Source: The Edge Malaysia, 24 April 2023

Cultivating a THRIVING START-UP ECOSYSTEM

The goal: 5,000 start-ups and five unicorns by 2025, and a world-class ecosystem by 2030. With more than 3,000 start-ups to date, it would seem that Malaysia is close to achieving its target. However, numbers don't paint the full picture; qualitative aspects are important too. **PG6**

COVER STORY

Cultivating a THRIVING START-UP ECOSYSTEM

BY **KIRAN JACOB**

The Malaysian Startup Ecosystem Roadmap (SUPER) 2021-2030, which aims to transform the country into a top 20 global start-up ecosystem by 2030, outlines goals to generate 5,000 start-ups (including five unicorns) by 2025. With only two years to go before the deadline, there are a total of 3,288 start-ups in the country, according to the MyStartup portal, and one unicorn in the form of integrated car e-commerce platform, Carsome Sdn Bhd.

Despite a quantifiable figure being important, industry stakeholders note that the goals need to be quality-driven. The focus needs to lie on how conducive the local economy is to encouraging innovation.

Numbers are not tell-all indicators as the quality of start-ups needs to be in tandem with the quantity produced. Start-ups today prioritise high valuations and exit plans over building sustainable long-term businesses, observes Fabian Bigar, CEO of MyDIGITAL Corporation.

"While numbers are great data points, the substantial outcomes of these start-ups are always the community goals in mind — job creation, accessibility, inclusion and, of course, innovation," says Fabian.

The growth of the start-up ecosystem brings about a host of benefits to the country. Start-ups, described as innovative, growth-oriented, disruptive and following a J-curve growth trajectory — which shows an initial loss immediately followed by a dramatic and steep gain — in the road map are projected to contribute RM30.8 billion to the country's gross domestic product (GDP) by 2030.

"It is good to have quantifiable goals as it compels everyone, from the agencies to the ecosystem players, to strive to achieve these goals. But what is more important is that by striving to achieve these goals, we will indeed be creating more start-ups and more founders will dream big. Even if they don't become unicorns, they will still create many more successful companies that will contribute to employment and the GDP. That itself is already a success," says Dr Sivapalan Vivekarajah, co-founder and senior partner of ScaleUp Malaysia Accelerator.

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Sivapalan, ScaleUp Malaysia Accelerator

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DETERMINING QUALITY

Despite being one of the trailblazers to invest in the digital economy more than two decades ahead of its regional peers with the rolling out of mega projects like the Multimedia Super Corridor in 1996 to attract world-class technologies and global investments, the local start-up ecosystem is still lagging behind.

For Malaysia to once again stake its claim as Southeast Asia's leading start-up hub, the need for a quantitative assessment and qualitative analysis of the ecosystem to measure success is imperative. According to Startup Genome, there are more than 4,000 start-ups in Singapore. Meanwhile, as at January 2022, Vietnam had 3,800 start-ups, notes Statista.

Quantitative metrics that provide an indication of the health of the ecosystem include the number of exits, volume and size of funding rounds, number of local and foreign investors as well as their corresponding activity and patent activity.

"While monitoring density and ecosystem value (number of start-ups and total combined with valuation) in the local ecosystem is a good starting point, we need to ensure that other aspects are managed as well to ensure a holistic view of the effectiveness of intervention policies in developing a healthy start-up environment," explains Fabian.

The qualitative aspect of the ecosystem can be inspected once the numbers are collected. This will provide the big picture view on the start-up scene in relation to the wider lens of the economy.

There are two forms of analysis that can provide the required insight and foresight to spur the growth of the start-up landscape, notes Fabian. First, create an investment heatmap to identify hotspots and predict upcoming trends. Next, look at job boards to identify high-demand skills and in turn shape education to meet industry needs.

"Beyond supporting and advancing traditional economic metrics such as job creation, opening of new markets or boosting production in the supply chain, the value of creating a thriving start-up ecosystem lies in its ability to change lives. The fresh perspective brought on by the innovation created will spark a mindset shift required to build a resilient future," he asserts.

Taufiq Iskandar, CEO of Penjana Kapital Sdn Bhd, says: "Away from these measures like valuations and unicorn labels, we think the most important thing is for the local ecosystem to stay focused on nurturing risk-takers and changemakers as well as supporting innovative businesses that are based on emerging technologies."

A thriving start-up ecosystem lies in a highly diversified economy, enabling start-ups to emerge from a plethora of different industries.

"With ScaleUp Malaysia, our 30 investments come from industries such as travel, fintech, insurtech, agritech and autotech," says Sivapalan.

"While monitoring density and ecosystem value ... is a good starting point, we need to ensure that other aspects are managed as well to ensure a holistic view of the effectiveness of intervention policies in developing a healthy start-up environment."

Fabian, MyDIGITAL Corporation

[redacted]

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Gan, KPMG Malaysia

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However, there is no breakdown of the sectors that the 3,288 start-ups occupy. Sivapalan says there should be a unified database for start-ups to facilitate ease of tracking.

"Currently, we have many agencies that deal with start-ups, from Cradle Fund Sdn Bhd and Malaysia Digital Economy Corporation (MDEC) to Malaysian Research Accelerator for Technology and Innovation (MRANTI). They should all create a unified database so we can track the number of start-ups," he says.

Most of the start-ups identified in KPMG and HSBC's "Emerging Giants in Asia Pacific" report are from the fintech space. Malaysia's Fintech Map 2022 by Fintech Malaysia states that there are 294 fintech companies in the country.

"It seems that this pattern will persist beyond 2023, as we anticipate a greater number of start-ups flourishing in this sector. Judging by its pace of acceleration, we will also see more collaborations between financial institutions and large-scale technology providers to build customised solutions and value-creation services. These developments will further strengthen the country's expertise in this space, attracting more investors," says Alvin Gan, head of technology consulting at KPMG Malaysia.

Start-up Genome's "Global Startup Ecosystem Report 2021" (GSER) states that Islamic finance plays a large role in the nation's fintech sector. As of 2020, it encompassed 37% of the banking system.

Environmental, social and governance (ESG) start-ups will gain significant attention in the coming years too, adds Gan.

"The current government is also committed to prioritising ESG-focused development initiatives, which will boost growth in this particular start-up scene. There is a firm belief that technology, and specifically start-ups, will play a key role in ESG, from reducing carbon emissions to measuring ESG impact and reporting," he points out.

An example would be Pantas Software Sdn Bhd with its climate due diligence solution. The solution is able to identify misreporting within a company's climate report through human expertise and algorithms.

The SUPER road map identifies seven sectors that have high commercial potential and create social and environmental impact. These are fintech, digital content, cybersecurity, life sciences, education, agriculture and energy. Start-up Genome's GSER highlighted gaming and fintech as sectors with untapped market potential in Malaysia.

OVERCOMING STUMBLING BLOCKS

Malaysia has a notable presence in the global start-up landscape. Start-up Genome's GSER states that the country is ranked among the top 100 emerging ecosystems in the world, with Kuala Lumpur being in the top 21 to 30.

"Malaysia's biggest draw is its proximity to fast-growing Southeast Asia and deeply-rooted cultural linkages to most countries in the region. Southeast Asia will become the world's fourth-largest market by 2030 with a combined GDP exceeding US$2.6 trillion (RM11.5 trillion). Its middle class is fast approaching 400 million spending more than US$200 billion a year just in the internet economy. This means that our entrepreneurs and businesses have a huge market to tap into," says Penjana Kapital's Taufiq.

"The country has well-established physical and digital infrastructure, with high internet penetration rates of approximately 90%, and ongoing efforts to upgrade information and communications technology (ICT) infrastructure through initiatives such as Jalinan Digital Negara (Jendela) and 5G deployment. This creates significant growth opportunities for businesses and innovation."

To facilitate continued growth in the start-up landscape, obstacles need to be overcome. The SUPER road map clearly highlights the challenges in the ecosystem, among which are a lack of:

- Private sector-driven funding;
- Local and foreign talent with the required technical and digital skills;
- A clear path from ideation to commercialisation for start-ups;
- Robust policies and regulations to provide a sustainable start-up environment; and
- Validation and support with lack of access to cross-border market penetration.

As such, the five identified key ecosystem drivers are funding, talent, innovation, policies and regulation, and market environment. Alongside this, the roadmap also highlights 16 interventions that would be used as stepping stones to achieve Malaysia's goal of being ranked in the top 20 global start-up ecosystem.

Funding is essential to enable faster growth and the ability to compete. Prime Minister Datuk Seri Anwar Ibrahim has recognised there is great potential for start-ups in Malaysia and the need for government policy intervention in strengthening the start-up ecosystem, especially in the areas of financing, talent development and fiscal incentives, reported The Edge Markets.

As such, government-linked investment companies (GLICs) such as the Employees Provident Fund (EPF) and Khazanah Nasional Bhd will pump in more than RM1 billion into innovative and high-growth local start-up companies.

Khazanah has also launched the "Future Malaysia" programme under its Dana Impak mandate, reported The Edge Markets. The programme will support the local start-up ecosystem with a RM6 billion investment over five years.

"The Malaysian government via government-linked funds and GLICs has to be as aggressive as our regional peers when it comes to supporting and funding local start-ups in their middle- and late-stage funding phases so that they are able to scale and become regional champions. This is a key element to improve on should Malaysia hope to create more unicorns and successful tech companies," says Eric Cheng, co-founder and group CEO of Carsome.

Budget 2023 also announced a tax deduction of up to RM1.5 million for firms that list on Bursa Malaysia's ACE and LEAP markets until year of assessment 2025.

"This tax deduction is also expanded to include the cost of listing technology-based companies on Bursa Malaysia's Main Market. I take this as an encouraging development as these mechanisms aim to enable start-ups to have access to later stage financing in Malaysia, so that they would not need to seek listing abroad," says KPMG's Gan. "Improving access to later stage financing will enhance Malaysia's competitiveness against neighbouring countries that may have better-developed ecosystems for start-up funding that help attract international financiers and will bring higher valuations for their public offerings."

"New initiatives in the revised Budget 2023 ... are key to helping local start-ups expand regionally."

Cheng, Carsome

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"If producing five unicorns is the goal, it is essential for Malaysia to work on its funding ecosystem and the industry's fundraising capacity."

Taufiq, Penjana Kapital

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"Public-private partnerships play an important role in helping to develop the talent that is needed to spur the growth of start-ups in the country."

Karel, HSBC Malaysia

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Public-private partnerships are another way to fill the funding gaps in the ecosystem. Penjana Kapital was established in 2020 on a public-private partnership model. Private capital from strategic international and private domestic investors for venture investing will be matched by the government.

Dana Penjana Nasional, Penjana Kapital's matching fund-of-funds programme, is reported to have a fund size of RM1.3 billion, with RM527.64 million in investments approved, as at January 2023.

To enhance private-sector participation, a corporate tax incentive of up to RM20 million for companies to invest in start-ups has been made available. Higher levels of corporate investment are key to providing guidance and mentorship for start-ups to scale and grow beyond regional borders.

"We have a corporate investment tax incentive that incentivises corporates to invest directly in start-ups or to set up a corporate venture capital arm or to invest in VC funds," says Sivapalan. *Digital Edge* reported on the incentive in the March 13 issue (*The Edge Malaysia*, Issue 1463).

"Public-private partnerships play an important role in helping to develop the talent that is needed to spur the growth of start-ups in the country. Such partnerships can help inculcate upskilling programmes, bridge the supply-demand gap in the technology sector and build a sustainable pipeline of technical talent. This can be done by leveraging the expertise of the private sector, together with various talent development programmes offered by the government," says Karel Doshi, head of commercial banking at HSBC Malaysia.

Carsome's Cheng adds, "Government initiatives such as the National Technology and Innovation Sandbox and MYStartup, along with the involvement of tech companies from the private sector — such as Microsoft and Amazon Web Services, among others — become a healthy coalition to encourage the growth of start-ups. New initiatives in the revised Budget 2023 — such as the role of Invest Malaysia Council and the National Committee on Investment in overseeing investment in high-technology sectors, Khazanah and the EPF's reported investment of [about] RM1.5 billion in local start-ups and a RM40 million allocation for the Malaysian Co-Investment Fund (MyCIF) — are key to helping local start-ups expand regionally."

Funding can also cause a ripple effect in the ecosystem. Without funding, start-ups are not able to hire the best talent or create innovative products.

For instance, an increase in start-ups and funding entering Singapore, Vietnam and Indonesia has seen these countries hire more engineers, states Glints and Monk's Hill Ventures' "Southeast Asia Startup Talent Report 2023".

Engineering is the most in-demand function in these countries. Singapore is the market with the highest-paid engineers compared to Indonesia and Vietnam.

To retain talent and foster a culture of ownership, founders are starting to offer staff an employee stock ownership plan (ESOP), albeit more skewed towards senior talent, reads the report. It also works as a retention tool for talent.

"When it comes to equity compensation, over 86% of start-ups in the region have offered ESOP, though this is concentrated to only one-third of the talent. Most ESOPs have only been given to the C-suite and senior talent," states the report.

"I am a firm believer that we have sufficient talent in the country, but many work in conventional companies because of better pay or venture abroad for the same reason. With better-funded start-ups, they will be willing to join the start-up ecosystem. With funding, start-ups can also hire foreign talent; so talent is not the issue, funding is," says Sivapalan.

BECOMING A UNICORN

KPMG and HSBC's "Emerging Giants in Asia Pacific" report highlights characteristics that start-ups require to endure the tumultuous terrain they are subject to. These are superior technology and technical knowledge; expert knowledge of local markets or local customer behaviour, which allows their businesses to be hyper localised; mastery of logistics channels and supply chain operations; successful adaptation of their business models based on correct identification of market gaps and a winning culture that attracts and retains talent.

KPMG will collaborate with MDEC to accelerate the growth of 20 high-potential Malaysian technology companies to become national unicorns by 2025. This is in support of MDEC's Founders Centre of Excellence (FOX) programme.

The 20 shortlisted start-ups participating in FOX will receive customised consulting and advisory support in areas such as market insights, technology updates, risk management, governance and regulatory compliance.

"Unicorns are generally large companies that will hire and pay high salaries for their talent. They also have higher revenues and as they grow, they can become highly profitable entities. All these will contribute to the nation and the economy," says Sivapalan.

Accelerators and incubators could provide start-ups a leg up in the race to becoming an unicorn.

Carsome, Malaysia's first unicorn, introduced Carsome Mobility Lab, an auto ecosystem-focused accelerator co-organised with Sunway iLabs. The programme focuses on helping start-ups navigate funding through one-to-one mentoring, workshops and access to funding and partnership opportunities with industry leaders.

100 Soonicorns by ScaleUp Accelerator Sdn Bhd and Proficeo Consultants, in collaboration with Penjana Kapital and MDEC, is designed to groom local start-ups to become the next unicorns of Malaysia. The programme will provide access to local and global investors.

"If producing five unicorns is the goal, it is essential for Malaysia to work on its funding ecosystem and the industry's fundraising capacity. The venture market here is largely driven by government funds. Unlike other successful unicorn hubs, Malaysia needs to develop its venture capital market that is driven by private-sector players, funded primarily by private capital. This is crucial for the sustainability of our funding landscape," says Taufiq. E