

Fostering Startup Ecosystems in India

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Abstract:

Because of India's improving entrepreneurial performance, some analysts consider the country as the next Asian miracle (Huang, 2008). The State's domination over the economy is gradually declining and there are some signs that the country is moving toward a market-oriented system. India has also set explicit policy and objective to become a leading business-friendly economy (World Bank, 2008).

Keywords: entrepreneurship | India | startups | SMEs

Article:

1. Introduction

Because of India's improving entrepreneurial performance, some analysts consider the country as the next Asian miracle (Huang, 2008). The State's domination over the economy is gradually declining and there are some signs that the country is moving toward a market-oriented system. India has also set explicit policy and objective to become a leading business-friendly economy (World Bank, 2008).

Most impressive of all, in January 2016, the Indian government launched the "Startup India" program. The program seeks to provide a number of policy measures, initiatives and incentives in order to foster startups in the country. Tax exemption for startups for three years, a US\$1.5 billion corpus fund to support startups, exemption of capital gains tax for venture capital investments, 80% reduction in patent registration fees and ensuring a 90-day window for startups to close businesses are among the top incentives the Indian government plans to offer to stimulate startups in the country (The Hindu, 2016).

Despite the above-noted positive trends, entrepreneurial activities are hindered by business-unfriendly labor laws, adverse corporate bankruptcy regulations and the lack of clear property rights (Economy Watch, 2014; GIPC, 2016; Hanstad, 2013; Kshetri, 2014). Moreover, many Indian entrepreneurs still struggle with a culture that looks down on capitalism and is indifferent

to hard work, improvement and innovations (Kshetri, 2011b). Other challenges include a big entrepreneurial financing gap (ET, 2015) and the country's poor R&D and innovation performance (Economist, 2007; Kshetri, 2014).

The objective of this paper is to examine the current state of startups in India and analyze the key determinants. The paper is structured as follows. We proceed by first examining the current state of startups and SMEs in India. The section following this looks at the determinants of entrepreneurship and startups in the Indian context. The final section provides concluding comments.

2. The Status of Startups and SMEs in India

Startups and SMEs have played a key role in the Indian economy. India has the world's third-largest number of startups (ET, 2016b). According to the National Association of Software and Services Companies, the number of new companies launched in India grew by 40% in 2015 (Fortune, 2016). Likewise, as of the mid-2016, India was estimated to have more than 45 million SMEs, which accounted for about 40% of the country's gross domestic product (GDP) (ET, 2016b).

New organizational mechanisms such as incubators have helped startups to grow and bring innovative products and services into the market. As early as in 2010, it was reported that India had around 40 incubators, which mentored between four and 20 startups each (Chaudhary, 2010). One such incubator, Villgro (<http://www.villgro.org/>) reported that, as of the mid-2016, it mentored 119 startups. It also invested US\$2.2 million seed money in these startups and helped them to raise investments of more than US\$19 million.

Despite the above positive trends, India falls behind many other developing economies on important indicators related to startups and entrepreneurial activities. For instance, in terms of high-expectation business launchers per capita, India underperforms Brazil (Lewis, 2007). In the World Economic Forum's Global Competitiveness Report 2015-2016, India ranked 55th (WEF, 2016b). In the 2015 Prosperity Index, prepared by the London-based think tank, Legatum Institute, India ranked 99 out of the 142 economies analyzed (Legatum Institute, 2015). In the Legatum Prosperity Index's Entrepreneurship & Opportunity category, India's rank was 94.

A technology entrepreneur, who is also a Member of Parliament, pointed out two challenges that Indian startups have faced. The first obstacle concerns "government apathy, corruption and a complex approvals process". Others have argued that corruption is likely to make the Israel model of government funding for startups highly ineffective in India. Note that the Israeli government provides a highly supportive role to facilitate entrepreneurship. For instance, it is reported that 80% of the first US\$500,000 for every idea identified is funded by the government. It is speculated that such a model "will lead to favoritism, cronyism and corruption" in the country (Shah, 2010).

Second, the country's entrenched corporates have exhibited a tendency to "oppose or kill startups which challenge them" (Chandrasekhar, 2016). Others have observed that a small number of well-connected industrialists have dominated the Indian economy and protected themselves from

outside competition (Weitzman and Fontanella- Khan, 2011). For instance, about 10 families reportedly control more than 80% of the stock in India's largest corporations (Malhotra, 2009). Research has indicated that the 1991 reforms have had little or no effect in promoting SMEs and their development.

3. The Determinants of Entrepreneurship and Startups: The Indian Case

Determinants of entrepreneurship are the factors that affect entrepreneurial performance (Ahmad and Hoffmann, 2008). Prior research shows that the various determinants of startups and entrepreneurship development can be divided into three categories: a) Regulatory framework, b) Values, culture and skills, c) Access to finance, market, R&D and technology (Kshetri, 2014).

3.1. Regulatory Framework

Government policies and actions affect the costs, risks and barriers to competition faced by entrepreneurial firms and hence the range of opportunities that are potentially profitable. While there are a variety of mechanisms by which laws, regulations and policy would affect a country's entrepreneurial performance, this section focuses on four major aspects: Laws and regulations affecting business registration, corporate bankruptcy laws, labor regulations and property rights.

3.1.1. Laws and Regulations Affecting Business Registration

According to the World Bank's Ease of Doing Business 2016 Report (World Bank, 2013), India ranked 130 out of the 189 economies considered in terms of the regulatory climate for startups and entrepreneurship. To start a business, 14 procedures are needed to be completed which take 29 days and cost 17% of the country's per capita income. Note that for OECD high income countries, the averages are 4.7 procedures, 8.3 days and 3.2% per capita income respectively.

Despite this progress, however, red tape, bureaucracy and corruptions in the country, both at the national and state levels, lead to longer time, higher costs, and reduced speed and flexibility for entrepreneurs (Majumdar, 2004). In the Legatum Institute's survey in 2011, about 80% of Indian entrepreneurs viewed that corruption was getting worse (Sharma, 2011). The Wall Street Journal published a story about a X-ray entrepreneur, who reported that he was asked for bribes by government officials for everything such as speeding up his business permit (Sharma, 2011)

3.1.2. Corporate Bankruptcy Laws

Corporate bankruptcy laws are among the most discussed issues. Note that according to the World Bank, it takes 7 years to close a business in India compared to the OECD average of 1.7 years. Among the measures outlined in the program is a 90-day window for startups to close businesses. This reduction is a welcome improvement concerning this important determinant of entrepreneurship.

3.1.3. Labor Regulations

Indian labor market is governed by about 250 labor rules at the central and state levels, which make the country's labor laws are less flexible and less business-friendly than those of China. These laws arguably are restrictive in nature, hinder investments in the manufacturing sector and discourage firms from introducing new technology that might require reducing the workforce (Economy Watch, 2014). These labor regulations thus limit businesses' capacity to grow and compete in the global economy. In India, for instance, companies with more than 100 employees require government permission to dismiss workers (Kshetri, 2014).

3.1.4. Property Rights

Clear property rights would allow entrepreneurs to use the assets as collateral and thus increase their access to capital. Problems related to property rights are key challenges facing entrepreneurial development in India. Some argue that the lack of land ownership remains among the most important barriers to entrepreneurship and economic development in India. One estimate suggested that over 20 million rural families in India did not own land and millions more lacked legal ownership to the land where they built their houses, lived on and worked (Hanstad, 2013).

Indeed landlessness is arguably a more powerful predictor of poverty in India than caste or illiteracy (Hanstad, 2013). This issue is important because poverty reduction is considered to be one of the key impacts of entrepreneurship, especially in the context of developing countries such as India (Ahmad and Hoffmann, 2008; Kshetri, 2014).

Especially for entrepreneurial firms that rely heavily on intellectual property (IP), they face a unique challenge in economies with weak IP protection laws and enforcement mechanisms. According to the Global Intellectual Property Center's International IP Index 2016, India ranked 37 out of the 38 countries. Only Venezuela's IP index was worse than that of India (GIPC, 2016). India is characterized by ineffective intellectual property rights laws and enforcement mechanisms. A complaint among multinational drug companies is that Indian generics drug makers manufacture counterfeits of patented drugs and sell them for a long time. Due to the Indian court system's slow and often ineffective response, multinational drug companies' legal attempts to stop the counterfeiters often take many years (Bhattacharya, 2015).

3.2. Values, Culture and Skills

3.2.1. Values and Culture

The underlying values and culture of a society affect the entrepreneurial patterns. Some argue that Indian society has a negative attitude toward entrepreneurship. Not long ago, an entrepreneur was viewed as someone that was unemployed and unemployable (Ganesh, 2016). Such a social stigma about an entrepreneur led to a preference for jobs in multinationals or the government sector (Kshetri, 2014). An observation is that the stigma of being an entrepreneur is gradually disappearing (Ganesh, 2016).

Of even more concern perhaps is how entrepreneurial failure is viewed. An executive of Google India noted: "And don't even think about what will happen if you fail as an entrepreneur."

Socially, you will have lost your eligibility for marriage until you get a job. Financially, you'll be saddled with loads of debt, and politically, good luck on somebody acknowledging your entrepreneurial endeavor as real work experience. With all these challenges, one wonders why anyone bothers trying to become an entrepreneur in India?"

3.2.2. Entrepreneurial Skills

Studies have underscored the important role entrepreneurial skills play in the success of entrepreneurs. A study conducted with self-employed individuals enrolled in a Peruvian microfinance program indicated that even a little entrepreneurship training can significantly enhance the business performance (Karlan and Valdivia, 2006).

The lack of entrepreneurial education and training has been a matter of concern for the development of a startup ecosystem in India. About a third of the Indian population was estimated to be illiterate in 2016 (WEF, 2016a). An upshot of this is that Indian startups lack skills and experience to build scales and do sales, marketing, and product management (Rai, 2014). In a survey by Accenture among Indian enterprises, 53% of the respondents cited the lack of talent to be a key challenge in the deployment modern technologies such as big data and cloud computing. McKinsey estimated that India will need 200,000 data scientists in the near future (Fractal, 2015). India's No. 2 e-commerce site, Snapdeal.com said that the company has not been able to find the coders and other big data manpower it needs. The company has recognized the need for worldwide recruitment for experienced programmers dealing with big data, cloud computing and the software for interacting with customers and suppliers. In 2015, it hired a cloud specialist from a Silicon Valley startup. The company was expecting to hire 12 more. Snapdeal was also reported to be considering to establish a software development center in the U.S. and buying firms there in order to capture the needed manpower (Thoppil, 2015).

Due to the lack of entrepreneurial education in India, the country's successful companies invest heavily in employees through extensive training and development in firm-specific skills. One study found that firms in the country's IT industry provide 60 days of formal training to newly hired employees and they are paid during the period. Some firms go even further. For instance, Tata Consultancy Services is reported to have a seven-month training program for science graduates in order to convert them into business consultants, and every employee in the company gets 14 days of formal training annually (Cappelli et al., 2010). Infosys has its own internal college to educate new employees, which trained 80,000 employees in "design thinking" as of the mid-2016. The goal is to make sure that its employees can advise on the design of IT systems rather than just taking instructions (Mundy, 2016).

3.3 Access to Finance, Market, R&D and Technology

3.3.1. Access to Markets

Access to and demands of an entrepreneurial firm's products in the domestic and foreign markets are a critical factor determining the attractiveness of entrepreneurial activities. In addition to private demand, procurement regulations and policies that give priority to new companies in government contracts for goods and services would create better opportunities for potential

entrepreneurs. In the same vein, governments' export-promotion strategies in various countries have expanded entrepreneurial firms' opportunities in foreign countries (Kshetri, 2014).

Among other measures, a key component of the "Startup India" program is US\$ 32 billion infrastructure spending in fiscal year 2016-17 to build 10,000 km of national highways and upgrade additional 50,000 km. The goal is to help SMEs' access to the huge India market.

Nonetheless there are a number of market access barriers faced by SMEs and startups. As noted earlier, Indian economy has many characteristics of oligarchic capitalism, which have hindered SMEs' market access. It is also the case that various regulations hinder the access to the domestic market in India. For instance, there are taxes for bringing goods into a state, for taking them out of a state as well as for moving them within a state (Economist, 2008).

3.3.2. Access to Finance

Entrepreneurs need capital in all phases of business life. A critical practical challenge that most startups face is the ability to acquire the capital, from access to early seed funds to access to the stock markets. When there is limited credit availability and the entrepreneurs' initial capital requirements are substantial, low wealth households face higher barriers to starting an entrepreneurial venture. Among the main sources of finance for startup are bank financing, the capital market, venture capital (VC or Venture), microfinance, crowdfunding, supply chain financing and informal financing (Kshetri, 2014). The formal financial market remains largely inaccessible to startups and SMEs. According to McKinsey, 43% of SMEs in India borrow from informal sources. They do so partly because of the lack of collateral and working-capital lines (Mukherjee, 2016).

According to a study conducted by research firm KPMG and Snapdeal, about 41% of SMEs in India lacked access to bank loans or other financial products offered by banks and other formal financial institutions. The study found that a financing gap of over US\$43.5 billion existed in the Indian entrepreneurial landscape (ET, 2015). Observers have noted that potential entrepreneurs in India, who have graduated from a less well known university or those who belong to a poor family face difficulties in getting funding (Gandhi, 2010). The state banks have done little to promote productive entrepreneurship in India. A complaint often heard is that business merits play a little role in loan disbursements (Bikchandani, 2010). Lending is disproportionately oriented toward powerful economic and political interests such as influential family-owned groups.

In 2012, the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE) launched SME platforms, which has increased SMEs' access to capital market. In the first two months of 2016, 21 SMEs filed documents with BSE and NSE to raise a total of US\$27 million crore through IPOs (ET, 2016a).

According to Sa-Dhan, an association of microfinance institutions, the Indian microfinance industry was US\$ 9 billion in the FY 2015-16 (The Hans, 2016), which is expected to reach to US\$20 billion by 2019 (Shaaw, 2016). In the fiscal year (FY) 2015-16, the rural area accounted for 28% of the total loans disbursed by microfinance institutions (MFIs) (The Hans, 2016).

According to the VC analytics firm Tracxn, funding for startups in India amounted US\$6.4 billion during the first nine months of 2015, of which online marketplaces attracted about US\$3 billion of investments in 166 deals (Velayanikal, 2015). Prior researchers have described a number of difficulties that stand in the way of VC financing in India (Dossani and Kenney, 2002). Indian bureaucracy and regulations act as barriers to VC investments. Prior researchers have emphasized the importance of improving the environments related to tax, currency exchange and other policies in order to attract VC firms.

In this regard, the US\$1.5 billion corpus fund is undoubtedly a welcome step. This “structured fund of funds” will invest in VC funds over four years, financed by the government and the state-owned Life Insurance Corporation (LIC) (Fortune, 2016). There are nonetheless some challenges to allocate this VC fund. Prior research has also emphasized the importance of rationalizing and improving the mechanisms to reduce risk if VC funds come from publicly held financial institutions, which are likely to be managed by risk-averse decision makers (Dossani and Kenney, 2002).

Crowdfunding, which involves raising small amounts of capital from a large number of individuals, is considered to be a major disruption in entrepreneurial financing (Kshetri, 2015). While crowdfunding is in infancy in India, it is becoming an increasingly important source of external finance for some Indian startups. One estimate suggested that there were 30 crowdfunding platforms (CFPs) in India as of the mid-2016 (newsx.com, 2016). As of June 2016, the Indian seed capital and angel investment platform, LetsVenture helped 70 companies raise US\$27 million. The average deal size was about US\$370,000 and the highest amount raised was US\$1.33 million (Babu, 2016).

While some studies have shown that remittances are mainly used for consumption instead of investment activities, research has also indicated that households receiving international remittances tend to invest more in entrepreneurial activities than those not receiving remittances (Adams, 2006). Remittances contribute to entrepreneurship by increasing savings and promoting credit mobilization and other forms of investment. Remittance-receiving families often receive funds that are much larger than required for immediate expenditure. They thus deposit the excess funds in the formal banking system, which enhance the banking system liquidity. In India, which is the highest remittance-receiving country, remittances have led to the establishment of new businesses and social service organizations such as nursing homes and educational institutions (Abdelal et al., 2008). In 2010, the Gujarat state’s Chief Minister noted that the state’s economy was growing despite the global financial crisis (GFC) due to increasing investments that were being made by the Indian diasporas (Kshetri, 2011a).

Supply chain financing is a new mode of financing in which companies collaborate with financial institutions to provide financing and other related services such as technical assistance, management, corporate governance, legal compliance to small firms in the company’s supply chain (Kshetri, 2014). Another example is PepsiCo, which started supply chain financing in India in the 1990s through a contract farming arrangement with farmers in the Punjab state to buy tomatoes and chilies. Subsequently the company extended this model to other states and diverse agricultural commodities. It has collaborated with State Bank of India (SBI), which has provided

credits at low interest rates to over 12,000 farmers in six states in India. In addition, PepsiCo has also collaborated with another Indian bank, ICICI to provide farmers with weather insurance (Kshetri, 2014).

In recent years, large players in the e-commerce sector are taking initiatives to improve the access of this form of financing to SMEs. In 2015, India's largest e-commerce website, Snapdeal announced plans to disburse loans of around US\$150 million to SMEs by March 2016 under its seller financing platform, Capital Assist. It was reported that the firm has teamed up with banks and non-banking finance companies for this purpose (ET, 2015). Flipkart has similar lending schemes. In the early 2016, Amazon India announced its plans to offer loans to key vendors selling on its portal. The sellers can apply for short-term working capital loans in order to buy more inventory and increase sales on Amazon.in (Maheshwari, 2016).

3.3.3. R&D and Technology

Access to technology greatly facilitates entrepreneurial activities. According to a 2012 report of the Internet Innovation and the Small Business and Entrepreneurship Council, a small business startup can save over US\$16,000 by using high-speed broadband. For instance, high-speed broadband allows working from home rather than in the office, reducing costs associated with travel and office space (Kshetri, 2014). Similarly, due to lower startup costs for an online shop-front, Internet based technologies can provide small firms the opportunity to overcome the limitations of size and compete more effectively and/or in larger markets with bigger sized establishments.

In the World Economic Forum's 2016 Global Information Technology Report, India's overall rank was 91 (WEF, 2016a). While India ranked 8th in affordability of ICTs, only 15% of Indian households had Internet access and mobile broadband subscriptions per 100 people was just 5.5.

R&D would provide opportunities for high-quality entrepreneurship and enhance an entrepreneurial business's competitiveness. R&D would help create new inventions and innovations, which can be used to develop new products, services or processes. India lags behind industrialized countries and its neighbor China in terms of various indicators related to R&D and innovations. Due to India's poor R&D and innovation performance, some liken entrepreneurial activities in the Indian IT and offshoring industry to a "hollow ring". An Economist article notes: "India makes drugs, but copies almost all of the compounds; it writes software, but rarely owns the result. ... [it has] flourished, but mostly on the back of other countries' technology".

4. Concluding Comments

To some extent, the 1991 economic reform facilitated and stimulated entrepreneurship in India. Likewise, entrepreneurs have generally welcomed the steps taken by the Indian government to stimulate entrepreneurship under the "Startup India" program launched in January 2016. The impact on the broad economy is, however, barely noticeable. While billionaires, oligarchs and state-owned companies are benefiting from privileges, the playing field is not level for SMEs and new venture startups, which face a host of barriers.

Severe and widespread poverty persists in the country while there is great and rising affluence among people working in the software and outsourcing sectors. In sum we cannot really take the existence of a few entrepreneurial firms in the Indian IT sector as proof positive that India provides a conducive environment for entrepreneurship. In fact, it is possible to draw the opposite conclusion on the basis of the fact that very little entrepreneurial impact is felt by the mass of the population.

Inappropriate regulatory elements and legal bottlenecks as noted above have severely hampered the productive entrepreneurial activities. While some influential entrepreneurs are in a position to take advantage of institutional holes, SMEs tend to be more adversely affected by the dysfunctional institutions. Overall, the structural inertia of the Indian economy has acted as a barrier to foster startups and modern entrepreneurship. Some observe that reform inertia has been an obstacle for India to outperform China. Structural reforms are thus needed so that entrepreneurs are encouraged to start businesses and startups can compete more freely and fairly.

While entrepreneurial traits such as a high need for achievement, innovative thinking, creativity, breakthrough ideas, high risk-taking propensity, perseverance, and flexibility are more or less universal to become a successful entrepreneur, the ability to fit to the environment is probably even more important. The success of an entrepreneur interested in starting entrepreneurial venture in India hinges on the ability to learn and adapt to the unique Indian environmental contexts, overcome the challenges and take advantage of various incentives such as those available under the recent Startup India program. It is also important to note that a number of favorable changes are taking place from the standpoint of startups. These include more entrepreneurship friendly culture and regulations.

A related point is that important ingredients are missing in the Indian startups and entrepreneurship landscapes, which means that entrepreneurial firms need to take extra efforts and measures. As noted above, due to the lack of entrepreneurial education in India, the country's successful companies invest heavily in employees through extensive training and development in firm-specific skills. However, most startups often are not in positions to do what established firms such as Infosys, Tata Consultancy Services or Snapdeal do to recruit and train employees. This means that startups need to be prepared with this reality and plan accordingly.

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