Capital Allocation Shift and Scale Conversion Challenges in India's Startup Ecosystem (2022–2026)

Deep Soni[1], Rohit Kumar Mishra[2], Mr. Kuldip Dubey[3]
[1,2]*MBA (Business Analytics) Parul University Vadodara, India*
[3]*Assistant Professor (MBA Department), Parul University Vadodara, India*

***Abstract*—The study aims to investigate the evolution of the technology startup ecosystem in India in 2022 and 2026 and how these shifts would result in structural differences between the years of active expansion and constrained funding. The study will also be aimed at pointing out the shift in patterns of capital allocation such as more concentration towards late-stage investments and buyout investments. In this time, there was a loss of capital at the initial stages, which posed obstacles along the way in the effort of converting a proven startup into a business model.**

This study also aims at bringing into focus the scale conversion issue in which the startups have been proven technically viable but are facing challenges in making the next transition. The study also aims at pointing out the likely structural imbalances of the startup ecosystem due to capital concentration in mature assets. The study also aims at emphasizing the significance of balanced capital sequencing in maintaining innovation and the long-term viability of the startup ecosystem.

***Index Terms*—Capital Allocation, Startup Ecosystem, Private Equity, Venture Capital, Scale Conversion, India**

I. INTRODUCTION

The ecosystem of Indian technology startups is one of the biggest in the world and it was transformed considerably between the years 2022 and 2026. The reason behind the high growth rate was observed in 2020-2022 can be explained by the fact that the liquidity and optimism were very high during this time. Nevertheless, the macroeconomic aspects such as the high world rates and inflation resulted in the decrease of capital inflows growth.

The amount of funding startups received in 2022 was 25 billion USD, but in 2023, the figures dropped drastically and to 7 billion USD. This implies that growth strategies have changed to financial sustainability. Although the funding environment has still been seen to stabilize in 2024, totalling 11.6 billion USD, and 4.8 billion USD in the first half of 2025, the capital received by startups has changed dramatically. Investment received by startups grew among the late-stage startups and the private equity buyouts which meant that there was a transition among the early-stage startups. This created a structural issue on startup growth.

Table 1: Startup Funding Trend in India (2022–H1 2025)

Year	Total Funding (US$ Billion)
2022	25.0
2023	7.0
2024	11.6
H1 2025	4.8

Source: EY-IVCA, Tracxn

It can be identified that there are two key changes during this period. The former is a capital allocation change, which gives preference to mature startups and less risky investments. The second is a scale conversion constraint, in which the startups have a problem of expansion between the initial-stage validation and the stage of growth funds. This leads to a highly critical question of whether this change in early-stage startups to late-stage startups will be a source of impediment to the innovation pipeline.

II. LITERATURE REVIEW

However, existing research studies on the subject of startup financing describe the difference between venture capital and private equity in terms of the stage and associated risks. It is generally assumed that venture capital is related to early-stage investments, which are associated with high risks and innovation

potential. On the other hand, private equity is related to mature businesses and is associated with high levels of efficiency and value creation through control transactions.

Nonetheless, the majority of the available research studies have addressed the topic of venture capital and private equity individually but not in a combination or even as a pair. This is specifically so in the environment of new economies such as India where capital sequencing is set to will be very instrumental in terms of early-stage investments, which will create a pipeline of the late entrants. The trends of the past few years within the industry depict a rising pattern of the number of buyout transactions that involve a sort of private equity rather than the conventional venture capital investment. This has been largely attributed to increased favoritism towards financial stability in an environment that is volatile in the macroeconomic environment. Nevertheless, the topic has received little coverage as regards to its implication on startups as regards to scale conversion between small-scale validation and scalable business. This paper is an endeavor to bridge the gap as far as its applicability to the Indian scenario is concerned.

III. RESEARCH METHODOLOGY

This study adopts the descriptive and analytical research design and secondary data to determine the trend in the distribution of funds.

The most important parameters, which the research will take into consideration, are the volume, deal stages, and types of transactions. These parameters are pegged on industry reports by EY-IVCA, Tracxn, and Zinnov-NASSCOM, between 2022 and 2026.

Analytical rigor is ensured with the use of financial parameters. The funding trend of the long-term is measured through the compound annual growth rate (CAGR). It is computed by the following formula: [(Ending Value/ Beginning Value)/n] -1. The ratio between the private equity and the venture capital is employed to determine the comparative significance of the types of investments. The share at the beginning of the process is determined by dividing the seed financing with the overall financing.

An organized evaluation of the amount and type of funding of the ecosystem is conducted with the help of this methodological framework.

IV. DATA ANALYSIS AND CALCULATIONS

The funding trajectory of the Indian startup ecosystem indicates a significant contraction followed by partial stabilization.

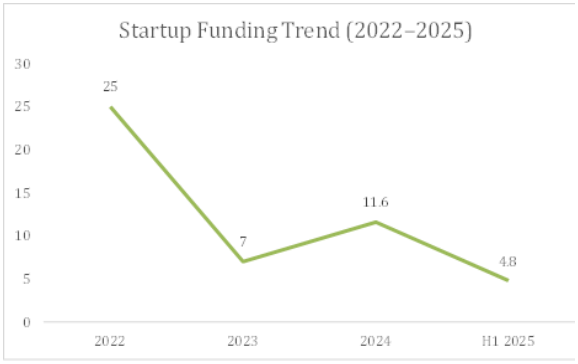

Chart 1: Trend in Startup Funding in India (2022–H1 2025)

Source: EY-IVCA, Tracxn

The fall between 2022 and 2024 indicates massive correction in the flows of capital which is being instigated by tighter liquidity conditions in the world and evolving preferences of the investors.

The period 2022-2024 compound annual growth rate (CAGR) is determined in the following manner:

CAGR = [(11.6 / 25) ^ (1/2)] - 1 CAGR = (0.464^0.5) - 1 CAGR ≈ 0.681 - 1 = -31.9%

Such a negative growth rate should suggest a steep decline in the funding activity, as it is a sign of the shift between the high-growth capital deployment to the more disciplined investment environment.

Disproportionate loss has been experienced in early-stage funding. It was estimated that seed funding in the first half 2025 was about US$452 million and the total financing was US$4.8 billion in the same period of time. The share in the early stage is thus calculated as:

Early-stage Share = 452 million/4.8 billion ≈ 9.4%

It means that at the initial stages, investments are currently a comparatively low percentage of the total amount, which reflects the decline in the pipeline of startups.

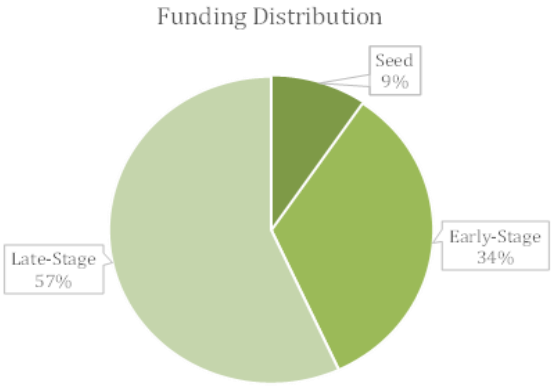

Chart 2: Distribution of Startup Funding by Stage (H1 2025)

Source: Tracxn (2025)

Conversely, the late-stage investments and buyout deals have taken precedence. Buyout investments reached approximately US$2.1 billion and the startup investments reached about US1.7 billion in November of 2025. The ratio of the private equity to venture capital is hence:

PE/VC Ratio = 2.1 / 1.7 ≈ 1.24

A ratio of more than one signifies that the capital is becoming increasingly focused on buyout transactions which is a shift to mature and less risky investment.

V. RESULTS AND DISCUSSION

The analysis reveals that the Indian startup ecosystem is undergoing a structural shift in the pattern of investments. Investments are increasingly favoring mature startups and buyout deals.

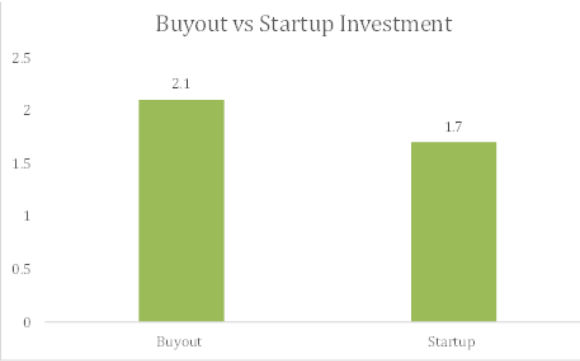

Chart 3: Comparison of Buyout and Startup Investments in India (November 2025)

Source: EY-IVCA (November 2025)

The major challenge that arises from the structural shift in the Indian startup ecosystem is the challenge of scale-up. Startups are still highly technically proficient and have the potential to innovate; however, they are facing challenges in advancing from the validation phase to the commercialization phase.

The reduction in early-stage investments is a point of concern in the Indian startup ecosystem. If the number of startups that are adequately funded in the early stages of their development reduces in the present scenario, the number of startups that are likely to grow and mature in the future is also likely to reduce.

At the same time, the rise in the share of buyout deals in the Indian startup ecosystem indicates that investors are focusing more on the optimization of the existing assets rather than investing in new innovative ventures. This might create structural problems in the Indian startup ecosystem in the future.

The reduction in early-stage investments and the rise in the share of late-stage investments in the Indian startup ecosystem might create a problem in the future in the form of a gap in scalable startups.

VI. CONCLUSION

Indian startup ecosystem is experiencing a shift in the way it has been towards a more disciplined and sustainable investment environment. Although this change has offered relief to the financial system, and diminished the rate of excessive risk-taking, it is also presenting a problem in the form of capital allocation to particular stages of the startup lifecycle.

Besides this, the findings of the study show that there should be a balance in terms of capital allocation towards early-stage innovation and late scale scaling. The necessity to raise the level of early-stage funding and commercialization will play a critical role in the solution of the problem of scale conversion.

It will be essential to ensure an effective circulation of money to all parts of the ecosystem to enable sustainable innovation, startup scaling and systemic economic objectives.

REFERENCES

[1] EY-IVCA. (2025–2026). Private Equity and Venture Capital Industry Reports. Mumbai. Tracxn. (2025). India Tech Startup Funding Report. Bengaluru.

[2] Zinnov & NASSCOM. (2025–2026). India Tech Startup Ecosystem Report. Bengaluru.