Optimization
Volume 16, Issue 2, July-December 2024 (pp. 74-79)

RESEARCH ARTICLE

Cash Burn Model in Business: A Study of Select Start-ups Worldwide in Achieving Profitability

Charudev Gupta[1], Jitender Goel[2]* and Sandeep Kumar Goel[3]*****

ABSTRACT

The cash burn model of business involves a way of achieving growth by increasing the customer base of the business without achieving profitability. To fund their operations as well as other expenditures for the initial period, these start-ups take the help of funds raised from investors or sometimes government grants. In this context, the present paper attempts to discuss the concept of the Cash Burn Model, analyze the case of select start-ups that are using the Cash Burn Model, and find out the feasibility of the Cash Burn Model for the Indian economy in order to give practical suggestions to the new-age startup founders about when and how they should decide to adopt the cash burn model as their business model for the initial phase of their incorporation. The select start-ups for the present paper include Flipkart, Byju's, and Ola. It is found that companies that have employed this model of business and are market leaders in their industry, even after so many years of existence, have not been able to become profitable. The investors of such companies have also not been satisfied with the results that they are getting, and hence they are finding ways to exit from the deal; one of the popular ways to do so is by the issuance of an IPO. It is concluded that these companies should aim for profitability after gaining a certain market share of that product, which for now can be achieved by some innovative ideas for properly monetizing the services they provide to their customers, and that can be achieved by changing the mindset of the consumers.

Keywords: Cash burn, Start-ups, Funding, Burn rates, Cash flow, Profitability, Startup Ecosystem

INTRODUCTION

Cash burn model of business involves a way of achieving growth by increasing the customer base of the business without achieving profitability. To fund their operations as well as other expenditures for the initial period, these start-ups take the help of funds raised from investors or sometimes government grants. Such start-ups provide services that actually give their customers the convenience of doing their general but important tasks and ease their lives. They offer lucrative benefits with those services so that people can eventually develop habits of using their services to do that task, and over time, this new habit then becomes irreversible. Until then, these companies do not aim at attaining the state of profitability. There have been many popular companies like Amazon,

[1]Student, Department of Commerce Acharya Narendra Dev College, University of Delhi, New Delhi, India

[2]Assistant Professor, [3]Professor, Department of Commerce, Acharya Narendra Dev College, University of Delhi, New Delhi, India

(*Corresponding author) email id:
*jitendergoel@andc.du.ac.in, **charudev27@gmail.com,
***sandeepgoel@andc.du.ac.in

How to cite this article: Gupta, C., Goel, J., & Goel, S. K. (2024). Cash Burn Model in Business: A Study of Select Start-ups Worldwide in Achieving Profitability. *Optimization, 16*(2): 74-79.

Source of support: Nil

Conflict of interest: None

Received: 09/07/2024; Accepted: 04/11/2024

Netflix, and Uber that have used this model for growth in their initial period. Before all this, let's first understand what is meant by the term 'Business Model.' A business model is essentially the plan through which the business is generating income. There are certain components of a business that help the business owner decide the most suitable business model for his/her business, viz. product/service, target market, delivery, and cost. Now, the detailed explanation of all these components is given further.

The first component would be the Product/ Service which the business has to offer, usually all around the world. The most successful companies that have used the Cash Burn Model have offered services that ease not-so-important regular tasks for their customers. For example, UBER made it easy to take a taxi for its customers, AMAZON made shopping just a few clicks away from its users, and SPOTIFY made it easy for people to listen to songs without even downloading them. There are several similar examples that show the same story. "Then the next component is Target Market, companies that use the cash burn model initially cater to a young, urban population, particularly the working population, who are tech-savvy customers and do not want to engage their energy and time in not-so-important tasks." The target market of ZOMATO/SWIGGY is mostly the young generation, who like to stay in the comfort of their homes and order food from restaurants. The target market of PAYTM consists of people who want to enjoy the convenience of managing their monetary transactions without the hassle of carrying cash and withdrawing cash from ATMs from time to time. The third component in our list of factors important to determining the most suitable business model is Delivery; this means how the business plans to get its product into the market. For that, they must know where their market is located and should accordingly decide their channels of promotion and selling channels. So, mostly, the businesses that employ the cash burn model these days do their promotions through different platforms of social media. For example, TESLA CEO Elon Musk, who has a personal brand name worldwide, uses Twitter to promote his company's new launches. Mobile phone brands like OnePlus and Xiaomi get their promotion done through tech influencers on YouTube and other platforms who review the products of these companies. Furthermore, the fourth component is Costing of the product, so since these products/services are mostly new for customers, start-ups have to make big investments in marketing to get the customers to try those products. Then more funds are required for further research and development to improve the product, which is why these businesses have to bear high costs. For example, Paytm in FY 2017-18 made expenses of Rs. 3884 Crore, in FY 2018-19 made expenses of Rs. 7730 Crore, and in FY 2019-20 they made expenses of Rs. 6138 Crore. Similarly, another popular start-up, Zomato, in FY 2018-19 made expenses of Rs. 460 Crore, then in FY 2019-20 made total expenses of Rs. 3109 Crore, and till FY 2023, the total expenses of the company went up to a massive Rs. 5506 Crore. These companies spend a humongous amount of cash to get into the nerves of their customers and make them fall into the habit of using their services/products.

The paper aims to understand if the Cash Burn model of business is effective or not for the Indian economy and whether it really provides the right kind of output as it is supposed to, even after a long period of time. This question has not been answered adequately in any of the few papers written on the topic.

OBJECTIVES

- To analyze the case of select start-ups that are using the Cash Burn Model.
- To find out the feasibility of the Cash Burn Model for the Indian economy.
- To help startup founders understand the ways to select a feasible business model and decide whether they should opt for the Cash Burn Model or not.

LITERATURE REVIEW

Shah (2021) this paper talks about the reasons for the failures of different Indian startups at an early stage of their existence. This paper points out broadly all the possible reasons for the failure of different Indian startups and discusses one of the biggest reasons for startups to fail, especially those that have secured funding and grants and have taken advantage of government schemes for financing their operations. The biggest reason that the author points out is financial mismanagement. It has also suggested some ways to tackle the problems, such as establishing financial goals, focusing on both the financial aspects, cash flows, as well as the profitability of the company, which is also very important. Companies must borrow only the amount that they need and must strategically plan their expenses based on their cash flows.

Sakunia and Parikh (2020) this paper outlines that when companies try to use their cash pool to give high discounts and offers to their potential and acquired customers, by getting into a price war with their competitors, especially in a price-conscious market like India where most of the time the switching cost for customers is low, the companies do not actually get much benefit from their efforts and tactics merely by putting cash into such schemes. Eventually, some company that might offer better deals to your current customers might poach them from you.

Kumar (2024) this paper suggests that every company that employs the cash burn model should calculate their burnout rates to understand the short-term financial viability of their business. This will help the business with its future planning and resource allocation. It is essential to benchmark the cost and the extent of the burn rate in order to do proper cost management and governance of the cost.

RESEARCH METHODOLOGY

This study employs inductive research to analyze various real-world cases of different start-ups. This method equips us to properly manage the information and generalize the information based on our observations to derive the outcomes based on our study and analysis. A lot of quantitative as well as qualitative information has been gathered from various credible sources. Primarily, a search was initiated on the Advanced Google Database using a string of keywords. Several articles, research papers, and case studies of the businesses that have used the cash burn model have been studied. The tactics used by the companies to become profitable and how their customers reacted to those tactics were also studied. Using the induction research technique, the cases of different Indian start-ups have been studied to find out the reasons why companies in India are struggling to become profitable after using this model.

RESEARCH ANALYSIS

Today's business trends are making traditional practices outdated. In recent times, it has been observed that the majority of start-ups forget the basics of business, which state that first the business should look for survival in the market, then work for profits, and after attaining that, businesses should focus on sustainability. However, now businesses are first aiming to achieve growth, secure a promising customer base, and capture a significant market share in the industry, and then look for ways to become profitable. In this context, the following is an analysis of select start-ups that have used the Cash Burn Model.

Among several Indian companies, which we selected to read and analyze their case studies to find answers to our research questions, the first study that has been carried out is Flipkart, which is as follows:

Flipkart

Flipkart was started in the year 2007, and since then, Flipkart has raised around $10.8 billion from investors. It is an online marketplace that helps sellers connect with their potential customers and assists sellers by increasing their market size while helping customers get more convenience, more options, as well as better deals while shopping. It initially started as an online bookstore, which has now expanded into almost 80 categories of products, ranging from electronics, furniture, and clothes to groceries and toiletries.

Even after being more than a decade old, this company has still not been able to achieve profitability. According to various reports, Flipkart had a cash burn of $3.7 billion in FY 2022, which is, in any case, a very high annual burn rate. It is the second-largest e-commerce company in India, and still, it has been spending a tremendous amount of funds for its expansion into different industries and markets, as well as in new technologies like machine learning and artificial intelligence. To complement the investments, there is also stiff competition in the Indian market, which necessitates additional discounts and cash backs, contributing to its high yearly burn rates.

Flipkart has five prominent revenue streams, which include the following:

- Commission charges from the sellers in the marketplace and also the convenience fees (payment processing fees) from them.
- Its own subsidiary named E-kart offers logistics and delivery services.
- It allows brands to run their advertisements on its website, thus generating revenue from that.
- Flipkart offers additional benefits and exclusive deals through its subscription.
- It provides financial services to its sellers and earns through interest and fee charges.

Byju's

Byju's was started in the year 2011; it is now valued at $5 billion after its valuation was slashed earlier this year from $22 billion by the global investment group Prosus. It is an Edtech giant that has its target market of mostly all kinds of students as well as aspirants; it provides services to all types of people, ranging from school students to competitive exam preparers.

Byju's, in FY 22-23, reported a cash burn of $4.6 billion, and on top of that, this edtech giant is facing a lot of problems these days. Its social image is depleting because of the news coming out about its faulty marketing and sales practices and its policies. There have also been a lot of news stories catching people's eyes about their discrepancies in financial reporting, due to which their auditors are resigning as well. To top it all off, Byju's also defaulted on a loan repayment, and due to all these reasons, some of its other lenders are asking for early repayment of loans.

According to reports, Byju's utilizes these funds by investing heavily in technological developments for its app/website, for the high fees of its teachers; it is also investing a lot in its marketing, but majorly, they are spending on acquisitions of companies. To date, Byju's has acquired a lot of companies like WhiteHat Jr., Osmo, Tynker, and recently, it also acquired an offline coaching giant, Aakash Institute. These are some of the reasons why it is continuously showing such high annual burn rates.

Byju's earns from selling its course subscriptions and other edtech products like tablets, laptops, software, pendrives, and all related items.

Ola

Ola is a ridesharing and now also an automobile company that was started in 2010. India's transport industry's unicorn brand is currently valued at $3.5 billion. In FY 22-23, it reported a yearly burn rate of $1.3 billion. Ola is involved in providing cab services, financial services, and food delivery services. Ola has also set up its own cloud kitchens in selected cities, and in recent years, Ola has also entered the EV market and launched its own manufactured electric vehicles.

Ola has been strategically utilizing its funds to acquire companies in new markets and new industries or supporting industries for the purpose of expanding its business and growing as fast as it can.

Ola has multiple big and small revenue streams, which are as follows:

- On-demand cab services, airport rides, and corporate tie-ups are some ways through which Ola attracts customers for transportation services.
- Cab leasing services are available for drivers who cannot afford to buy a car upfront, so Ola earns a commission from every ride of such vehicles. They also have rental charges for their cabs and security deposits.
- Ola also provides financial services operations under Ola Financial Services Private Limited.
- Ola Select is a subscription plan in which customers receive additional benefits and discounts.
- Ola food delivery services and in-house cloud kitchens.
- Ola has tied up with numerous OTT platforms to provide its cab customers with some entertainment during their rides.
- Ola Stores is another service they provide for the delivery of daily needs and charge a commission from customers as well as fees from merchants. This is one venture of Ola that is profitable.
- And now, they have also entered the EV market under the name Ola Electric.

CONCLUSION AND SUGGESTIONS

All these companies that we discussed above, even after coming from different industries, have some things in common. They have been in the market for more than a decade and have become big names in their industries, but still, none of them are profitable. They are all constantly expanding their market size and market share. The biggest challenge that most of these companies are facing is that they are not able to monetize the extra benefits that they are providing to their customers. Additionally, due to a lot of stiff competition in the market, they are working from the mindset of gaining more market share rather than utilizing their existing customer base to become profitable. These companies, along with many others like them, are facing similar issues, which is that in the Indian consumer mindset, some things are hard-wired already. Unlike the consumers of developed countries, where businesses using this business model thrived, Indian consumers tend to go for economical options available. Rather than being loyal to one brand, consumers here prefer the brand that provides a better deal with the product.

Such companies first need to change the mindset of their customers. They should start focusing on their existing customer base and undertake innovative and mindful actions that make their customers habitual to pay for the services they avail, whether it be a third-party enabler in between, because that third-party enabler is adding value to the services that consumers are opting for by enhancing the convenience in their lives. They should run innovative ad campaigns that educate consumers on the need to change their mindset and that this would be better achieved if, instead of competing with other players in the competition, they come together for this purpose.

Once consumers start making better decisions for choosing higher-quality products, the demand for low-quality products will also start to decline and eventually will completely go down. Because of that, the demand as well as the supply of good-quality products will also increase, leading to a better lifestyle for the consumers themselves.

The final implication of this study would be to advise companies that aim to grow rapidly by increasing their market share and burning cash that they must plan their operations for both short-term and long-term periods to move forward accordingly, keeping several factors in mind such as the purchase behavior and consumer behavior of their target market, the value that their product has to offer, the ability of the product to become a habit for customers, current and potential demand for the product, and the ability of the promoters of the company to manage the company's finances properly.

FUNDING ACKNOWLEDGEMENT

We would like to acknowledge that this research paper is part of the ELITE undergraduate research program, 2022-23, funded by Acharya Narendra Dev College, University of Delhi. We are grateful for this support, which enabled us to conduct this important study.

REFERENCES

An overview of Byju's business model: How it functions as India's biggest EdTech startup. (n.d.). Buildd. https://buildd.co/marketing/byju-business-model

Equitymaster. (n.d.). India's big startups burn through cash at alarming rate. Equitymaster.https://www.equitymaster.com/detail.asp?date=08/13/2023&story=2&title=Indias-Big-Startups-Burn-Through-Cash-at-Alarming-Rate

Juno School of Business. (n.d.). How Flipkart makes money. LinkedIn. https://www.linkedin.com/pulse/how-flipkart-makes-money-juno-school

Login consent - MoneyControl. (n.d.). https://www.moneycontrol.com/financials/zomato/profit-lossVI/Z/1#Z

Paliwal, U. (2022). Paytm share price, news, name, value, market - Buy sell Paytm shares. UnlistedZone.https://unlistedzone.com/shares/paytm-unlisted-share-price-market-value-today

Sakunia, D., Parikh, P., & Entrepreneurship Development Institute of India. (n.d.). High cash burn in a price-conscious economy with low switching costs. In AIMS International.

Samsukha, A. (2022, November 4). Business model types explained using real-world examples. Tech Blog | Mobile App, eCommerce, Salesforce Insights. https://www.emizentech.com/blog/types-of-business-models.html

Schmidt, M. (2023, August 24). Cash flow basics: How to manage, analyze, and report cash flow. https://www.business-case-analysis.com/cash-flow.html

Shah, S. (2021). A study on failures of start-ups: The reasons and suggestions. Marketing, Finance & HRM, 94.

Shastri, A. (2023, January 30). In-depth business model of Flipkart | IIDE. IIDE. https://iide.co/case-studies/business-model-of-flipkart/

Sundar Kumar, R. L. N. (2024). Estimating the burn rate in startup environment and a study of burnout cost in recently listed companies. https://www.icsi.edu/media/webmodules/CSJ/May_24/20.pdf

Zomato Profit loss: Check Zomato profit & loss account annual statement. (n.d.). Mint.https://www.livemint.com/zomato/profit-loss-annual/companyid-s0005117