Indranil Deb

Much hope was pinned by MSMEs when the new Government took office in June 2014. Almost 22 months later, and after several policy announcements, the major ones being "Make in India" and "Startup India, Standup India" - one gets a fair idea about the Government's intent or its abilities on its policies relating to the MSMEs.

India Not Yet a Fovoured Land for Small Businesses, Startups or Innovators

India is home to over over 50 million MSMEs and this number is growing. Currently, around 15 technology 'Startups' are born every day or around 450 in a month or 5,400 in a year. There are around 500 Individual Investors who actively invest in Startups and early-stage businesses. Everything added up, this is a large an active universe. And one that deserves an orderly existence.

Much hope was pinned by MSMEs when the new Government took office in June 2014. Almost 22 months later, and after several policy announcements, the major ones being "Make in India" and "Startup India, Standup India" – one gets a fair idea about the Government's intent or its abilities on its policies relating to the MSMEs. Unlike earlier, the budget is no-longer the centre-piece of Indian fiscal policy-making authority. The Indian economy is large, complex and dynamic. The global business environment, too has become volatile and fast-changing. Hence, policy-announcements and regulatory / administrative interventions round the year have become the norm.

The Union Budget, however, is the most important policy statement of the ruling party – and is supposed to give various stakeholders in the economy (both domestic and global) a general roadmap or direction about the priorities and prerogatives of the party in power.

In his Budget Speech (para 124), the Finance Minister said: "Startups generate employment, bring innovation and are expected to be key partners in 'Make in India' program. I propose to assist their propagation through 100% deduction of profits for 3 out of 5 years for startups set up during April 2016 to march 2019. MAT will apply in such cases. Capital Gains will not be taxed if invested in regulated/notified Fund of Funds and individuals in notified startups in which they hold majority shares." Apart from this statement, the recent Budget has several announcements relating to Startups and MSMEs. However, after studying the various policy announcements made by the Government, on the actual measures introduced so far, and the results on the ground, one can conclude that India is still not a place favourable to MSMEs, Startups and Innovators.

Let's examine the reasons as to why India is still no country for MSMEs, Startups and Innovators.

On January 16, 2016, the Prime Minister announced the Start-Up India, Stand-Up India Scheme.

Under the 'Startup India Scheme, Startup means an entity, incorporated or registered in India not prior to five years, with annual turnover not exceeding Rs.25 cr in any preceding financial year, working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property. (Provided also that an entity shall cease to be a Startup if its turnover for the previous financial years has exceeded INR 25 crore or it has completed 5 years from the date of incorporation/ registration. Provided that such entity is not formed by splitting up, or reconstruction, of a business already in existence. Provided further that a Startup shall be eligible for tax benefits only after it has obtained certification from the Inter-Ministerial Board, setup for such purpose.)

The benefits available to Startups under the scheme are as follows:

- Easy availability of Seed Funding
- Income Tax Exemptions for 3 years
- 80% Patent fee will be refunded
- Labour & Environment laws exemptions. No Inspection from PF, ESIC & Environment departments for 3 years.

- Capital Gain Tax exemption for investment in eligible Startup
- Exposure to best Startup mentorship
- Easy Exit from the Startup within 90 days

One of the other important requirements is that:

The startup application for the scheme must be supported by a recommendation certificate for innovative nature of business from any one of the following establishment:

- Incubator established in a post-graduate college in India like IIT, IIM etc. or.
- Incubator funded from Government of India (in relation to the project) or
- Incubator recognized by Government of India or

Funding by an Incubation Fund or Angel Fund or Private Equity Fund or Business Accelerator or Angel Network duly registered with SEBI that endorses innovative nature of the business; the Budget announcements(in order of importance), pertaining to Startups and MSMEs are as follows:

Setting up of Coordinating Hubs

- National hub in the Ministry of Micro Small and Medium Enterprises (MSME) to support SC/ST entrepreneurs(The powers, role and function of this hub has not been clarified);
- Entrepreneurship education and Training will be provided in 2,200 colleges, 300 Schools, 500 Government ITIs and 50 Vocational Training Centres through Massive Open Online Courses (MOOCs). Aspiring entrepreneurs, particularly those from the remote parts of the country, will be connected to mentors and credit markets.(A detailed plan is not available)

Legal, Regulatory Compliance

- 100 per cent FDI for the food processing industry;
- Amendment in Companies Act to create a more enabling environment for startups — registration of company in one day;
- Amendments in the Motor Vehicles Act.

Tax Incentives

Lowering of corporate tax for small enterprises (turnover below Rs. 5 crore) to 29 per cent. Normal rates of surcharge and cess would apply;

Full tax exemption for first three years for startups launched during April 2016 to March 2019 — however, MAT will apply;

New manufacturing companies incorporated on or after March 1, 2016 can be taxed at 25 per cent, plus surcharge and cess, provided they do not claim profit-linked or investment-linked deductions and do not get investment allowance and accelerated depreciation;

Complete pass-through of income tax to securitisation trusts, including trusts of asset reconstruction companies — securitisation trusts have to deduct tax at source;

Capital gains are also tax-exempt if invested in regulated/notified Fund of Funds, and when invested by individuals in the notified start-ups in which they hold a majority share.

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10 per cent tax on income from worldwide exploitation of patents developed and registered in India by a resident;

Holding period for long-term capital gain reduced from three to two years in the case of unlisted companies;

Corporate income tax rate for small enterprises with turnover below Rs.5 crore is reduced to 29 per cent (plus surcharge and cess). The turnover limit has been doubled to Rs2 cr for the Presumptive taxation scheme under section 44AD.

The holding period for unlisted companies seeking long-term capital gains has been proposed to be reduced from three to two years.

Access to Capital and Financing

The Mudra Bank was set up in 2015. A credit target of Rs.1.8 lakh crore is set for 2016-17, against the actual dispersal of Rs.1 lakh crore in 2015-16 (till early February).

An equity capital of Rs.2,400 crore has been allocated to Mudra and Credit Guarantee Fund under the Pradhan Mantri Mudra Yojana.

Yojanas, Schemes, Incentives

- Allocation of Rs.1000 crore to the Startup India Standup India Scheme
- Rs.500 crore allocated for scheduled caste, scheduled tribe and women entrepreneurs under the Stand Up India scheme — 2.5 lakh entrepreneurs expected to benefit;
- Government of India to make contribution of 8.33 per cent for all new employees enrolling in EPFO for the first three years of employment.

A National Scheduled Caste and Scheduled Tribe Hub will be formed in the MSMEs Ministry in partnership with industry associations to help SC/ST entrepreneurs meet obligations under the procurement policy 2012 and adopt global best practices.

Proposal for skilling one crore youth through skill development programmes

In the Railway Budget announced on Fenruary 25, 2106, the Railway

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Minister announced that the national transporter will provide grants to startups to innovate—and the 76-year-old businessman Ratan Tata will be one of its mentors. An announcement of setting aside a sum of Rs.50 crore for providing innovation grants to employees, startups, and growth-oriented small businesses to support internal and external innovation was made. The Plan was to find solutions to problems facing Indian Railways through an annual "innovation challenge."- that would focus on solving some critical issues, such as low-level platforms, coach capacity, and digital capabilities at stations.

What Startups and MSMEs in India Really Need?

EASE OF DOING BUSINESS

In the past 22 months, we would have expected the Government to come out with a wide-definition of MSMEs (including the much smaller universe of Startups), classifying them under 3 or 4 broad categories (based on a judicious combination of quantitative (capital employed, revenue earned, number of employees, etc.) and qualitative factors (educational qualification and skill levels of the founding team, innovations and patents, etc.)

On January 16, 2016, the Government of India announced the Startup India Standup India Scheme.

In order to qualify for government benefits under the Startup India Standup India scheme, Startups have to be approved by an inter-ministerial board that vets and clears if the applicant is eligible to be classified as a start-up.

This is like going back to License-Permit Raj. If you talk to founders, they'd tell you that they would hate to go thru such an application process, as it is cumbersome, or it would mean hiring a professional to fulfil the requirement.

In its campaign to promote the scheme, the Government lists the following steps for business entities interested in participating in the Startup India scheme:

- Register a Private Limited (Pvt. Ltd.) or LLP
- File for trademark
- Develop a prototype Product or Service which is technology driven and solve new market problem
- Keep your company ROC filing up to date
- Search for a recognized Incubator or Angel Funding Firm
- Apply for Patent (If the process is a new innovation)
- Get recommendation from Incubator or Angel Funding Firm
- Apply to Inter Ministerial Board for approval

With the announcement of the Startup India Standup India scheme, the Government seems to have only made administering and running the MSME sector more complex.

Over 95% of existing Indian MSMEs are either Sole Proprietorships or Partnership firms.

Single Window Portal

What would have probably worked well would have been the setting up of a "Single Window Portal"- type of interface. The policy could have allowed for Self-attestation (certification) by the Founder - for being eligible to qualify as a Startup and file a simple application-cum-registration form online. There could be penalties, ranging from cancellation of the Registration (along with all the benefits that come with such eligibility), to monetary penalties and even the risk of criminal prosecution- depending on the seriousness of the misrepresentation or non-disclosure.

So, would an entrepreneur want to start a business venture that doesn't scale to fast? Maybe. Even someone sets up a mobile-repair shop, now its called a startup. Does it do anything innovative? Probably not. Is it going to disrupt the market? Certainly not. Is it infinitely scalable? No.

Given these conditions, does the venture still fulfil the conditions of providing jobs, adding value to customers, delivering quality and offering growth opportunities to its employees? Sure, it does.

What happens to the typical existing MSME businesses such as the mobile street-food-vendors, barber-shops, the motorbike-repair garages and the stationery and Xerox stores?

The policies give rise to a situation that has no Plan for a transition phase that allows existing MSMEs to convert themselves into entities that can participate in the Government's growth plans for MSMEs.

One Code for MSMEs

Currently, an MSME has to comply with several bodies and authorities- under the Shops & Establishments Act, Local Municipal Authority (Trade License), the Labour Department,

> The present system of compliances and returns need to be overhauled and a new model put in place. If the business entity does not cross a certain threshold, of say Rs. 2 cr.(in case of manufacturing business) and Rs. 1 cr (in case of service businesses), they should be exempt from submitting monthly and quarterly returns- and be required to simply file an annual return.

One the biggest irritants facing MSMEs is the multiplicity of taxes. A typical MSME has to face the burden of the following taxes: Indirect taxes-Local Municipal Taxes, Local Body Tax, Octroi, Excise Duty, VAT, Service Tax, Customs Duty, Securities Transaction Tax, etc.

Registrar of Companies(ROC), and the various local, state and central tax authorities. A single MSME Registration Code with validity across the country should be enforced. With the GST likely to be passed in the present session of the Parliament, the FinMin would have done well to initiate some steps in this direction.This would help simplify the compliance needs of MSMEs and help them focus on running their businesses.

The present system of compliances and returns need to be overhauled and a new model put in place. If the business entity does not cross a certain threshold, of say Rs. 2 cr.(in case of manufacturing business) and Rs. 1 cr (in case of service businesses), they should be exempt from submitting monthly and quarterly returns- and be required to simply file an annual return. It would also make it easy, from the compliance angle, if the annual licence fees/charges of the various authorities were clubbed together and a composite fee (turnover or investment-linked slabs), of say, Rs. 5,000, Rs. 25,000 and Rs. 50,000 were charged.

Similarly, there should be a simple process for a business entity to voluntarily close down. A single Exit-form may be introduced and a simple process that enables a business unit to close down within, say, 10 days from the date of submission of the Exit form, in the normal course (unless there are tax dues pending or serious litigation of claims or other commercial or legal disputes pending against the business entity), instituted.

Judicial Boards for MSMEs

The sorry state of affairs of the Indian justice system especially at the level of the lower courts is too well known to be repeated. It is time that the MSME sector needs to be freed from this "web-of-slow-grinding-moving-litigation-process". Many ventures started up by the best and the brightest in the land have to die a slow and painful death because of the way in which the legal system currently works. It is time that the Government instituted special courts or other judicial boards or authorities- forums for quick and affordable dispute-resolution mechanism for MSMEs.

One would have expected that the government pays special attention to improving the ease-of-doing business (setting-up single-window mechanisms, hiring and training more personnel to handle queries and needs of MSMEs, setting up fast-track courts or SBA-type boards with regulatory and quasi-judicial powers - and providing them with resources for their smooth functioning). This appears to be missing.

Also missing in the budget are any measures that would have directly or indirectly promoted an ecosystem of mentorship with indirect and latent rewards and incentives for mentors, coaches and other knowledge-workers who work for the development and growth of entrepreneurship in India.

Easy Access to Capital

It is extremely difficult for MSMEs to access capital in India. The MUDRA Bank (the Government's much celebrated success story) boasts of having disbursed Rs.1 lac cr. to 2.5 cr. beneficiaries in the course of 1 year – that is, an average disbursement of Rs.40,000 per applicant/business-unit.What can you buy with Rs.40,000? Not even a high-end, standard configuration laptop.(This scheme could only become useful for the ruling political parties to use as tools to convert BPL voters. The real impact and benefit of this scheme will be known after 4-5 years.)

The sector needs easier access to larger pools of capital. And entrepreneurs need to be given options to explore several new and innovative sources of capital. Imposition of tax on Angel Investments and the holding period for eligibility for a lower rate of tax for long-term capital gains tax are huge deterrent to capital-raising for Startups.

Similarly, the Government could have used innovation and imagination by exempting prize-winnings of Business Plan Contests and Innovation Awards from taxation. This would have helped spur a culture of the setting up of more Startup "hubs" and "events" in the country.

Simple Tax Tegime

One the biggest irritants facing MSMEs is the multiplicity of taxes. A typical MSME has to face the burden of the following taxes: Indirect taxes-Local Municipal Taxes, Local Body Tax, Octroi, Excise Duty, VAT, Service Tax, Customs Duty, Securities Transaction Tax, etc. In addition, all entities are subject to Direct Taxes such as Income Tax and Capital Gains Tax

The Goods and Services Tax (GST) Bill, expected to be passed in the present Budget Session of Parliament, could go some way in simplifying the tax-regime. If the Government were seriously committed to propagating the expansion of the MSME sectors, one of the ways would be to have a special tax-regime for MSMEs- where, say, within the ambit of the GST, there could be progressive rate of taxation (say 0%-5% for the first 3 years, 5%-10% for the next 3 years and then the universal rate being applicable to the Startup after 6 years.)

The Angel Tax (introduced in the Budget of 2012) continues to be retained. Most start-up founders raise 'angel' money from friends and family, who are taxed as they are not part of registered angel networks. The tax is levied on start-ups that receive funding from Individual Angel Investors, based on the perceived difference (between