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BALANCING VALUATION AND VALUE CREATION IN FINTECH STARTUPS

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Abstract

The research explored the relationship between valuation, value creation, and the profitability of digital lending start-ups. The objective was to determine whether strategies prioritizing high valuations and capital influx correlate with long-term profitability as compared to those focused on sustainable value creation. The methodology employed in the study hypothesized a positive relationship between value creation and company profitability, and a negative relationship between prioritizing high valuations over value creation and company profitability. Two digital lending companies were examined from the company's published audited financial statements, and analysed through financial ratios, regression, correlation, the value proposition, the funding, the valuation, and their impact on the company's profitability. It was observed that the company that addressed societal challenges, leveraged economies of scale, and adapted to per capita income dynamics witnessed consistent profitability, while the company that chased capital and inflated its valuation experienced unstable profitability.

Keywords:

Fintech, Value Creation, Valuation, Profitability, Digital Lending

1. INTRODUCTION

The advancement of innovative technologies is a critical catalyst for economic growth. In today's startup ecosystem, unicorns are emerging at an unprecedented rate, some achieving high valuations through real value creation, while others rely on inflated valuations. Back in 2013, it typically took around 13 years for a company to become a unicorn. By 2023, this time frame had shortened to just 5.5 years. However, in 2023, nine Indian unicorns lost an average of 49% of their value.

Valuing a startup presents unique challenges compared to established companies with stable revenues and profits. For mature businesses, valuation typically involves calculating a multiple of earnings before interest, taxes, depreciation, and amortization (EBITDA) or other industry-specific multiples. In contrast, startups, with their limited revenue and uncertain futures, require different approaches to valuation. Ultimately, startup valuation combines both science and art, influenced by market conditions, management strength, and industry factors [18]. The most common valuation method for startups is the Discounted Cash Flow (DCF) method, which estimates present cash flows discounted by the investor's required rate of return. The main purpose of valuation is to compare the worth of a company to its current market value [8]. A company is considered overvalued if its market price exceeds its intrinsic value, meaning investors pay more than its earnings, as measured by earnings per share (EPS), return on equity (ROE), and return on assets (ROA). Relying solely on funding rounds for valuation can strain investor relations and harm long-term sustainability. Undervaluation occurs when a company's stock price is below its intrinsic value. Fintechs are reshaping the banking industry with innovative technological solutions that enhance customer-centricity and create sustainable value. This disruptive growth results in valuations that exceed those of traditional banks. However, valuation methods used for fintechs, such as real options, discounted cash flows (DCF), and venture capital benchmarks, may not fully account for risks like credit issues, data security, and regulatory challenges. While high valuations signal strong growth potential and value creation, they also highlight the distinct risks that investors must consider [31]. The strategies advocated by McKinsey that prioritize long-term value, considering returns on investment and cost of capital, have helped in promoting sustainable growth and benefited all stakeholders, rather than pursuing short-term gains from inflated multiples. Ultimately, creating substantial and lasting value is crucial for the enduring success of the business [17]. Singh [45] distinguished between valuation and value creation, noting that while valuation is an outcome of business success, value creation is the input. She argued that true success should not rely solely on fluctuating valuation metrics but should focus on generating lasting value for stakeholders through stable revenue, cash flow, and long-term economic benefits. This approach encourages entrepreneurs to prioritize innovation and stakeholder satisfaction over short-term gains for greater resilience and sustainability [47].

It has been demonstrated that in the digital environment, value creation is predominantly driven by consumer needs and preferences. Businesses must align their strategies with these consumer demands to effectively generate value. Given that consumer demands are heterogeneous, uncertain, and interactive, startups must leverage these aspects to seize opportunities and create genuine value [9]. Pinelli et al. [39] emphasized that entrepreneurs create value through both outward and inward value propositions. Outward propositions involve promises made to stakeholders, such as customers or employees, to obtain their resources or services. For example, a new product represents an outward proposition to customers, while a salary is an outward proposition to employees. Inward propositions refer to the valuable resources or benefits stakeholders provide to the enterprise, such as funding, ideas, or feedback. Value creation involves turning inputs into valuable outcomes, measured by metrics like Return on Capital Employed and Market Share, through innovation and problem-solving. Valuation assesses a business's worth using methods like the Asset, Income, and Market Approaches. While value creation focuses on long-term success, valuation can be subjective and vary among investors. For instance, Paytm, a fintech company, launched its initial public offering (IPO) with a valuation of $19 Billion, but its stock price fell by 70% within a year by November 2022, highlighting the volatility of valuation. On the contrary, Zerodha, a bootstrapped fintech, achieved significant profitability without relying on excessive valuation, reporting over ₹20,000 Million in FY 2022 with minimal external investment [1].

This study aims to investigate the relationship between a company's valuations, value creation, and its profitability. Two

hypotheses were framed to explore this: the first examines the relationship between value creation and profitability, while the second assesses how inflated valuations relative to value creation impact profitability and financial leverage. Our objective was to validate these hypotheses through quantitative analysis of digital lending companies at both national and international levels. The findings will be discussed in subsequent sections, emphasizing their contributions to understanding how fintechs can prioritize sustainable value creation while remaining profitable, rather than solely relying on inflated valuations that do not correlate with profitability metrics. This paper contributes to the financial ecosystem, including fintechs, by observing that they should prioritize ethical practices and focus on long-term value creation over short-term gains from inflated valuations.

2. LITERATURE REVIEW

2.1 VALUE CREATION BY THE FINTECHS

Varas et al. [53] described that entrepreneurs refine their value propositions across four key dimensions: Argument, Application, Design, and Financial Model. These elements are crucial in understanding how fintechs position themselves in the market and how they create value for their target audience. Value creation by fintechs can be understood from the perspectives of various stakeholders, including customers, investors, and financial institutions, each benefiting differently from fintech innovations. Fintechs create value by driving profitability and enhancing financial inclusion. Existing literature on fintech highlights several key areas of value creation and development. For instance, the growth of India's fintech sector, driven by historical economic trends and the expansion of microfinance and non-banking financial institutions (NBFCs), has been accelerated by leveraging technology to scale operations [29]. Fintechs, through digital transformation, aim to enhance financial service accessibility, efficiency, and affordability, contrasting with traditional services [27]. Partnerships between fintechs and traditional banks not only benefit the entities involved but also promote financial inclusion and economic growth by reducing operational costs and improving profitability [38].

Value creation in fintechs relies on production, innovation, and the strategic use of platforms. Banks are adopting open, modular business models that reduce transaction costs and leverage network effects. Successful Fintechs balance diverse revenue sources with co-creating value in partnership with banks. A key challenge is finding the right level of platform openness; being too open can limit profitability and value capture, while being too closed can hinder adoption and the platform's value proposition [37]. Digitization and technological adoption are crucial for maintaining global competitiveness, with fintechs needing agility to scale and expand internationally [21]. Fintechs thrive particularly in economies where access to loans are limited, empowering them to broaden their customer base and drive profit generation [19]. The creation of scalable platforms facilitates economies of scale, enabling fintechs to lower expenses and establish robust user networks, akin to principles observed in shared economies [15].

Using a modified Unified Theory of Acceptance and Use of Technology (UTAUT) model, Al Nawayseh [2] found that perceived benefits and trust significantly influence users' behavioural intentions to use fintech applications, while perceived risks negatively affect trust but do not directly impact usage intention. Enhancing sustainability and promoting financial inclusion within the fintech sector revolves around four fundamental pillars of digital financial transformation: ***Pillar I:*** Digital ID and eKYC for Identification and Simplified Account Opening. ***Pillar II:*** Open Electronic Payment Systems, Infrastructure, and a Supportive Regulatory and Policy Environment that facilitates the digital flow of funds from traditional financial intermediaries and new market. ***Pillar III:*** Initiatives for Account Opening and Electronic Delivery of Government Services, Empowering Access, and Savings. ***Pillar IV:*** Development of Digital Financial Market Infrastructure and Systems to Enhance Access, Utilization, and Stability of Value-Added Financial Services [24].

Digital transactions mitigate crisis effects, while artificial intelligence (AI) and blockchain improve efficiency and inclusivity. Fintech innovations disrupt traditional banking by increasing access and streamlining financial processes [10]. In India, the banks remain as the primary source of capital. However, fintech companies are also becoming popular due to their innovative use of technology in financial solutions. It is precisely due to this that Indian banks are open to collaborating with fintechs, provided they have the required expertise. Fintechs are now prioritizing their profitability and return on assets (ROA) to secure a sustainable future for their business. Presha Paragash, CEO, Credit Saison India, illustrated that fintechs can be profitable and sustainable by taking the unit economics into consideration and carefully analysing the customer acquisition cost. Another aspect affecting profitability is the delinquency. If a lender is lending at relatively high interest rates, incurs borrowing cost, and also faces high delinquencies, the resultant narrow spread negatively impacts profitability [14]. The prospects for fintechs in India are promising, driven by rising credit demand and the government's focus on financial inclusion and digital services. The fintechs can serve the vast untapped market of a population exceeding one billion, the majority of which lacks access to traditional financial institutions. In 2023, only 33 of the 70 largest public fintech companies reported profitability, with top-quartile firms in terms of EBITDA outperforming bottom-quartile companies by approximately 25 percentage points across all cost categories [4]. According to De Wet [11], EPS remained one of the most widely used and popular financial performance benchmarks and was regarded as a key indicator of a company's profitability and financial health. The study reported that a significant portion of the reported EPS growth was driven by retained profits along with debt use, which expanded the asset base, increased sales, and boosted earnings. The magnitude of this EPS growth was influenced by retained income, the company's capital cost structure. Research gaps exist in evaluating how fintech's value creation impacts profitability, which this study will explore through the following hypotheses:

- *Null Hypothesis (H0)*: There is no positive relationship between value creation and the profitability of digital lending companies.
- *Alternative Hypothesis (H1)*: There is a positive relationship between value creation and the profitability of digital lending companies.

2.2 VALUATION OF FINTECH COMPANIES

The prevailing trend among fintech startups is a pursuit of valuation at the expense of genuine value creation, driven by a rush to achieve unicorn status swiftly. The rapid escalation in valuations largely stems from the availability of abundant capital. The emerging markets have been incubated with venture funds, particularly from Japan and the United States, at a certain level of risk. These capital-chasing companies become demanding and exacting when the tables turn against the funded profit sector. Many startups are in the rat race to become the next unicorn/decacorn/hectocorn, and hence their valuations are unreasonably high, without even having begun their business operations. In sustainability, concepts like reduce, reuse, and recycle are well-known, but an additional aspect, *refuse,* is increasingly relevant today. Startups must exercise agility by accepting funds only when necessary, as excessive capital can harm growth. Just as excess is detrimental in other areas, an overabundance of capital can destabilize fintech businesses. Jha [23] also reported similar findings, emphasizing that easy access to capital does not guarantee success. It is preferable to have investors or critics warn of possible pitfalls before receiving funds, rather than facing the consequences afterward, which can be prohibitively costly.

Investors are shifting their focus from unicorns to 'cockroach' startups, characterized by adaptability and resilience in challenging business climates. The recent decline in startup funding, exacerbated by the collapse of major funding sources like Silicon Valley Bank, has prompted a re-evaluation of investment strategies [43]. Funding for fintechs peaked in 2021 at $6,948 Million, after which it gradually declined, entering a phase referred to as the 'funding winter [50]. The recent funding winter has led to a course correction in the ecosystem, emphasizing the importance of realistic valuations and the development of strong, profitable businesses. These businesses are positioned to create lasting value for all stakeholders over time, aligning naturally with fair intrinsic valuations. Robust businesses with solid fundamentals are crucial for India to achieve a 10 trillion-dollar economy [46]. In 2022, the global financial services sector witnessed the rise of significant fintech unicorns, including India's 'Open,' which achieved unicorn status as the country's 100th unicorn. Despite individual successes, the fintech industry encountered funding challenges amidst global economic uncertainties. For instance, Swedish BNPL fintech company 'Klarna' experienced a valuation decline from $45 billion in 2021 to $6.5 billion in 2022 [7]. Additionally, some fintech companies are downsizing their workforce under the guise of corporate restructuring without regulatory obligations for public disclosure. The primary goal is to reduce operational costs, although in some cases, founders have misused funds for personal gain by appointing family members as financial controllers, altering financial strategies for personal benefit [12].

Financial ratios like ROA, ROE, Net Profit Margin (NPM), and EPS are essential tools for investors to assess a company's profitability and financial health. Research shows that these metrics significantly influence stock prices, as strong financial performance tends to attract investor demand, leading to higher share prices [3]. Return on Equity (ROE) is a key indicator of profitability and is often linked to higher stock prices. However, financial leverage can increase ROE, while also raising risk. Companies with high ROE due to heavy debt may have lower stock prices compared to those with lower ROE and less debt [5]. The findings from Supriyadi [48] confirm that both ROE and ROA are positively correlated with a company's value. The price-to-earnings (P/E) ratio represents the ratio of the price per share to earnings per share, and it indicates the amount investors are willing to pay for each dollar of reported profit. EPS, referred to as "the bottom line," is considered the most important figure on the income statement for stockholders [5]. Equity valuation is typically influenced by maximum returns from a stock, the prevailing risk-free rate in the economy, and the market risk premium. For investors and financial managers, the composition of debt and equity in a portfolio plays a critical role in determining long-term expected returns. Typically, returns from capital projects are profits or income derived from investments, expressed as a fraction of their cost. Financial analysts view the debt-to-equity ratio as a key capital structure metric when assessing a firm's valuation [34]. Industrial organizations often make excessive use of borrowed money without considering its earning potential, which can lead to financial instability, failure, or bankruptcy in the long term. Unplanned use of debt and other financing methods can distort a company's capital structure, negatively impacting its financial position. Therefore, it is crucial for businesses to carefully manage financial leverage and the cost of capital. The key challenge companies face when raising funds is deciding between debt or equity [33]. The literature review identified key research gaps, particularly regarding the pursuit of high valuations for unicorn status driven by external funding. This research will explore how prioritizing valuations over value creation affects the long-term profitability of digital lending companies through the following hypotheses:

- Null Hypothesis (H0): There is no negative relationship between prioritizing high valuations over genuine value creation and the profitability of digital lending companies.
- Alternative Hypothesis (H1): There is a negative relationship between prioritizing high valuations over genuine value creation and the profitability of digital lending companies.

3. RESEARCH METHODOLOGY

The research methodology examines key variables of value creation, valuation, and profitability. The methods used included hypotheses testing [32], secondary data analysis, and quantitative techniques to examine financial metrics and statistical relationships within digital lending companies.

3.1 SAMPLING AND RATIONALE:

Two digital lending companies, (i) SATYA MicroCapital, an Indian company, and (ii) Upstart Holdings, Inc., an international company were selected to test the hypotheses. SATYA MicroCapital focused on value creation within the Indian market, targeting the bottom of the pyramid population, while Upstart Holdings, Inc. offered insights into valuation metrics on a global scale.

- ***Type of Data Used*****:** Secondary data
- ***Method of Data Collection:*** Data were collected from company websites and publicly available sources.

Information included financial statements, general company details, geographical presence, product and service offerings, funding strategies, valuation metrics, value propositions, and broader socio-economic impacts.

- ***Research Approach:*** Quantitative
- ***Research Design:*** The research type was descriptive to provide an overview of the company's financial standing and diagnostic, to identify causal relationships between variables.
- ***Research Tools:*** The research utilized descriptive tools such as financial analysis [20] and valuation analysis [36] and inferential tools such as regression analysis [26], and correlation analysis [42] to examine financial metrics and strategic impacts. The data were analysed using Minitab Statistical Software [35] for Pearson's correlation and Microsoft Excel was used for regression and descriptive statistics.
- ***Variables Used:*** Key variables analysed included metrics of value creation, profitability, financial leverage, and valuation.

4. RESULTS AND DISCUSSIONS:

4.1 CASE STUDY 1 – SATYA MICROCAPITAL

4.1.1 Brief Background:

Satya MicroCapital, LendingKart, Blacksoil, DMI Finance, and MoneyTap are the top leading Indian lending companies [6]. Among these lending companies, SATYA MicroCapital, founded by Mr. Vivek Tiwari in January 2017 in New Delhi, was selected for its innovative integration of technology in financial services in catering to the bottom of the pyramid population. As a microfinance NBFC, SATYA MicroCapital focuses on empowering rural women through digital and financial inclusion. The company aims to be the preferred choice for individuals at the base of the economic pyramid by fostering entrepreneurship and livelihood creation. As of March 31, 2023, SATYA MicroCapital reported Assets Under Management (AUM) of INR 46,843.07 Million, reflecting a 62.42% increase from the previous year. The company operates across 50,000 villages in 22 states with 449 branches, serving over 1.5 Million women entrepreneurs in rural and semi-urban areas, demonstrating its commitment to sustainable growth and socio-economic upliftment. Product offerings include loans ranging from ₹25,000 to ₹5,00,000, with tenures extending from 6 months to 3 years.

4.1.2 Value Proposition:

- ***Advancing Financial Inclusion through Digital Inclusion:*** As part of its digital inclusion efforts, SATYA MicroCapital has made significant advancements, as observed from [40, 41]. From FY'21 to FY'23, digital channels managed 93% of collections through Unified Payment Interface (UPI), Aadhar Pay, and Bharat Bill Pay (BBPS), and 100% of disbursements. The number of digitally onboarded customers grew from 615,429 in FY'22 to 875,380 in FY'23, representing a 42.3% increase. Additionally, UPI-transacting customers in unbanked rural areas surged from 21,860 in FY'22 to 222,744 in FY'23. The company's financial inclusion efforts also expanded its reach to 449 branches in unbanked rural centres by FY'23, marking a remarkable 140% increase from 187 branches in FY'21. This initiative is part of the company's broader Environmental, Social, and Governance (ESG) initiatives aimed at reducing its carbon footprint.
- ***Socio-economic Upliftment:*** SATYA MicroCapital's VEDA provides free, high-quality education to rural areas, bridging educational gaps across Tier 1 to Tier 4 cities. Additionally, in partnership with the SATYA Shakti Foundation, SATYA MicroCapital launched a year-long Mega Health Check-Up Drive, hosting over 100 health camps across 10 states.

4.1.3 Financial Analysis:

In FY 2022-23, the company reported revenues of INR 7,360.46 Million and expenses of INR 6,646 Million, reflecting an 83% increase in revenue and an 86% rise in expenses compared to the previous year. Among the expense categories, finance costs totalling ₹2,972.2 Million and employee expenses amounting to ₹2,023.6 Million emerged as the largest cost centres, comprising 45% and 30% of the total expenses, respectively in FY'23. The number of employees also increased by 24% during the fiscal year compared to the previous period. Profitability showed improvement, with profits rising by 63% to reach INR 530.44 Million in FY'23 (Fig.1).

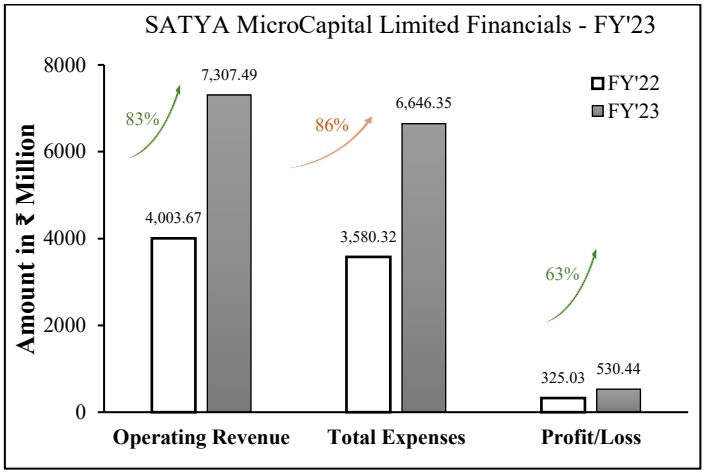

Fig.1. Financial Summary – SATYA MicroCapital Limited (Adapted from Annual Reports of Satya MicroCapital Limited)

The analysis of the financial data available in the annual reports (SATYA MicroCapital Limited, 2023) was conducted and the results are presented in Table.1-Table.3.

Table.1. Balance Sheet – SATYA MicroCapital Limited

Balance Sheet	March 31, 2023 (₹ in Million)	March 31, 2022 (₹ in Million)	Growth (%)
Total Assets	46,582.04	28,872.59	61%
Total Liabilities	37,977.67	23,239.94	63%
Total Equity	8,372.59	5,522.67	52%

Table.2. Financial Performance Indicators – SATYA MicroCapital Limited

Financial Metrics	March 31, 2023 (₹ in Million)	March 31, 2022 (₹ in Million)	Growth (%)
Total Revenue	7,360.46	4,015.41	83%
Total Expenditure	6,646.35	3,580.32	86%
PBT	714.11	435.09	64%
Tax Expense	183.67	110.06	67%
Profit After Tax (PAT)	530.44	325.03	63%
Diluted EPS	9.6	7.05	36%

Table.3. Financial Ratios – SATYA MicroCapital Limited

Ratios and Metrics	March 31, 2023	March 31, 2022	Formula Used
Pre-tax ROE	10.28%	9.10%	PBT / Average Equity
Post-tax ROE	7.63%	6.79%	PAT / Average Equity
Net Income Margin	7.21%	8.09%	PAT / Total Revenue
Operating Profit Margin	9.70%	10.84%	PBT / Total Revenue
Debt Equity Ratio	4.38	4.12	Total Debt / Total Equity

4.1.4 Descriptive Analysis of Financial Metrics:

1. **Return on Equity:** SATYA MicroCapital generated a 7.63% post-tax ROE, reflecting effective use of equity to generate profits despite the challenges of credit risk and operational efficiency in the lending sector.
2. **Debt-Equity Ratio:** With a Debt-Equity Ratio of 4.38 in FY'23, SATYA MicroCapital relies heavily on debt financing, which is typical in the lending sector where capital is deployed through loans.
3. **Net Income Margin:** A strong net income margin of 7.21% (Table.3), coupled with 83% revenue growth and a 63% increase in PAT (Table.2), highlights SATYA MicroCapital's financial strength.
4. **Capital Adequacy Ratio:** SATYA MicroCapital reported a capital-to-risk weighted assets ratio (CRAR) of 19.23% in FY'23, with Tier I Capital at 17.50% and Tier II Capital at 1.73% [41]. This strong capital position demonstrated the company's financial stability, resilience against losses, compliance with regulatory standards, and confidence among investors and stakeholders.
5. **Profitability:** SATYA MicroCapital's profit growth of 63%, from ₹325 Million in FY'22 to ₹530.44 Million in FY'23 reflected both strong investor returns and the company's impact on financial inclusion and socio-economic empowerment in rural and semi-urban India.

4.1.5 Regression Analysis – SATYA Micro Capital Limited:

Inferential statistics using regression analysis was conducted to examine how value creation, measured by basic EPS, impacts profitability (PBT and NOPAT). Basic EPS was regressed against PBT and NOPAT to evaluate the relationships between these variables for FY'23 (Table.4).

Table.4. Regression Statistics for Basic EPS on PBT and NOPAT of SATYA MicroCapital Ltd. for FY'23

PBT with Basic EPS		**Anova**	
Multiple R	0.998	F	930.12
R Square	0.997	Significance F	0.00007744
Adjusted R^2	0.996		
NOPAT with Basic EPS		**Anova**	
Multiple R	0.989	F	131.03
R^2	0.978	Significance F	0.0014
Adjusted R^2	0.97		

Both regression analyses reveal strong correlations between Basic EPS and the dependent variables (PBT and NOPAT). The correlation coefficients are 0.998 for PBT and 0.989 for NOPAT, indicating very strong relationships. The R^2 values show that Basic EPS explains a substantial proportion of the variability in both PBT (0.997) and NOPAT (0.978). The high F-values and significant p-values (< 0.05) confirm that these relationships are statistically significant. The coefficients and significance of Basic EPS in predicting PBT and NOPAT for SATYA MicroCapital Ltd. in FY'23 is shown in Table.5. The results affirm that value creation is positively associated with profitability in Satya MicroCapital Ltd.

Table.5. Coefficients and Statistical Significance of Basic EPS in Predicting PBT and NOPAT of SATYA MicroCapital Ltd. for FY'23

Metric	Coefficient	p-value	Inference
PBT with Basic EPS	72.195	0.00007744	The coefficient of 72.195 indicated that for each unit increase in Basic EPS, PBT increases by approximately 72.195 units. This strong effect is statistically significant, with a very low p-value.
NOPAT with Basic EPS	53.929	0.00143	The coefficient of 53.929 indicated that for each unit increase in Basic EPS, NOPAT increases by approximately 53.929 units. This effect is also significant, with a p-value < 0.05.

4.1.6 Pearson Correlation Analysis between NOPAT, PBT and Basic EPS – Satya MicroCapital Ltd.:

Further, correlation analysis was conducted using Minitab Statistical Software and the p-values were derived from the software to determine the statistical significance of the

relationships. Fig.2 shows Pearson correlation coefficients of 0.998 between Basic EPS and PBT; and 0.989 between Basic EPS and NOPAT, indicating a very strong positive linear relationship between value creation (represented by Basic EPS) and profitability (PBT and NOPAT) for Satya MicroCapital. The NOPAT was calculated by the author using the formula (PBT - other income / 1 - tax rate). The tax rate used is at 25.168%, as taken from the annual reports of [41]. Satya MicroCapital's performance was analyzed from 2019 to 2023, post break-even.

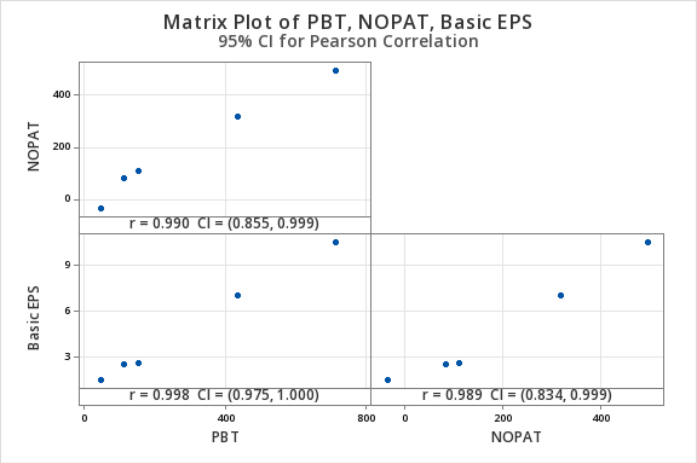

Fig.2. Pearson Correlation of PBT, NOPAT, and Basic EPS for Satya MicroCapital Ltd. (2019-2023)

Table.6. Author's Analysis from Annual Reports of Satya MicroCapital Limited

Metrics 1	Metrics 2	N	Correlation	p-value
NOPAT	PBT	5	0.990	0.001
Basic EPS	PBT	5	0.998	0.000
Basic EPS	NOPAT	5	0.989	0.001

The p-value of 0.001 (Fig.2) for both correlations is significantly below the 0.05 threshold [25], which confirmed that these correlations are statistically significant at the 5% level, and suggested that the observed relationships are unlikely to have occurred by chance. To summarize, the high correlation coefficients and significant p-values confirm a strong positive relationship between value creation (Basic EPS) and profitability (PBT and NOPAT) for Satya MicroCapital. Thus, H0 is rejected, and H1 is accepted. The findings of the present study are consistent with the research by [49], which stated that there is a positive relationship between EPS and profitability, as measured by net profit.

4.2 CASE STUDY 2 - UPSTART HOLDINGS, INC.

4.2.1 Brief Background:

Upstart Holdings, Inc., founded in 2012, is an AI-driven lending platform that initially offered an Income Share Agreement (ISA) product but shifted focus in 2014 to provide personal loans. With this pivot, Upstart Holdings began offering a traditional 3-year loan and has expanded its offerings to include a 5-year loan product as well. The startup primarily targets college graduates aged 28 to 35. Beyond traditional credit scoring methods, Upstart Holdings developed an in-house income and default prediction model that incorporates education (including colleges attended, GPA, and standardized test scores) and employment history to assess creditworthiness more comprehensively. Upstart's platform connects consumer loan demand with AI-powered bank partners through a configurable cloud application, supporting various credit policies and lending parameters by leveraging data from all partners. Consumers access Upstart-powered loans via Upstart.com or bank-branded platforms [51, 52].

4.2.2 Value Proposition:

- Upstart AI enables lenders to approve a broader range of borrowers at competitive rates
- Over 80% of borrowers receive instant approval with no documentation or phone calls required

4.2.3 Financial Analysis:

The company raised a $1.75 Million seed round from First Round Capital, Kleiner Perkins Caufield & Byers, New Enterprise Associates, Google Ventures, Crunchfund, and Mark Cuban, followed by a $5.9Million series A round with investors like Eric Schmidt, Marc Benioff, and Khosla Ventures. They secured $35 Million in a Series C round from Third Point Capital in June 2015, $32.5 Million from Rakuten in 2017, and a Series D round of $50 Million from The Progressive Corporation in 2019. Upstart went public via an IPO in late 2020, marking a significant milestone in its growth and expansion in the lending industry [44].

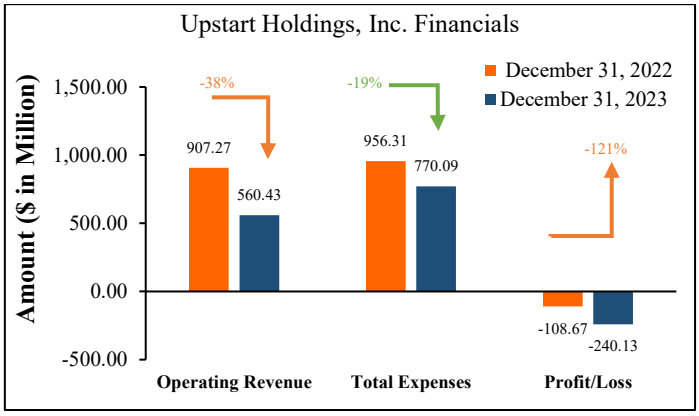

Fig.3. Financial Summary – Upstart Holdings, Inc. (Adapted from Annual Reports of Upstart Holdings, Inc.)

In 2023, revenue decreased by 38% compared to 2022, with key sources including referral and platform fees from bank partners, annualized fees for loan servicing, and additional income from interest and securitization activities. Expenses decreased by 19%, driven by a 63% reduction in sales and marketing costs to $127.14 Million. However, engineering and product development remained the largest expense category, totalling $280.14 Million, or 36% of total costs. Despite these cost reductions, the company's net loss widened to $240.13 Million in 2023, up from $108.67 Million the previous year (Fig.3).

A detailed financial analysis of the company's performance is presented in Table.7-Table.9 and have been sourced from annual reports of Upstart Holdings, Inc. [52].

Table.7. Balance Sheet - Upstart Holdings, Inc.

Balance Sheet	December 31, 2023 ($ in Million)	December 31, 2022 ($ in Million)	Growth (%)
Total Assets	2,017.10	1,936.05	4%
Total Liabilities	1381.80	1263.62	9%
Total Equity	635.31	672.44	-6%

Table.8. Financial Performance Indicators – Upstart Holdings, Inc.

Financial Metrics	December 31, 2023 ($ in Million)	December 31, 2022 ($ in Million)	Growth (%)
Total Revenue	513.56	842.44	-39%
Total Expenditure	770.09	956.31	-19%
PBT	-240.03	-109.07	-120%
Tax Expense	0.11	-0.41	-127%
PAT	-240.13	-108.67	-121%
Diluted EPS	-2.87	-1.31	-119%

Table.9. Financial Ratios – Upstart Holdings, Inc.

Ratios and Metrics	December 31, 2023	December 31, 2022	Formula Used
Pre-tax ROE	-37%	-15%	PBT / Average Equity
Post-tax ROE	-37%	-15%	PAT / Average Equity
Net Income (Loss) Margin	-47%	-13%	PAT / Total Revenue
Operating Profit (Loss) Margin	-47%	-13%	PBT / Total Revenue
Debt Equity Ratio	1.64	0.68	Total Debt / Total Equity

4.3 DESCRIPTIVE ANALYSIS OF FINANCIAL METRICS

- The history of funding rounds, starting from a seed round of $1.75 Million in 2012 to subsequent series rounds, including a series D round of $50 Million from The Progressive Corporation in 2019, and culminating in an IPO in late 2020, highlights Upstart's access to capital and its ambitious growth aspirations. However, the negative profitability margins and ROE in 2022 and 2023 suggest that the company may be prioritizing achieving high valuations through funding rounds rather than creating genuine value through profitable operations.
- Upstart's financial metrics indicated challenges in translating the revenue into consistent profitability. It's net income (loss) for the period ending December 31, 2023, was -$240.13 million and the operating profit (loss) margin was -46.76%.

4.3.1 Valuation and Value Creation Analysis - Upstart Holdings, Inc.:

Table.10. Value Creation and Valuation Metrics – Upstart Holdings, Inc. as on 18th September 2024

Metric	Parameter	Figure
Value Creation	EPS	-2.33
	ROA	-10.39
	ROE	-32.5
	Return on Investments (ROI)	-12.52
Valuation	Current Market Price ($)	37.69
	Discounted Cash Flow Fair Value ($)	-116.58
	Upside / Overvaluation	-409.3%
	Cost of Equity	8.25%
	Cost of Debt	5.70%
	Weighted Average Cost of Capital (WACC)	7.70%
	Market Cap ($ in Million)	3,374
	Enterprise Value ($ in Million)	3,912
ESG Scores	ESG Score	14.25
	Environment Score	3.86
	Social Score	25.84
	Governance Score	13.04

Source: (valueinvesting.io, 2024)

The analysis of value creation and valuation metrics (Table.10) revealed the following:

- **Value Creation**: The negative EPS, ROA, ROE, and ROI figures indicate that Upstart Holdings Inc. has struggled to achieve profitability. Despite a high market valuation (Market Cap of $3,374 Million and Enterprise Value of $3,912 Million), the company shows significant losses (negative EPS of -$2.33) and poor returns on assets and equity.
- **Valuation:** The high overvaluation of -409.3% indicated that the current market price of $37.69 exceeds the discounted cash flow fair value of -$116.58. This discrepancy is primarily influenced by the cost of equity (8.25%) relative to the cost of debt (5.70%), indicating that investors may be demanding higher returns (thus higher cost of equity) compared to what the company can sustainably generate through its operations, impacting its valuation negatively.
- **ESG Considerations**: ESG ratings are closely tied to the cost of capital & Upstart's capacity to secure funding. However, Upstart's ESG score of 14.25, with a strong Social Score of 25.84, may have a positive impact on its reputation and stakeholder perception.

4.3.2 Correlation Analysis – Upstart Holdings Inc.:

Table.11. Correlation Coefficients of Profitability and Financial Leverage with Valuation Metrics – Upstart Holdings, Inc.

Profitability/ Financial Leverage Metrics	Valuation Metrics	N	Correlation	p-value
Contribution Profit	P/E	4	-0.942	0.058
Debt Equity	Enterprise value to future cash flow (EV/FCF)	4	-0.983	0.017

4.3.3 Correlation Analysis - Upstart Holdings, Inc.:

The company's valuation, which soared to over $27 Billion by 2022 from an initial $1.45 Billion at its IPO in late 2020, raises questions about the sustainability of such growth amidst declining profitability metrics [30]. Given the substantial valuations achieved by the company, the present study tested hypotheses by exploring the correlation between profitability, measured by contribution profit, and valuation metrics such as P/E ratio, as well as the correlation between financial leverage, measured by the debt-equity ratio, and valuation metrics such as EV/FCF. Since going public in 2020, valuation ratios like EV/FCF and P/E are sourced from the MarketScreener report for Upstart Holdings Inc [28]. Minitab Statistical Software was used to perform the correlation analysis, and the p-values were calculated within the software to assess the statistical significance of the relationship between the variables.

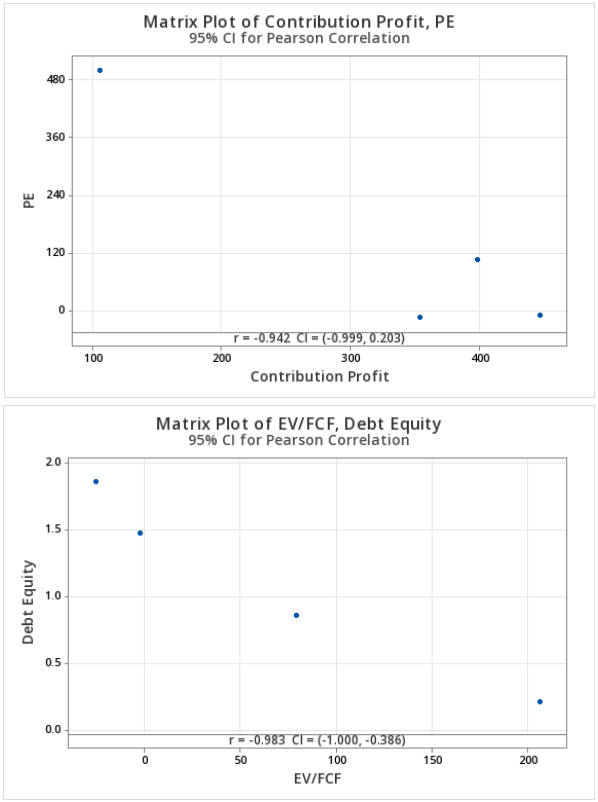

Fig.4. Pearson Correlation of Financial Leverage & Profitability with Valuation Metrics – Upstart Holdings, Inc.

The negative correlations of -0.942 between Contribution Profit and P/E Ratio, with a p-value of 0.058 (Table.11) supports the notion that high valuations are not aligned with profitability. The negative correlation of -0.983 between Debt-to-Equity Ratio and EV/FCF, having a p-value of 0.017 (Table.11) further suggested that high valuations are not supported by financial stability. The p-value for these correlations is < 0.10 (Table.11), suggesting that the correlations are statistically significant at the 10% level [32]. A significance level of 0.10 was chosen to account for the inherent limitations in statistical power due to the small sample size (n = 4), and to provide a more flexible threshold for detecting relationships between the variables [25]. The empirical evidence in Fig.4 suggested that prioritizing high valuations over value creation does not reflect strong financial performance and profitability, leading to the rejection of H0 and acceptance of H1.

Table.12. Author's Analysis from Annual Reports of Upstart Holdings, Inc. & Valuation Report

Year	2020	2021	2022	2023
EV/FCF	206	79	-2.36	-25.6
PE	499	106	-10.1	-14.2
Debt-Equity Ratio	0.21	0.86	1.47	1.86
Contribution Profit ($ in Million)	105.088	397.88	446.751	353.294

Our findings are similar to other reported studies that emphasize the risks of inflated valuations and their negative impact on startups' long-term profitability. [54] emphasized that startups should prioritize value creation over inflated valuations. While valuations indicate potential, true value is reflected in tangible benefits to stakeholders. Excessive focus on high valuations can lead to investor disillusionment and unsustainable practices. Startups should shift attention from initial valuations to demonstrating profitability and long-term growth. Investors must assess business models, monitor key metrics, and advocate for realistic valuations to avoid bubbles. A focus on genuine value creation ensures lasting success. [16] highlighted the risks of inflated valuations, citing WeWork and Zenefits. WeWork, once valued at $47 billion, collapsed due to financial losses and managerial problems, leading to a failed IPO and sharp devaluation. Zenefits, valued at $4 billion, faced regulatory issues and internal misconduct, resulting in a major revaluation and financial losses. Both cases show how inflated valuations can mask underlying problems, leading to financial and reputational damage. [13] noted the challenges startups faced due to the venture capital surge in 2021-2022, which led to unrealistic valuations and financial instability. Startups should secure funding only when necessary, focusing on steady revenue and realistic growth to avoid overspending and maintain healthy valuations.

5. IMPLICATIONS OF THE PRESENT STUDY

As the fintech industry evolves, the need for ethical, sustainable, and socially responsible practices becomes increasingly urgent. Incorporating Environmental, Social, and Governance (ESG) principles into fintech operations is not only a moral imperative but also a strategic advantage in a world that is increasingly focused on responsible business practices. In

corporate governance, it has become clear that profit-making alone is no longer sufficient as a sole objective. While the Environmental and Governance components of ESG are widely acknowledged, the Social Responsibility often receives less attention but deserves greater consideration. The present study explored the relatively uncharted territory of socially responsible capitalism, emphasizing the critical role of the social aspect in corporate practices.

The observations of the present study also stressed the significance of incorporating corporate social responsibility into the foundational principles of all companies. Our analysis suggested that India's corporate sector can serve as a model based on ethical foundations and principles. India can show the world that it holds a unique opportunity for a promising future by (i) contemplating the missed opportunities of the past 78 years and (ii) by demonstrating the value of socially responsible capitalism that benefits all stakeholders. Prosperity can be shared among all by doing things right, inclusively, and compassionately, making socially responsible capitalism a guiding ethos for the corporate world of tomorrow.

6. CONCLUSIONS

The findings of this study explored the relationship between funding, valuation, value creation, profitability, and financial metrics of the startup companies. It illustrated the pivotal role of ethical, value-driven strategies that target the bottom of the pyramid, and thereby establishing a mutually beneficial path for both fintech enterprises and underserved populations. On the other hand, the pursuit of excessive valuation is a risky path, as more funds do not necessarily lead to more growth. Instead, right amount of funds is essential for achieving the right kind of growth.

The research acknowledged the dynamic nature of the market, where trends can shift rapidly, leading the companies either to profits or losses. It called for startups to align valuation with actual business expansion over instant short-term gains in the pursuit of unicorn status. Incorporating ESG principles, particularly the social responsibility, into corporate practices is crucial for inculcating sustainable and equitable societies.

To conclude, profits are essential for societal impact, but not at the cost of people, planet, and ethical principles. Entrepreneurs must balance valuation with value creation and align profits with purpose to ensure a stable and sustainable business. The damage from a lost reputation, eroded trust, and eventual business collapse far outweighs the short-term gains from excessive valuations and inflated share prices. Therefore, adopting a prudent, agile, and frugal approach is vital for achieving and maintaining long-term profitability.

7. SCOPE FOR FUTURE WORK

The funding of fintechs to kickstart product development is crucial not only at the beginning, but it is equally vital to support the fintech startups when they reach the stage of technological readiness for market entry. This phase demands a different set of financial resources to facilitate the product's successful launch into the market. Future research could focus on policies that address funding needs at this critical juncture. However, funding sources have become increasingly discerning and stringent over the past three years. Much of the venture capital funding has come from international sources due to favourable interest rates and opportunities in the local market. Now, as these dynamics shift, there is a funding downturn, referred to as a "funding winter." Research has indicated that the failure rate for new startups is currently 90%, with 10% not surviving their first year. Approximately 75% of fintech startups fail within two decades, and the technology sector has the highest failure rate among startups in the United States [22]. Policy initiatives should support startups throughout their journey, until they successfully enter the market, and not just with initial seed investments.

Our study is limited to digital lending startup companies. Future research could explore startups across various sectors to examine the dynamics of value creation and valuation on profitability.

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