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Public sector start-ups?

Government funding of start-ups, either directly or indirectly, in the midst of a thriving venture-capital industry, is ill advised

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YOU, US and Mark Zuckerberg have something in common — we are all joint investors in a venture-capital fund, albeit indirectly. The prime minister is expected to announce a "start-up policy" today in the form of a Start-up and Entrepreneurship Bill, which, among other things, will use taxpayer funds to spur investments in start-ups.

The government of India had announced an "India Aspiration Fund" in August 2015. Essentially, this meant investing Rs 2,000 crore of taxpayer money in venture-capital funds that will then be used to invest in various start-ups. Venture-capital funds are well acknowledged to be on the extreme "high risk-high reward" payoff matrix. That is, one could either lose every rupee invested or gain multiples of it. One of the recipients of our money was a venture-capital fund that also counts Iconiq Capital as a co-investor. Iconiq Capital is a US-based investment vehicle popularly known as the "secret billionaire fund" that manages the wealth of billionaires such as Facebook founder Mark Zuckerberg, Twitter founder Jack Dorsey, Linkedin founder Reid Hoffman, etc. When there is no apparent dearth of private money for such "aspirational India" initiatives, why should a government that still has to feed, clothe, educate and skill a vast majority of its citizens fritter away scant tax resources on such risky investments?

The start-up policy is a rightful recognition of the importance of start-ups to the country's economy and job creation. There are certainly some unique characteristics of these new, innovative start-ups that make a policy impetus in areas such as intellectual property rights, net neutrality, ease of shutdown, etc, very useful. However, government funding of start-ups, either directly or indirectly, in the midst of a thriving venture-capital industry, is ill advised. It is claimed that the inspiration for this initiative is Israel's "Yozma" programme, which helped catapult that country to having the second largest technology start-up industry in the world, after the US. Except, the Israeli government used taxpayer funds to launch Yozma in 1993 to give birth to a new venture-capital-backed start-up industry. In India, this is already flourishing.

Over the last 10 years, in India, $60 billion has been invested in more than 3,000 new start-ups. Indian start-ups received nearly 50 times more venture capital in 2015 compared to 2000. In 2015, venture-capital investments in India were higher than net foreign investments in stock markets for the first time in history, leaving out the global financial crisis years. Venture-capital financing for Indian start-ups has grown at a compounded rate of 30 per cent over the last 15 years. India already has the third largest start-up ecosystem in the world, boasting of more than 12,000 active start-ups. That there is a thriving and growing private venture-capital industry for providing risk capital to start-ups in India is quite evident. It is then inexplicable that the government should seek to squander away scarce tax rupees in the garb of providing a funding impetus to the start-up ecosystem — when, clearly, there are worthier claimants such as issues of rural distress, bad loans in the banking sector, and distraught power sector finances.

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The need for state intervention in any economic activity is either to kick start it, or to step in when private markets have failed. Neither is the case with venture-capital funding for Indian start-ups. While it is an entirely laudable objective to multiply the number of start-ups in India, it cannot be done through taxpayer funds, which will need to be protected against investment losses. It is also understandable if the government's investments are in the realm of social-impact investments that funnel money into sectors such as education and agriculture, where private capital may not tread. However, there are no such sectoral restrictions in this initiative. The argument that India cannot be reliant on foreign venture capital and needs to cultivate a domestic pool of capital is also valid. But even that does not justify direct government co-investment with other foreign investors into risky venture-capital funds. Tax incentives for investors are a more rational response to further boost venture-capital activity.

Taxpayer funding of risky venture capital is neither justifiable as an attractive investment opportunity nor as a policy tool to generate jobs when there is a well-functioning private funding market. Surely, the party that rode to power on a "minimum government, maximum governance" promise cannot be serious about contemplating a new class of "public-sector start-ups"?

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