Emerging Financing Options for Make in India: A study with budget 2016 Analysis

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ABSTRACT:

Finance is one of the major activities for any business. As per the Indian government, the digital/start-up ecosystem generates employment, brings disruption as well as innovation and is expected to be key for the Make in India programme. The 'Start-up India Action Plan' proposes a 19-point action list which will enable setting up of incubation centers, easier patent filing, tax exemption on profits, setting up a Rs.10,000 crore corpus fund, ease of setting-up of business, a faster exit mechanism, among others.

Key Words: Finance, startups, Tax and Regulations, Make in India

Introduction:

Finance is one of the major activities for any business. According to a recent study, 94% of businesses fail during their initial years of operations and mostly because of the lack of finances. The long painstaking yet exciting journey from the idea to revenue generating business needs a fuel named capital. That's why, at almost every stage of the business, entrepreneurs find themselves asking – How do I finance my startup?

In case the venture is self-funded(bootstrapping) there can be no better option than that. However, a Startup is mostly the result of a novel idea that is the brainchild of its founder(s) and often than not funds are always a challenge. Financing is generally of two types i.e. (a) equity financing or (b) debt-financing (see chart1; table 1). However, emerging unconventional modes in financing of startups are trending in our business environment.

Unconventional Modes Of Financing Options Which Are Now Becoming Popular In India:

1. Crowd Funding:

This is recent phenomena being practiced for getting seed funding through small amounts collected from a large number of people (crowd), usually through the Internet. Now we have companies existing in India which are specializing in "Crowd Funding".

The entrepreneur can get money for his venture by showcasing his idea before a large group of people and trying to convince people of its utility and success. Wishberry.in and Catapooolt are a few among many such forums operating / present in India. The entrepreneur needs to put up on a portal his profile and presentation, which should include the business idea, its impact, and the rewards and returns for investors. It should be supported by suitable images and videos of the project.

SEBI in 2014, even rolled out a 'Consultation Paper on Crowdfunding in India' proposing a framework in the form of Crowdfunding to allow startups and SMEs to raise early stage capital in relatively small sums from a broad investor base. The Consultation Paper defined Crowdfunding as solicitation of funds (small amount) from multiple investors through a web-based platform or social networking site for a specific project, business venture or social cause. However SEBI till now has not issued any further regulations in this regard.

2. Incubators:

These set-ups precede the seed funding stage and help the entrepreneur develop a business idea or make a prototype by providing resources and services in exchange for an equity stake ranging from 2-10%. Incubators offer office space, administrative support, legal compliances, management training, mentoring and access to industry experts as well as to funding through angel investors or VCs.

These are usually government-supported institutes like the IIMs or IITs, technical institutes or private business incubators run by industry veterans or companies. The incubation period can be 2-3 years and admission is rigorous. Some of the top options in India include IIM-Bangalore NSRCEL, Microsoft Accelerator and IIT-Kanpur SIIC and the famous Sriram College of Commerce (SRCC).

3. Government Programs That Offer Startup Capital:

The Government of India has launched 10,000 Crore Startup Fund in Union budget 2014-15 to improve startup ecosystem in India. In order to boost innovative product companies, Government has launched ‘Bank of Ideas and Innovations’ program.

Government backed ‘Pradhan Mantri Micro Units Development and Refinance Agency Limited (MUDRA)’ starts with an initial corpus of Rs. 20,000 crore to extend benefits to around 10 lakhs

SMEs. Entrepreneurs are supposed to submit their business plan and once approved, the loan gets sanctioned. They get a MUDRA Card, which is like a credit card, which they can use to purchase raw materials, other expenses etc. Shishu, Kishor and Tarun are three categories of loans available under the promising scheme.

Also, different states have come up different programs like Kerala State Self Entrepreneur Development Mission (KSSEDM), Maharashtra Centre for Entrepreneurship Development, Rajasthan Startup Fest, etc to encourage small businesses.

SIDBI – Small Industries Development Bank Of India also offer business loans to MSME sector.

If complied with the eligibility criteria, Government grants as a funding option could be one of the best. One just need to make oneself aware of the various Government initiatives.

4. Startup competitions:

With the advent of startup culture, the number of events showcasing startups and startup ideas have multiplied manifold. These contests accept applications from entities with diverse backgrounds. An individual or a company, someone with just an idea or someone whose product is already in the market, choose the right platform to showcase idea or product.

The prize money is small in most of these events but winning at such contests can give visibility in media and opportunity to network with investors.

5. Accelerators:

The accelerator programs are run like university courses which have a fixed tenure and curriculum. An accelerator receives hundreds of applications each year for their programs which run for a few weeks to few months.

Startups are given small seed investment and access to a large mentor network, in exchange for a small equity stake, generally between 2.0% to 10.0%. Accelerators, typically, accept 1.0% to 2.0% of the total applications that they receive.

6. Customer Advance:

Once a company has a well-accepted product in the market, it can take advance payments from its customers for using the product or service. This advance works as an interest-free loan for the startup. Entrepreneurs can try to create a product or service that is so compelling for the customers that they do not mind paying a month’s or even a year’s advance for using the same.

Budget 2016- Tax and Regulatory update for Startups:

Prime Minister Narendra Modi unveiled an Action Plan for Startups on 16 January, 2016 highlighting various initiatives and schemes being proposed by the Government of India to build a strong eco-system for nurturing innovation and empowering Startups in the country.

The Action Plan proposes a 19-point action list which will enable setting up of incubation centres, easier patent filing, tax exemption on profits, setting up a Rs.10,000 crore corpus fund, ease of setting-up of business, a faster exit mechanism, among others.

General Initiatives

1. Compliances based on Self-Certification.

2. Startup India hub.

3. Establishment of Fund of Funds with a corpus of Rs.10,000 crore.

4. Credit Guarantee Fund for Startups.

5. Startup fests.

6. Launch of Atal Innovation Mission ("AIM").

7. Set up of Incubators.

8. Innovation centres.

9. Research Parks.

10. Promote entrepreneurship in biotechnology.

11. Innovation focused programs for students.

12. Annual Incubator Grand Challenge.

Regulatory

13. Mobile App and Portal for easy accessibility.

14. Faster Exit for Startups.

15. Legal support and fast-tracking patent application.

16. Relaxed Norms of Public Procurement for Startups.

Tax

17. Capital gains tax exemptions.

18. Income-tax exemption for 3 years.

19. Tax exemption for investments made above Fair Market Value(FMV).

Key Direct Tax Proposals

- Tax incentive for eligible Start-ups
- 100% of the profits from 'eligible business' shall be eligible for deduction for a period of 3 consecutive years out of a 5 year period.
- The start-up has the option to choose any consecutive 3 year period for the tax deduction out of the block of 5 years, from its incorporation.
- The start-up should not be formed by the splitting up or reconstruction of a business already in existence, or by transfer of previously used plant and machinery, subject to certain relaxations.
- No exemption from Minimum Alternate Tax ("MAT")

- Capital gains exemption in hands of investors
  (Investor acquiring at least 50% of share capital)
- Capital gains exemption to individual promoter (or HUF) on sale of a residential house property, if the sale consideration received is utilized to invest in atleast 50% stake in an "eligible start-up".
- Start-up to utlilse the above investment for purchase of new assets being plant and machinery and computers or computer software (in case of technology driven start-ups).
- Exemption withdrawn if specified conditions not satisfied

(Other investors)

- Capital gains exemption if long term capital gains proceeds are invested in the units of a specified fund as may be notified by the Government of India (Fund of funds as proposed in the Start-up India Action Plan to finance start-ups).
- Maximum investment of upto INR 5 Million, and amount to remain invested for a period of 3 years E. Deduction for employment generation.
- Benefits extended to all tax payers subject to tax audit.
- Additional deduction of 30% of employee cost for a 3 year period.
- Benefit not available where total emoluments exceed INR 25,000 per month and where contribution under EPS is paid by Government

- Patent Box Regime
- Concessional tax regime in respect of income attributable to a patent developed and registered in India.
- Royalty income on such patent liable to tax at 10% (plus surcharge /cess).
- No MAT to apply on such income.
- No expenditure or allowance in respect of such royalty income is allowed.
- Person resident in India should be the patentee.

- Equalization Levy on foreign eCommerce companies.
- Payments made towards online advertisement/ digital advertisement services to non-residents not having a Permanent Establishment ("PE") in India will attract Equalization Levy at 6%.
- The payer can be an India tax resident carrying out business or profession or a nonresident having a PE in India.
- No requirement of Equalization Levy if the total specified payments by a payer to a particular non-resident payee in a year is less than INR 100,000.
- Disallowance to the extent of 30% of expenditure, if payer fails to deduct levy and deposit it in due time with Government.
- There are tax filing obligations on the payer and interest/penal consequences are also provided for any non compliances by the payer.
- There are interpretation issues which would needs further evaluation i.e. availability of credit for the non-resident payee in home country, etc.

Concluding thoughts:

In line with the Start-up India Action Plan, the Union Budget 2016 provides for a 100% income tax exemption for a period of 3 years. This comes as a boost for startups set-up after 1 April 2016. Introduction for specific capital gains tax exemption for investment in start-ups is an added advantage.

The Budget however does not address if tax exemptions are available for existing start-ups. Further, given that start-ups usually incur losses in the initial years given the investment in technology and other development costs, one would have hoped for concessions in terms of an extended period for carry forward of losses which could be used for set-off against future profits. Start-ups could also have benefitted from a provision that does not impact its losses in the event of a change in shareholding. Further, introduction of the equalisation levy@ 6% on foreign eCommerce companies in relation to online advertisement revenue under a separate Chapter (and not under the Income-tax Act) has raised several issues and added to the cost of doing business in India. From an ease of doing business perspective, the plan to introduce a bill to amend the Companies Act, 2013 for further simplification and creating an enabling framework for start-ups by speeding the incorporation of company (as fast as one day), is a welcome move and showcases the Government's commitment to the start-up community.

Reference:

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Table 1: General financing options:

	Documentation	Interest payments	Ownership	Collateral	Govt. Regulation
I. Bootstrapping	___	Nil/flexible	___	___	___
II. Equity Financing					
Venture Capital	High	___	Shares & debentures	Convertable instruments	___
Angel Investors	High	___	Equity stake	___	SEBI
III. Debt Financing					
Banks & NBFCs Loans	High	Timely	___	yes	RBI
ECB	High	Timely	___	___	DEA, MoF, GOI, RBI
CGTMSE Loans	High	Timely	___	___	RBI, GOI
IPO	Very High	dividends	Shares	___	SEBI