India’s Startup Ecosystem

This article is based on “The Promise and Pitfalls of India’s Startup Boom” which was published in the Livemint on 30/11/2021. It talks about the growth of the startup sector of India and the key issues faced by the sector.

It is an era of unprecedented innovation and disruption — benefitting from the surge of startups, armed with transformative products, business models, and capital to take on the world.

Today, India is the third largest start-up ecosystem globally (by number of start-ups) with more than 15,000 start-ups established in 2020, up from 5000 in 2010. The underlying enablers of this startup ecosystem include smartphone and internet penetration, cloud computing, application programming interfaces (APIs), and a national payments stack in place.

Additionally, amid the Covid-19 pandemic, India has witnessed more number of Unicorn startups (startups having valuation of over $1 billion) in just 2021 than it did in the period 2011-20.

However, still there are many challenges that act as a hindrance in realising the true potential of startups in India.

Startup Sector in India

- **Increasing Investments in Startup Sector:** A private organisation (VCCircle) based weekly startup activity in its latest round has shown robust inflows in the startup sector.
  - The total value of private equity and venture capital deals involving new ventures jumped over threefold; nearly $1.7 billion was raised, with as many as 42 deals notched up.
  - Slice (Bengaluru based fintech) was India’s 41st (and the latest) unicorn in the year 2021, and the 11th fintech firm to achieve the status, after raising $220 million from investors.
• **Unicorns in India**: India currently stands third in the global list of the number of companies that have attained unicorn status (well behind the US and China, but ahead of the UK and Germany.).
  - While **fintech** and **e-commerce** companies have led this phenomenon and remained at the forefront of establishing the unicorn ecosystem, other sectors such as **edtech**, **food delivery** and **mobility** have also made significant contributions.
  - Against a cumulative number of 33 unicorns, from 2011 to 2020, the year 2021 alone has seen the emergence of 41 startup unicorns.

• **Role of Government Policies & Forex Inflow**: India’s changing reforms and policies towards start-ups and various government initiatives have helped the Indian start-ups scale.
  - The inflow of forex especially from leading tech companies such as Facebook, Google, and Microsoft into the Indian start-up ecosystem signals the immense potential of the domestic market.

• **Role of Technology**: Technology has played a key role in the making of pioneer business models.
  - Most of the unicorns have leveraged technology in all possible ways, from refining internal organizational processes to enhancing the value proposition for their customers.
  - The lockdown and social distancing pushed several businesses to shift from conventional methods to entirely digitally-driven operations, thereby creating better avenues for market forces.
  - Leveraging new-age technologies such as **artificial intelligence**, **internet of things**, **data analytics**, **big data**, **robotics**, etc. several startups worked towards bridging wide-ranging gaps that were introduced in the market.

• **Unicorns, Employment and Women Entrepreneurs**: The Indian start-up ecosystem is nothing short of a revolution with $106-billion worth of value-creation by 44 unicorns, in turn creating 1.4 million direct and indirect jobs.
  - Moreover, women entrepreneurs have also contributed immensely to the start-up ecosystem (Swati Bhargava of CashKaro and Falguni Nair of Nykaa to name a few).

**Challenge Associated**

• **Increasing Investments Do Not Ensure Success of a Startup**: Amid the Covid-19 crisis, when the central banks have released a global glut of liquidity, money is no more a difficult task to raise.
  - The billions of dollars being invested in startups represent the large bets on distant outcomes, and not value generation by way of revenues.
  - Plus, one cannot assume the high rate of survival of these startups with such investments, as it can be assured by profits.
• **India, Still a Marginal Player in the Space Sector:** While India’s startups in the fintech and e-commerce sector are doing exceptionally well, the space startup sector remains an outlier
  - Currently, the global space economy is worth $440 billion, with India having less than 2% share in the sector.
    This is despite the fact that India is a leading space-faring country with end-to-end capabilities to make satellites, develop augmented launch vehicles and deploy interplanetary missions.
  - The reason for the lack of independent private participation in space includes the absence of a framework to provide transparency and clarity in laws.
• **Indian Investors Unwilling to Take Risks:** The big investors in India’s startup sector are from overseas; Japan’s SoftBank, China’s Alibaba, and Sequoia from the US.
  - That’s because India does not have a serious venture capital industry with an appetite for risk.
  - The country’s established conglomerates have mostly stuck to traditional businesses.

**Way Forward**

• **More Investments are Important:** One cannot expect an entire herd of unicorns to gallop its way to glory. Such quibbles, however, should not dampen risk-taking.
  Whether the wagers of investors work out well, all these investments are crucial for the incubation of value-generators that could help rewire India’s economy for faster expansion over the decades ahead.
• **Policy Interventions:** Policy favour has helped the startup sector significantly, such as by exempting the tax on startup earnings for some years.
  - However, the taxation of stock options issued to workers is rather too complex.
    Levies on investments and capital gains made by early-stage investors can also be eased with a little more clarity.
  - Liability overlaps in complicated tax rules often let officials abuse their discretionary authority.
    The scope of this investor put-off needs reduction and the ambiguity shall be ended by introducing tax reforms. Top-level intervention would help.
• **Legislative Framework for Space Startups:** A stringent framework to provide transparency and clarity in laws with respect to the startup ecosystem in the space sector is required.
  The laws need to be broken down into multiple sections, each to address specific parts of the value chain and in accordance with the Outer Space Treaty.
• **Ensuring Availability of Capital:** The nation’s policymakers, risk-taking corporates and funding agencies need to **foster a conducive climate for ensuring easier availability of domestic capital.**
  ○ The **regulators have to play a more proactive role** in formulating appropriate regulations that **encourage innovation and support emerging business models.**
  ○ Besides promoting local funding, the government and corporate entities may need to invest in a big way through leading academic institutions to de-risk start-up investments in the long run.

*Drishti Mains Question*

Discuss the challenges that act as a hindrance in realising the true potential of startups in India.