Standing up to the start-ups

The finance ministry is inserting a new section (80-IAC) in the Income-tax Act from April 1, 2017, to provide a boost to start-up operations

DEVENDRA RAGHAV

THE Make-in-India initiative was launched to encourage national as well as multinational companies to manufacture in India. It was not only expected to create job opportunities and develop entrepreneur skills, but also entice capital and technology to the country. However, to make the project successful, there is a need to provide proper infrastructure with less dependence on bureaucratic process and appealing financial structure to encourage entrepreneurs to take more risks.

Start-ups are required to be registered and recognised by the Department of Industrial Policy and Promotion (DIPP) as a 'start-up'. However, in the application to DIPP, the recommendation is required from the specified agencies, where some element of bureaucratic process is involved. Once the gestation period of five years from the date of its incorporation/registration is over, it is no more treated as 'start-up' entity. Moreover, if it is profitable start-up and the turnover exceeds ₹25 crore, it is out of 'start-up' benefits. In addition, proprietorship firm is out of the preview of a start-up.

Recently, RBI permitted start-up enterprises to access loans under the external commercial borrowing (ECB) framework for a minimum average maturity period of three years. However, the lender should not be overseas branches/subsidiaries of Indian banks and overseas wholly-owned subsidiary/joint venture of an Indian company. It is promising to state that intangible assets (including patents, intellectual property rights) can be kept as a security, which is the solitary element available for most of the new-generation start-up entities. Guarantee issued by non-resident(s) is allowed only if such parties qualify as lender. It may be noted that start-ups raising ECB in foreign currency, whether having a natural hedge or not, are exposed to currency risk due to exchange rate movements and hence are advised to ensure that they have an appropriate risk management policy to manage potential risk arising out of ECBs.

RBI should make a mandatory provision in line with priority sector lending to augment financing of start-up units

To harmonise with RBI, the central government has reviewed the FDI policy on various sectors and has made amendments in the Consolidated FDI Policy to make headway in the Make-in-India concept. The amendment has further clarified on 'sectorial cap', where such limit/cap shall be reckoned in a composite manner. The maximum amount which can be invested by foreign investors in an entity will include all types of foreign investments, direct and indirect—except foreign currency convertible bonds (FCCBs) and depository receipts (DRs). Any equity holding by a person resident outside India resulting from conversion of any debt instrument under any arrangement shall be reckoned as foreign investment under the composite limit/cap. Foreign investment up to 100% under the automatic route is permitted subject to FDI policy and a precise definition has been given to manufacturing. There is openness given to a manufacturer to sell products made in India through wholesale or retail, including e-commerce, without government approval. It is an obligation on the borrower to be compliant with FDI provisions.

The finance ministry is inserting a new section (80-IAC) in the Income-tax Act from April 1, 2017, to provide a boost to start-up operations—a deduction of an amount equal to 100% of the profit and gains derived from such business for three consecutive assessment years out of five years beginning from the year in which the eligible start-up is incorporated.

The funding requirement of a start-up is opened up through FDI and ECB, but banks are not fully geared up to lend to start-up businesses; this carries a large amount of credit risk. There should be a provision of disclosure in the financial statement for such kind of lending to realise the Make-in-India dream.

It is generally observed that more emphasis is given on foreign investment in start-up operations and is used as a benchmark. It is prudent to consider total investments made by a start-up, including owner's contribution, as a benchmark. A general trend seen during campus recruitments of management institutes is that students prefer a start-up opportunity rather than taking a secure job with established companies. The regulator should make a mandatory provision similar in line with priority sector lending to augment financing to start-up units. While efforts are being made by the central government and regulators, it remains to be seen how far the young generation is going to take the benefit of such provisions.

The author is a senior executive in a leading bank. Views are personal