Fundraising Issues in Indian Startup Ecosystem

Why in news?

Due to interest rate hikes of global central banks and the ongoing banking crisis in the US, startups are facing difficulties in fund-raising.

What is a startup?

> *India had become the 3rd largest startup environment in the world as of August, 2022.*
>
> *India has the 3rd highest number of unicorns in the world next to US and China.*

- **Startup -** A startup is defined as an entity that is headquartered in India which
  - Was opened ***less than 10 years*** ago and
  - Has an annual turnover ***less than Rs 100 crore***
- It is an entrepreneurial venture in the early stages of operations, typically created for resolving real-life problems.
- **Unicorn** – It is a term given only to startups who have a valuation of ***over $1 billion***.
- **Decacorn** - The startups that exceed the valuation of ***$10 billion*** are grouped under the term called decacorn (a super unicorn).

What is the role of startups in the growth of the Indian economy?

- **Employment creation** – The startups are enabling more jobs than large companies or enterprises thus curbing the unemployment problems.
- **New investments** - Many multinational corporations are now outsourcing their tasks to small businesses in order to focus on their core competencies.
- **Research and Development (R&D)** - Start-ups heavily subsidise R&D as they frequently have to deal with high-tech and knowledge-based services.
- **Better GDP** - It is feasible to increase revenue domestically by promoting and supporting more start-up initiatives.
- **Democratizing the technology benefits** - Fintech startups are reaching out to remote areas with their solutions and making financial solutions easily accessible in tier 2 and tier 3 cities.

Why there is shortages in fund-raising?

- Interest rate hikes of global central banks
- Steep correction in valuation of technology stocks

- Increased risk aversion
- Ongoing banking crisis in the US and Europe
- Failure to deliver on their exaggerated growth promises due to Covid-19 pandemic
- Excessive liquidity created during the pandemic
- Change in consumption habits post-Covid
- High borrowing cost impacting profitability, leading to massive lay-offs in this segment
- Global venture capital investors who have suffered large losses in their portfolio are unlikely to provide much funding support



What could be done to address fund-raising?

- **Policy support** - The high net worth investors, investment funds and companies who have displayed a willingness to invest in fledgling companies should be channelized.
- **Fiscal and regulatory policies** - Investors need to be encouraged with suitable fiscal and regulatory policies to support the segment in periods when global funding dries up.
- **Abolition of angle tax** - Angel tax, which requires start-ups to pay income tax on capital received at a premium to their fair valuation should be abolished, since it deters fund raising from angel investors.
- **Alternate Investment Funds** - Investment into Alternate Investment Funds which invest in start-ups could be incentivized through a tax concession.
- **Capital gains tax rate** - Paid by resident individual investors on their start-up investment can be lowered.
- **Overseas exchanges** - Indian startups should be allowed to list on overseas exchanges.

References

1. Reuters | Issues Of Fundraising
2. The Hindu Business Line | Issues About Fundraising For Startups

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