is how it enables users to resell or exchange luxury items. Many distinguished investors such as Intel Capital, Vertex Asia Investments and Infocomm Investments are part of the Reebonz growth story. Reebonz's current focus is to expand its scale across Asia Pacific. If successful, Reebonz will be building the next billion dollar e-commerce group out from Singapore.

2 Transport

Why is this space hot? Please pardon the pun, but the third-party transport booking app space is "uber" competitive right now. This is a classic example of a disruptive business. This phenomenon has unsettled traditional taxi operators who lease vehicles and provide booking services. These traditional companies are heavily invested in infrastructure and fixed assets. But a new wave of digital start-ups are instead leveraging and optimising

infrastructure through innovative software. All this sector simply needs is an attractive business model that appeals to both commuters and drivers. The recent flood of capital into this space has inevitably heated up competition in the transport booking business. Consequently, some companies have also started to diversify by venturing into extra services, such as logistics and deliveries. Recently, Uber partnered with cosmetics company, Kiehl's, to distribute Kiehl's products across Bangkok. And, who knows? One day, Uber might also start pizza delivery.

Case Study: GrabTaxi

GrabTaxi is a transport booking mobile app that is now a billion dollar business following a US$250 million funding injection from Softbank. GrabTaxi is dubbed the "fastest taxi app in town". It allows users to get access to taxi fleets from different operators and make real-time booking. As it strengthens its presence in Southeast Asia, it is also considering entering the parcel deliveries business to optimise usage of its fleet of vehicles during off-peak times. This is a compelling value proposition especially in a region where logistics are often poor.

We spoke with Singapore cabbies and they unanimously chose GrabTaxi over the global player, Uber, for three reasons. First and foremost, Uber's payment to the driver was deemed "too slow". Uber adopts the cashless payment mode and reimburses taxi drivers every seven days and this is unfavourable for cabbies who need cash for vehicle rental fees and diesel. On the other hand, taxi drivers using GrabTaxi, typically collect cash from riders. Hence, taxi drivers' "salaries" will not be put on hold. Secondly, from their experience there are less "no show" cases of GrabTaxi users. Lastly, taxi drivers shared that GrabTaxi is more genuine and sincere when soliciting them to join their network. Clearly, GrabTaxi has managed to wedge itself well, with its network effect and explicit understanding of the needs of drivers.

3 Consumer Electronics and Robotics

Why is this space hot? Corporates have been talking about the joys of automation for a long time. But it is only recently that this is being raised on the consumer front where efficiency, simplicity and convenience are paramount. In this space, consumers expect a lot from just pressing buttons on a gadget. We believe that this space is going to get hotter as enterprising individuals seek to apply new technologies to solve existing real-life problems. For example, Infinium Robotics' drone waiters are aimed to plug and fill the Singapore's service staff gap. Drones can perform tasks in an efficient manner for a wide range of industries. We are all excited about "what's next" in the market that can make our lives easier and more comfortable. Perhaps robotic technology is the answer.

Case Study: Rotimatic

Rotimatic claims to be the first fully-automated appliance that uses robotic technology to produce fresh and, hopefully, delicious rotis. The benchtop gadget more or less fulfils the same type of role in a South Asian kitchen that an automated breadmaker does in a Western kitchen. It is mainly targeted at comparatively affluent families across the Indian subcontinent as well as the South Asian diaspora abroad. The first week of Rotimatic pre-orders yielded over US$5 million in sales. It can produce one roti every minute, much faster than the traditional handmade way.

Zimplistic, the Singapore-based firm behind Rotimatic, describes it as "the world's first robot that makes fresh homemade rotis and wraps". Users load in flour and water, select the kind of rotis they want by pressing a couple of buttons, and voila ... they have the "perfect roti" on their plates in a couple of minutes. The makers also claim Rotimatic is easy to clean. All of which satisfies the three conditions crucial to consumer acceptance: efficiency, simplicity, and convenience. We believe the success of Rotimatic will spur start-ups to jump on the bandwagon and start innovating more robotic products.

the challenge for business is to develop an idea and build a model that can scale and grow

What Metrics Do VCs Look for in a Digital Start-Up?

Digital start-ups often sacrifice profitability in the pursuit of growth in the beginning. This makes it difficult to identify the winners from the losers from a financial standpoint. So how do VCs do it? Three factors can be crucial in defining the worth of digital start-ups and are taken into serious consideration by VCs before making an investment decision.

1 High User Engagement and Growth

A successful digital company must possess high user engagement and growth. This all-important metric can be tracked using a measure of Daily Active Users (DAU) divided by Monthly Active Users (MAU). For example, DAU to MAU for Facebook has been reported to be over 60%. This indicates that over 60% of its users access Facebook every day. DAU helps companies with "almost everything" – from securing advertising revenues to directly monetising business via charging subscription fees. Mega-companies such as Facebook like to acquire digital start-ups with good user engagement (a DAU measure). That said, the biggest dilemma some corporates face is on deciding at what point they should start monetising their business at the expense of slowing user growth.

2 Market Dominator, Category Leader

You know a company is a category leader when its name comes to mind at the first mention of a particular category. For instance, think "taxi apps" and Uber or Grabtaxi are likely to pop into your head. Similarly, think about discount deal websites, and it could well be Groupon. VCs love to invest in "category leaders". Many prominent VCs concur that only investments in top players make business sense.

3 Potential Exit Opportunities

VCs are profit-driven and strategic. It is imperative that good exit opportunities are visible for invested companies so that VCs can cash out their investments. There are two types of exit opportunities: corporate acquisitions and public listing.

Large corporate players are generally adept at incremental innovation, but not disruptive innovation which may conflict with their existing businesses. But they recognise the need to get into new areas to grow and also to protect themselves from future competition. So the strategy many often take is acquiring proven start-ups by paying top dollar after disruptive innovation happens. For example, SingTel wanted to position itself as Singapore's leading digital listings source on food and restaurants. SingTel went out to the market in 2012 and paid S$12 million and acquired HungryGoWhere, an eating out recommendation and booking site. This was a tactical move to complement and entrench its digital life business strategy.

We see two waves of disruption which will prompt corporate players to acquire start-up companies.

The first wave is currently underway for telecoms, media, retail and transport sectors. The second wave is likely to impact banking, healthcare and education sectors over the next two to three years. Additionally, only a handful of start-ups exit via public listing as they may not have sufficient muscles to last till the listing stage.

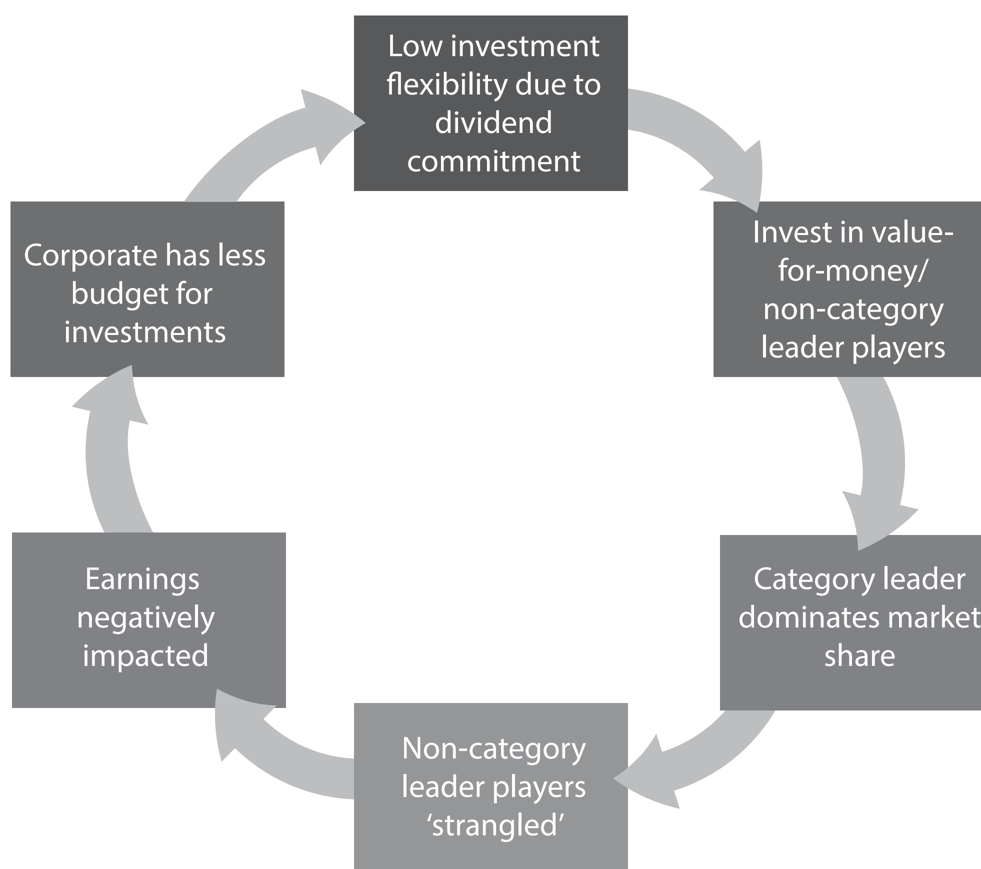
Space for Number Ones Only

Tim Draper is a well-known VC dealmaker who invested in great successes like Skype and Baidu. He says that in today's digital world, there is space only for Number One companies. An example is that of Facebook, the undisputed category leader in their sector with more than 1.3 billion users, which has dominated the market and ousted smaller players, like MySpace and Hi5. That said, one networking site has managed to avoid confrontation with Facebook and managed to grow into a category leader of its own: LinkedIn. LinkedIn actively differentiated itself as a professional network, rather than a social one, targeting a different portion of the market. LinkedIn created tools that are catered for a professional setting rather than social tools and trivia, such as chat interfaces and relationship status indicators that are commonly seen on Facebook. Hence, it was only through this differentiation that it was able to become a category leader, separating its market from Facebook's.

Paradigm Shifts: Old Versus New

Vicious Cycle of Investing in Value-for-Money Players

Diagram 2: Vicious cycle for corporates



Source: DBS Group Research

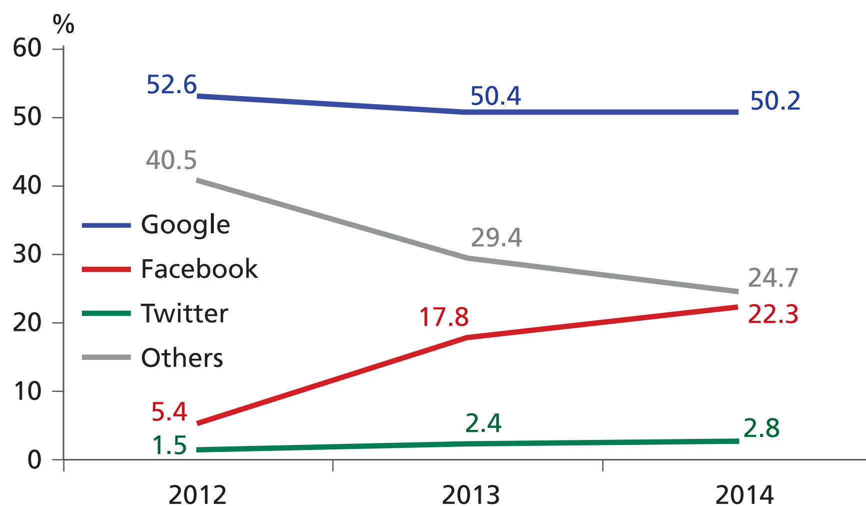
The traditional corporate mindset regards value-for-money investments as wiser and making more financial sense than paying top valuation for a market leader. There is nothing wrong with this strategy, especially since the duty of most listed firms is to ensure that investments and acquisitions are accretive for shareholders and dividend payouts are maintained.

However, dividend commitments restrict corporates and leave them with limited flexibility to buy potential acquisitions that can complement and grow the business well. This can become a vicious cycle.

Here is a scenario based on some real examples. A big telecommunications company buys a small mobile advertising start-up with hopes that this acquisition will boost its digital business. But it doesn't work out that way. Although promising, the start-up cannot dent

the dominance of Facebook and Google in the mobile advertising space. And so, the acquisition is a flop. According to eMarketer 2012-2014 data, only Facebook has really been successful in gaining mobile ad-revenue market share. In this situation, many small players are strangled and their big corporate investors are left with losses.

Diagram 3: Mega names Google, FaceBook and Twitter squeezing small players in net mobile internet ad revenue to gain market share



Source: eMarketer, Net Mobile Internet Ad Revenue Share Worldwide by Company 2012-2014

This brings us to the new school of thought. It maintains that to play the game, investors must not be afraid to pay high prices for category winners with high growth rates. SoftBank Corp., a Japanese telecommunications and Internet corporation, advocates this mentality and actively invests in many top winners of each category across the globe. Look at Softbank's investment in Chinese e-commerce giant Alibaba Group Holdings and you know that its strategy has paid off handsomely. Based on last November's performance, Softbank reaped a return of 4,350 times on the initial US$20 million investment it made in Alibaba in 2000.

> *investors must not be afraid to pay high prices for category winners with high growth rates*

Last December, Softbank invested S$250 million in the taxi service aggregator app, GrabTaxi. The deal was Softbank's biggest investment in a Southeast Asian firm. And, it embodies Softbank's strategy of investing in category leaders within markets with immense growth potential. Over the past year, the number of Grabtaxi users has jumped six-fold to about half a million. And, the taxi drivers in its network have grown four-fold

to 60,000. Now backed by Softbank, Grabtaxi is in a stronger position to battle the bigger global player, Uber.

Softbank has also paid high valuation for top players such as Snapdeal, an Indian online retailing marketplace (for US$627 million), and India's Uber equivalent, OlaCabs (for US$210 million).

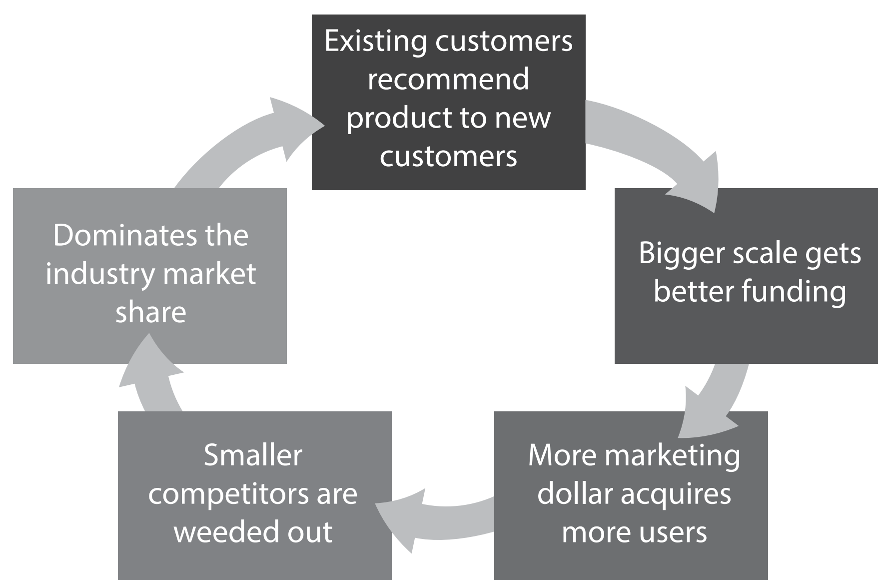
On a side note, Softbank pays out less than 10% of its earnings to its shareholders and uses most of the rest to acquire category-leading start-ups so as to build up the long-term business. That contrasts with the behaviour of many big traditional corporates which distribute most of their earnings as dividends, thus limiting the scope of their strategic investment strategies.

Virtuous Cycle of the Network Effect

The way to become a digital monopoly is to be the first to market a product that fits the needs of the consumers. Being first allows one to enjoy the full network effect. It is an essential building block. But it must also be matched with financial muscle to support the venture. In essence, the strategy of investing in market leaders creates a virtuous cycle. A first-in-market start-up and a big investor need each other to dominate the digital space.

All in all, it makes perfect business sense for investors to pay top dollar to invest in category leaders in markets with high growth potential.

Diagram 4: Virtuous cycle for top start-ups



Source: DBS Group Research

Disclaimers and Important Notices

The information herein is published by DBS Bank Ltd (the "Company"). It is based on information obtained from sources believed to be reliable, but the Company does not make any representation or warranty, express or implied, as to its accuracy, completeness, timeliness or correctness for any particular purpose. Opinions expressed are subject to change without notice. Any recommendation contained herein does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. The information herein is published for the information of addressees only and is not to be taken in substitution for the exercise of judgement by addressees, who should obtain separate legal or financial advice. The Company, or any of its related companies or any individuals connected with the group accepts no liability for any direct, special, indirect, consequential, incidental damages or any other loss or damages of any kind arising from any use of the information herein (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof, even if the Company or any other person has been advised of the possibility thereof. The information herein is not to be construed as an offer or a solicitation of an offer to buy or sell any securities, futures, options or other financial instruments or to provide any investment advice or services. The Company and its associates, their directors, officers and/or employees may have positions or other interests in, and may effect transactions in securities mentioned herein and may also perform or seek to perform broking, investment banking and other banking or financial services for these companies. The information herein is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation.

Living, Breathing Asia