Startups in India and Data Localisation

This editorial is based on **"Data localisation norms may need easing, but startups should compete without relying on heavy hand holding of state"** which was published in The Indian Express on 18/07/2022. It talks about the startup ecosystem in India and impact of Data Localisation.

For Prelims: Startup Ecosystem in India, Unicorn Club, India Venture Capital Report, Atal Innovation Mission, Data Localisation, Foreign Domiciliation, Inflation, Industry 4.0

For Mains: Startup Growth Scenario in India, Impact of Data Localisation on Startup Ecosystem in India

Startups are the engine of exponential growth, manifesting the power of innovation. Several big companies today are the startups of yesterday, and have become the **shining beacons of innovation.**

India is home to the third-largest base of technology startups in the world after the US and China. With a growing entrepreneurship culture and a supportive ecosystem, India's startups and small businesses are not only expected to further drive economic and business transformation but also cement its position as a **key growth driver to India's dream of becoming a 5 trillion dollar economy.**

What is the Startup Growth Scenario in India?

- **India is a hotspot for startups. In 2021 alone, Indian startups have raised more than 23 billion dollars,** spread over 1,000+ deals, with 33 startups entering the coveted unicorn club.
  - So far, the year 2022 has added 13 more startups to the **unicorn club.**
- According to the **India Venture Capital Report 2021** published by Bain and Company, the number of cumulative start-ups has grown at a Compounded Annual Growth Rate (CAGR) **of 17%** since 2012 and crossed 1,12,000.
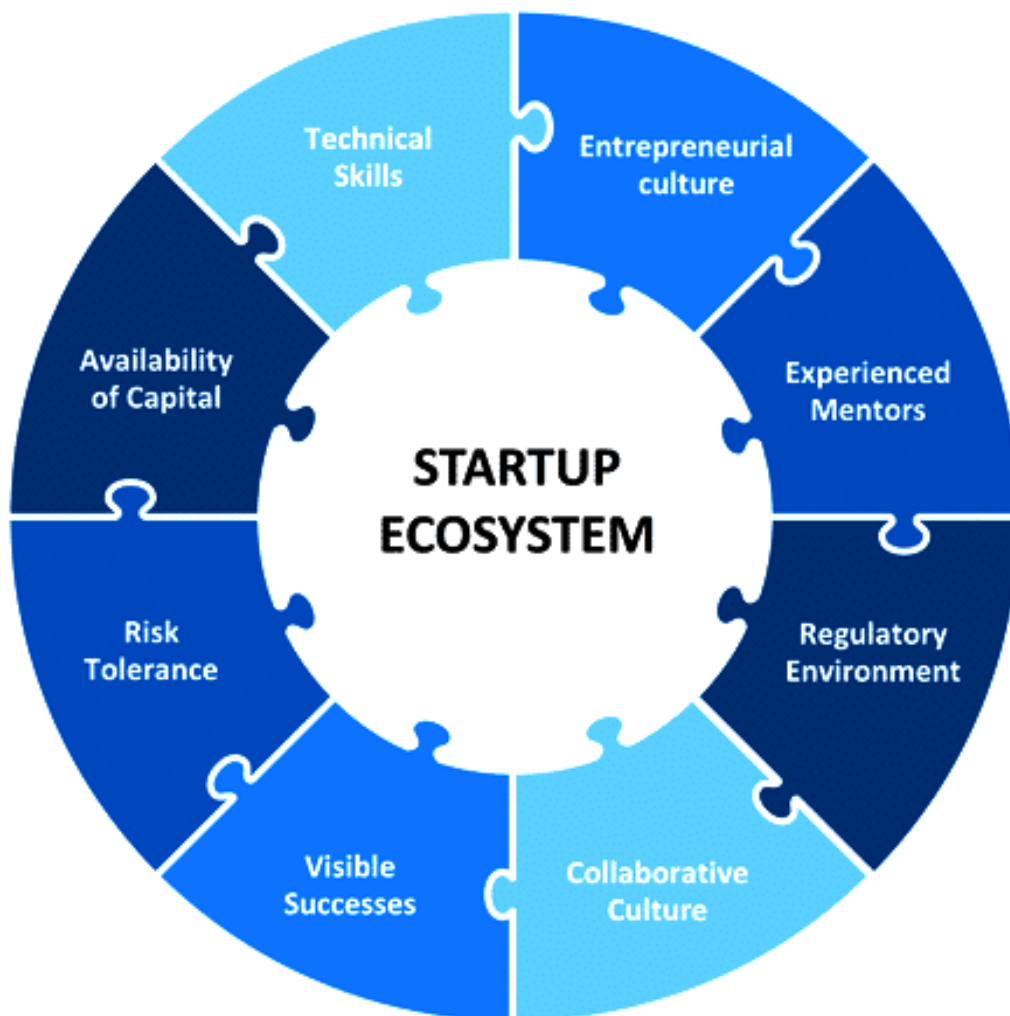
What has led to the Booming of India's Startup Ecosystem?

- **Recognition of Significance of Startups:** India has recognized the need to develop **innovation and incubation centres** for its large student community to foster innovation and entrepreneurial mindset through academic institutions.
    - A **rising number of incubators** and a steady **inclination of young executives towards starting their own ventures** is also propelling the entrepreneurship and early-stage startup ecosystem in India.
    - Establishment of new incubation centres - Atal Incubation Centres **(AICs) via the** Atal Innovation Mission has also nurtured innovative start-up businesses in their pursuit to become scalable and sustainable enterprises.
- **Availability of Potential:** A study on **tech startups of 2021** revealed that a **sizable number of edtech founders are young graduates from IITs and premier engineering colleges** or those who worked for global consulting firms.
    - This **availability of ambitions of young Indians with risk taking ability along with the right blend of passion, expertise, and mindset** of Indian entrepreneurs puts India's early-stage startup ecosystem at an advantage in cashing on the opportunities of a booming market.
- **Startup Specific Initiatives:** The Government of India has been playing a crucial role in facilitating the growth of early-stage startups through the implementation of progressive policies and creating relevant infrastructure.
    - Under the Startup India Initiative **launched in 2016**, the government has endeavoured to simplify complex legal, financial and knowledge requirements in an effort to **encourage the participation of early-stage potential startups.**
- **Startup-Corporate Collaborations: Established corporates who lack innovation capacity** and agility, and **nimble early-stage startups who lack cash for growth** and networks for market access, provide a **unique and scalable platform for such collaborations** and

multiplied wealth creation.
- Various corporate-startup partnership programmes have been driving innovation and accelerating the growth of early startups in India.
  - **Microsoft India has accelerated more than 4,000 startups**, while **Tata Motors is engaged with half a dozen startups and exploring partnerships with 20 more.**

Data Localisation – How will it Affect the Growth of Startups in India?

- **An Obstacle to Global Coverage:** In addition to Indian Customers, **Many start-ups have customers** abroad and a **localisation mandate could make it tricky for them to do business with international customers.**
- **Third Party Server Issue:** Many Indian Start-ups use third-party services from companies who may not have a physical presence in India and a **hard localisation mandate impedes cross-border business.**
  - These services often need to access your core database. Not just local start-ups, Big Tech like **Google and Meta have also raised concerns** on the proposed data localisation provisions.
- **Foreign Domiciliation**: Currently, **nearly 30 of India's unicorns are domiciled outside the country,** driven outside by outdated forex regulations, non-implementation of relevant federal regulations, tax terrorism, and lack of local capital incentives.
  - **DeepTech and healthcare start-ups still do not get adequate early capital to grow in this country** and are **forced to domicile outside.**
- **Impact on Data Service Export**: One of the major factors behind India becoming a world leader in digital services export is uninterrupted flow of data across borders and favourable policies.
  - **Data Localisation may add a regulatory compliance cost** to the companies, particularly the **Micro, Small and Medium Enterprises.**
  - It will also **hinder the participation of domestic start-ups in global value chains,** thereby **affecting foreign investment and innovation in the country.**

What is Understood by Data Localisation?

- Data Localisation is **storing critical as well as non-critical data within the territorial boundaries of the country.**
- The most important aspect of data localisation is having control over our own data which makes the country **more resistant to issues around privacy, information leaks, identity thefts, security** etc.
  - It has also helped the countries develop their own startups, evolve locally and also thrive in their own language.
- The Ministry of Electronics and Information Technology (MeitY) has drafted a **Bill on Protection of Personal and Sensitive Data.**
  - Under the Draft Bill, **entities dealing with users' personal data are mandated to store a copy of such data within India and the export of undefined "critical" personal data is prohibited.**
    - **Personal data** includes **information- online or offline- that could be used to identify an individual** and hence allows profiling that person.

What Other Areas Require Attention?

- **Lack of Proper Funding:** Indian start-ups find themselves in a **steep funding downturn.**
  - According to the report by **PwC India,** funding in Indian start-ups dropped by 40% in the April-June quarter **due to geopolitical tensions** led by **Russia's invasion of Ukraine**, decrease in **tech stock valuations**, and **inflation**.
- **Education and Upskilling:** In order to transition beyond the current capabilities and achieve the **demographic dividend**, education, reskilling, and upskilling of India's workforce is crucial.
  - It needs to be acknowledged that **apart from the domestic policy environment,**

the **global environment and technological advances are also changing,** and it is imperative that **India is prepared for this revolution.**

What Efforts Shall be Made to Strenghten the Startup Ecosystem?

- **Data Protection:** India can adopt a **'regulatory sandbox'** approach including regulatory impact assessment.
  - **Local private players** can be incentivised to establish **Data Protection Centres in India.**
  - A **careful balance needs to be struck between privacy and innovation.**
- **Support from Investors:** The **accelerated development of the start-up ecosystem needs significant funding** and therefore the role of **venture capital and angel investors is critical.**
  - The venture capital investors need to have adequate **risk management frameworks** at the portfolio level, as it is a critical part of all successful venture capital operations.
- **Handholding by the Corporate Sector**: Apart from policy-level decisions that promote entrepreneurship, the onus is also on **India's corporate sector to foster** entrepreneurialism, and create **synergies to build impactful technology solutions,** and sustainable and resource-efficient growth.
- **Physical and Digital Connectivity:** The collective future efforts of the public and private sectors to improve physical and digital connectivity will help unlock the **untapped potential of rural and** semi-urban India to truly lead **Industry 4.0** and beyond.
- **Grabbing Opportunities amid Changing World Order:** With the recent events creating capital distrust in China, the world's attention is sharpening on the lucrative tech opportunities in India and the value that could be created.
  - For this, **India requires decisive policy measures in addition to the** Digital India initiative**.** India needs stronger regulations for both global and domestic investments in start-ups.
  - It is also important to create a **repository of investor-KYC, ensuring traceability and seamless governance.**

Drishti Mains Question

"Startups are the engine of exponential growth, manifesting the power of innovation". Critically analyse in context of Startup Ecosystem in India.

UPSC Previous Year Question (PYQ)

Q. What does venture capital mean? (2014)

(a) A short-term capital provided to industries
(b) A long-term start-up capital provided to new entrepreneurs
(c) Funds provided to industries at times of incurring losses
(d) Funds provided for replacement and renovation of industries

Ans: (b)