The Economic Times

January 4, 2016
Page No. 10

STARTUP POLICY

Get Down to Business

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Prime Minister Narendra Modi is expected to announce India's new startup policy on January 16. Several states have already announced their own policies and others will follow. But why do we need a startup policy at all?

A major priority for any government is job creation. Given that 60-70% of jobs are created in the small and medium enterprises sector, and that too in the first five years of operation, creation of new businesses, or startups, must be a high priority.

Governments must clearly define the targets of their policies so that the support reaches the intended beneficiaries only. Which is why it's important to clearly identify what a startup is. But first, let's look at the types of startups and outline the support they require.

First, the policy must help anyone wanting to start a new business. By making the registration process simple and easy, we can encourage them to formally register their businesses. We must simplify labour laws and other compliance requirements. We can simplify the tax code for small businesses with revenues less than, say, ₹5 crore, and employing less than 50 people.

To help promote the registration of every business and get them added to the formal economy, we must define a startup as any business within the first three years of its existence, employing 50 people or less, and having a revenue of ₹5 crore or less. The benefits to these startups are simple and easy registration processes, simpler compliance requirements and simpler tax laws, and lower tax rates.

Lower tax rates can be justified since more businesses will get registered and pay taxes. Government must simplify the policy regarding closing down a business, especially in the first three years of its existence — the startup phase. There should not be any requirement for pre-approval by a government agency to get these benefits.

Building on the first definition of all new businesses, certain types of startups can be given additional incentives, grants and soft loans. Examples are investments in technology upgradation, skill development, and to promote women's or rural entrepreneurship.

In rural areas, we will find people wanting to start new businesses. But they need business plans that are tried and tested and training on the business plan. A programme to select people with entrepreneurial aptitude can be launched.

Hence, an entrepreneurship-training programme can be launched to create rural entrepreneurs. This mirrors the skills training programme and creates job-creators rather than job-seekers. It can be the model for a new business management course, like vocational training in skills.

Startup, step in

Third, there is a requirement to create new, innovative products and services based on research undertaken in our academic and research institutes. The incentives for these can be grants to convert research into new products and services.

Every year, the government can announce a certain number of grants. Institutes as well as individuals or groups can compete and apply for the grants. Those that are converted into startups can be recognised as innovative startups and tax breaks can be given for a certain number of years, especially since it may take a few years for these innovations to get market acceptance.

Most startups are self-funded. They grow to become a sustainable small business and remain small. Some of them may go for loans to fund their capital or operational expenses. Equity funding may not make sense for most of these. Government must encourage banks and other financial institutions to provide loans to small businesses at favourable terms and with limited paperwork.

Some of the startups may want to invest large sums of money to scale up rapidly. The increased risk is warranted since the rewards can be huge if the business scales up and garners significant market share. These are candidates for equity funding and go through the various stages of funding: angel, seed, venture, private equity, IPO, etc.

Government must encourage equity funding of these startups and allow significant external investments to happen in startups. These can come from domestic and overseas funds.

Investments made in the first five years of a startup can be exempted from capital gains tax on exits. The revenue loss to the government can be estimated. But remember that 60-80% of startups fail and there would be no capital gains lost.

In the above two cases of funding, a startup is defined as a business in its first five years of existence.

The writer is a co-founder of Infosys