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Loopholes in the current entrepreneurial ecosystem in India

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Today India is having 60000+ startups, ranking 3rd largest in startup numbers, however when such stat is compared with per capita basis it reflects the gloomy picture of the entrepreneurship of the culture in India. As per Bain Co. 20% of MSMEs are run by women, however a majority of them are only owned by women on paper. As per India‟s entrepreneurial confidence Index by KPMG Indian entrepreneurs are fairly confident about their Ecosystem, entrepreneurs have rated the Indian entrepreneurial ecosystem at 3.10 out of 5. The pictures of entrepreneurship in India might be changing post LPG reforms and opening up of the Indian economy. Be it India‟s ranking at 63rd in World Bank ease of doing business index to India being the centre of 60+ unicorn startups. However having the vision of being a 5 trillion $ economy in the next 4 years, the entrepreneurial ecosystem in India still seems to be in the budding stages.

The Entrepreneurial ecosystem is a sum of economic, societal, political and legal forces, directly or indirectly influencing the budding as well as veteran entrepreneurs. Over successive years the government of India has been trying to make the ecosystem more conducive be it to attract FDI, kick start Make in India or assist budding entrepreneurs. However loopholes still remain in multiple areas due to numerous reason. Through this paper, we shall try to understand more about these loopholes, in which areas are they dominant, why are they still present and what can be done about it.

Loopholes:

1. Ease of Doing Business- Even though prima facie it might seem that India‟s performance on Ease of doing business Index has been drastically improved in recent years, however the fact that this Index does only reflect findings from 2 cities- Delhi and Mumbai, raises doubts on entrepreneurial ecosystem of the whole country. Also However, India continues to trail in parameters such as Ease of Starting Business (rank 136), Registering Property (rank 154), Paying Taxes (rank 115), and Enforcing Contracts (rank 163).
    a. Today, it takes an average of 18 days to set up a business in India, down from 30 days in 2009. On the other hand, New Zealand has a seamless process of business incorporation which takes place through a single window via one agency.
    b. It takes roughly 58 days and costs on an average 7.8 per cent of a property‟s value to register it, and 1,445 days for a company to resolve a commercial dispute through a local first-instance court.

c. In the case of paying taxes, even though the number of payments per year has significantly reduced in India from 59 to 12 over the last decade, time spent on this activity has not reduced much. While India takes 250-254 hours per year to pay taxes, New Zealand spends just 140 hours a year. Interestingly, time spent to pay taxes in New Zealand has doubled from 2009 to 2019.
d. Enforcing contracts is one parameter in which India"s performance has been very poor over the years. While India takes 1,445 days to resolve an average dispute, New Zealand takes approximately one-seventh of it, i.e., 216 days.

2. Policy Lacunae

   a. Over emphasis on certain sectors- Although the high-technology sector may seem like an obvious place to look for employment-generating high-growth firms, such overemphasis fails to acknowledge opportunities in the other sectors. Research suggests that high-growth firms exist across all sectors. Also PLI scheme currently has only been extended to only 13 sectors having export potential.
   b. Absence of uniform entrepreneurship or startup policy on a pan India basis, this subject is delegated to states where entrepreneurship as a subject remains neglected, at the same time lacks expertise and public-private partnership.
   c. The country's stringent tax regime has been one of the key reasons why businesses prefer to keep their distance from starting operations in India. Also, the recent issue of Retrospective taxation involving Cairn Group highlighted the taxation inefficiency and unpredictability.
   d. There is heavy scrutiny in registering as a startup with DPIIT in order to avail benefits of schemes like Startup India, because of which most do not even try and waste time only to be rejected later.
   e. Labor Laws- complying with both central as well as state labour laws involving bureaucratic hurdle proves to be a major challenge especially in case of scaling up. Moreover, the concept of self certification an labour laws exemptions remain underworked. States have 423 labour-related Acts, 31,605 compliances and 2,913 related filings.

3. Taxation

   a. The firms are being sandwiched between two sources of competition. On the one hand, if small firms did not register under GST, they could stand to lose market share as registered clients would not buy from them due to the perception of RCM and non-availability of ITC. On the other hand, small firms that choose to join GSTN faced higher compliance costs and the burden of excessive paperwork. If their business was with unregistered clients, they would have to absorb a part of GST themselves or lose market share.

b. Registration under GST came with the heavy cost of compliance in terms of increased paperwork, additional fee to accountants, and the mental load of keeping track of all bills, and collecting detailed invoices and receipts even for small transactions.
c. India"s tax structure is complex, taking – on average – 214 hours (in 2017) a year to prepare and pay taxes. Laws, rules, and practices can be confusing, and foreign companies who don"t seek specialized help may overpay some taxes and underpay others.
d. Despite provision of Composition schemes under GST meant for enterprises with turnover of less than 1.5cr, it has not been fully utilized by even eligible enterprises. This is because of perception that if they were not registered under GST, they would face a loss in their market share due to their transactions with businesses that wanted to avail of Input tax credit. Also provisions such as Reverse charge mechanism also prove to burdensome for MSMEs, which were earlier deriving competitive advantage of not being a part of tax regime.
e. Tax reforms and schemes that ought to encourage trading and ease of business – including on e-commerce platforms – have seemingly complicated the processes, and can potentially discourage small and medium businesses to explore new areas such as E-commerce platforms. In case small firms decide to move to E commerce platform, they have to give up Composition scheme and move into the standard GST regime.

4. Corruption

a. According to NCAER State Investment Potential Index 2017, entrepreneurs say corruption is still the biggest hurdle in doing business, followed by getting approvals. Also India ranks at 85th in corruption perception index of Transparency international.
b. Exporters and investors face non-transparent and often unpredictable regulatory and tariff regimes. Despite government legislation to improve international trade, there are still various hurdles to importing and exporting goods. Custom duty rates can be specific (rupees per unit) or ad valorem (percentage of value). In general, duty varies anywhere from 0% to 150%. Several layers of bureaucracy make it challenging to move goods efficiently, and companies must file a long list of documents before moving

products across borders.

5. Resolving Insolvency and disputes

    a. A study by Quality Council of India (done for Economic Survey) shows that the time taken from point of decision of closure to actually the company getting struck off from the Registrar of Companies is 1570 days (i.e. 4.3 years), even if all paperwork is in place and the company is not involved in any litigation or dispute. This is the best possible case of a routine activity. Interestingly, out of the total time taken, about 1035 days are taken for clearances by Income Tax, Provident Fund, GST departments and in taking back security refunds from various departments (Table 3). In contrast, voluntary liquidation takes about 12 months in Singapore, 12- 24 months in Germany and 15 months in UK. In Germany, for very large and active companies, it takes 2-4 years. Given the likelihood of disputes and litigation, for the comparable large cases it may take up to a decade in India.
    b. As per the World Bank‟ Ease of Doing Business report (2020), the cost of litigation in India is around 31 per cent of the claim value. This is significantly higher than in OECD countries (21 per cent) and Bhutan (0.1 per cent).
    c. The performance of India is enforcement of contracts is also seen in its ranking in World Rule of Law Index for 2020, where India ranks 69 out of 128 countries. Our performance is the worst in the category „Civil Justice not subject to unreasonable delay‟ where we are placed at rank 123 falling just behind Venezuela, Guatemala, Peru, Bangladesh and Columbia

6. Society

    a. Indian society suffers from traditions, customs, and superstitions. Religion, caste, and creed still dominate Indian society. Traditionally, some jobs are treated as inferior jobs. Due to the caste system, people hesitate to leave their traditional occupations. Such situations have resulted in a lack of interest in business, capacity to take a risk and constructive thinking.
    b. Also, the risk averse nature of Indian society remains a roadblock in development of entrepreneurial ecosystem.

7. Financial- “More than 70% of grievances from MSMEs relate to finance and credit. This budget has adequately focused on the aspect of Finance.” B.B Swain, Secretary, Ministry of MSME.

    a. Commercial banks appeared to be reluctant to lend to new entrepreneurs for want of past three years" income tax returns, financial statements, invoices, etc., even when they found the project/idea to be sound and commercially viable. Also entrepreneurs are required to make repeated visits to the branches for submission of the various documents.

b. Loan Processing : Banks often reject loan proposals without making an entry in the Loan Proposal Tracking Systems in several cases and they accept loan applications only when they see a strong possibility of actually extending a loan. The entrepreneurs themselves are unaware of the option of the online portal for submitting loan applications and tracking the status.

c. Lack of Financial Literacy- Only a few entrepreneurs are aware of the bill discounting as an option to finance their invoices and the electronic bill discounting platform, TReDS. Also awareness regarding schemes of the government like ECLGS and CGTMSE scheme remain very poor and thus the finances available under them remain under utilized.

8. Education and training

   a. Entrepreneurship as well as subjects related to it like management, finance, taxation, accounting etc are still neglected at high school level. Moreover the focus of education system draws parallels from education system introduced by British which was originally meant to curb rational thinking and ensure Indians end up being yes-men.
   b. Incubation centres, technological laboratories and other training institutes remain in the budding stages in Indian scenario.
   c. Also at higher education level, there is lack of industry-academia connect thus the learning remains a little less relevant in accordance with the real world issues and challenges.

9. Export regime- bottlenecks in exporting also directly affect the business ecosystem in India

   a. For instance, a study found that an apparels consignment going from Delhi to Maine (U.S.) takes roughly 41 days, but 19 of these are spent within India due to delays in transportation, customs clearance, ground handling and loading at sea-ports. Rest 19 are spent on high seas and last 3 in the USA.

   b. Also logistics cost is India is around 15% of GDP, whereas in developed nations it hovers around 8-10% of GDP. According to WEF, efficient infrastructure is critical to ensuring the effective functioning of the economy as a well-developed infrastructure reduces the effect of distance between regions, helps integrating the national market and connecting it to markets in other countries and regions.

10. Lack of availability of skilled labour-

    a. Only 20% of Indian workforce is skilled whereas the same stat is around 96% in countries like South Korea, highlighting mismatch between demand and supply of labour. On one hand the unemployment crisis has been on a 45 year high whereas on the other there is dire need of the right person on right job.
    b. Also as per Narayan Murthi, only 20% of fresh engineering graduates are employable. Even at the middle and upper management level, there is a similar mismatch.

Way forward:

1. Improving access and awareness regarding finance and other government schemes-

    - Need is to focus on financial literacy programmes for the MSMEs entrepreneurs covering the various financial products, processes and institutions, preferably using a cluster approach.
    - Banks need to shift their focus to cash flow based lending rather than insisting only on the collateral security, by developing alternative methods of credit appraisal for at least the first time entrepreneurs.
    - Awareness about CGTMSE, Small Finance Banks, Bill discounting facility (either through own bank, or through TReDS), need to be created by way of adequate credit counseling and financial literacy programs.
    - According to the website of GoI “startupindia.gov.in”, there are in total only 61,138 start-ups that are registered and recognized by DPIIT. Accordingly, even today majority of companies/startups are deprived of a host of benefits due to their lack of awareness and non-registration on DPIIT portal. Thus, it is necessary that GoI should take appropriate measures to ensure proper training and learning platforms for start-ups and encourage them to get registered and avail benefits to scale their business.

2. Labour Law Reforms to Create an Atmosphere of Trust and Consideration-

    - The Modi government‟s Labour and Employment Ministry drafted four Labour Codes - the Code on Wages; the Code on Industrial Relations, the Code on Occupational Safety, Health and Working Conditions; and the Code on Social Security. The new codes distinguish themselves by simplifying, merging and rationalizing the relevant provisions of the existing

Central Labour Laws. State governments must introduce reforms on similar lines.

- India ranks 86th in the Corruption perception index, there is a lingering fear of bureaucratic roadblocks and bribes. To overcome such a situation digitization along with improvement of bureaucratic culture should be the way forward.

3. EODB 2.0

- Transforming bureaucratic image from red tapism to red carpet for investors.
- active involvement of the states, digitization of manual processes and interventions, integration of the central and the state-level systems through IT bridges, single-point access for all citizen-centric services, and standardization and removal of overlapping compliances.
- expand the scope of a single-window portal - PARIVESH - to provide information to the applicants
- Cluster based approach of development of business ecosystem such as industrial estates, flatted factories, SEZs, NIMZ etc with due cooperation between centre and state governments.

4. Logistics

- Logistic cost need to be reduced via investment in infrastructure (as done by budget 2022-23 via PM Gati Shakti Mission) and also making our supply chains more efficient as well as resilient.

5. Exit Policy

- It is suggested that, when there is need for exit of enterprise from the market, there has to be proper framework for the revival and rehabilitation of such industries.
- There should be fast track courts for quickly disposing of routine commercial matter like those around negotiable instruments or contracts. Government should be discouraged from appealing against a matter where its argument has been turned down. This will bring down the pendency of legal cases.

6. Decrement in penalties; relaxation of timelines and fewer compliance under Companies Act, 2013

- GoI should ensure further relaxation(s) in compliances under the

Companies Act, 2013 more focused on boosting and easing the functioning of startups. There should be a decrease in penalties and fees for non-compliance to avoid unnecessary hassles and deterrents for young companies. Also, entrepreneurs should be provided with lenient timelines to enable them to focus on their core activities rather than being burdened by statutory abidance.

7. Taxation related measures

- Extending benefit of composition scheme to other service providers – Like manufacturers, traders and restaurant service providers, benefit of composition scheme must be extended to other service providers also.
- Amending Section 129 of the CGST Act to restrict levying of penalties only in cases where there is intent to evade taxes – Section 129 of the CGST Act must be amended to restrict levying of penalties only in cases where there is intent to evade taxes.
- Tax and compliance disputes should be resolved quickly in a time bound manner. Arbitration for old disputes related to tax and compliance should be simplified and fast tracked.
- Various taxes (service tax, income tax, VAT, etc.) that are paid at different points during the course of operation should be consolidate. Flexibility should be allowed for taxes to be paid once/twice a year. Retrospective application of taxes should be discouraged.

8. Rationalization of approvals/permits/clearances

- Blanket requirement for redundant approvals such as pollution certificate for service and IT sectors should be done away with.
- At present, the same rules and regulations govern a small business as also a large public company. Regulatory compliance for MSMEs should be delineated and minimized.
- Micro enterprises should be promoted by exempting them from regulatory compliance. Micro enterprises should be registered on the basis of self-declaration (of land, labour and machinery) with random checks by concerned authorities.
- Third party certification/accreditation – Third party certification should be recognized. Recognized Industry Associations could be allowed to certify on behalf of government agencies with random checks and stiff penalties for fraud (akin to self-employed individuals filing tax returns and declaring income with random checks by the IT department).

9. Single Window System

- A single window for facilitating and fast-tracking registration; obtainment of various clearances and permits; tax compliance; and exit from the business should be put in place. To facilitate and fast track the regulatory process, the ministry of MSMEs could set up STPI-like 1 nodal agencies. The nodal agency would co-ordinate with all departments (Registrar of Companies (ROC), Income Tax, Service Tax, VAT, etc.) to specify all required documents, avoid duplication in the application process, speed up the regulatory process, and promote transparency by tracking the progress of the application through an online portal.
- Ministry of MSME could identify and develop private agencies/consultants to train and accredit them for providing a host of services for MSMEs along the concept of e-seva centres. These agencies could be one-stop-shop for obtaining all statutory compliances at a single window. Ministry of MSMEs could facilitate and benefit these agencies/consultants by funding 75% of their total consultation fee

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