SAI STARTUP ASSOCIATION INDIA

April 28, 2020

Shri Piyush Goyal
Hon'ble Minister, Ministry of Commerce & Industry,
Government of India.

Shri Guruprasad Mohapatra
Secretary, Department for Promotion of Industry and Internal Trade,
Ministry of Commerce & Industry, Government of India,
Udyog Bhawan, New Delhi 110 011.

Sub 1: Request for assistance to the Start-up community and Clarification on Amendment in Foreign Exchange Management Rules.

Sub 2: Recommendation for establishment of Start-up India Fund

Sirs,

Greetings!

On behalf of the entire Start-up community, the Start-up Association of India (SAI), thank you for the continued constructive effort and support you have shown for the Indian economy including Start-ups, especially during the current times of crisis!

We commend and thank the government in its steps to protect interests of the nation and Indian corporates in distress who have become easy prey for acquisitions, especially when this pandemic is disrupting the rules of the economic playground worldwide.

We are writing to draw your kind attention to some of the nuances of the recently released Amendment and the far-reaching impact it has created as well for requesting you to grant certain leeway for the Start-up community. While we are certain that it has been done after due and careful consideration, however, we believe that there is room for further clarification on a few aspects concerning the Start-up ecosystem which we have highlighted in this representation.

Indian Start-ups are already going under immense financial stress and with Covid-19 added, the situation is grave. Start-ups contribute to large chunk of innovation and agility to innovate and adapt to the fast-changing priorities of the country and also addressing the emerging needs of the citizens of India. Indian Start-ups haven't had the benefit of access to capital due to a lack of domestic venture capital whereas over 90% of the capital for Start-ups in India is capital from overseas. They look out for support from the Government for favourable policies as well as for funds. Therefore, Indian Start-ups haven't had the opportunity to be as well-funded as its peers in neighbouring countries or around the world, despite that Indian Start-ups have grown and India is now one of the leading Start-up eco system. This pandemic has significantly hurt future business prospects of Indian Start-ups which were already reeling under financial pressure and therefore lacking in their ability to survive the downturn triggered by the pandemic. With a global recession in the line of sight it is likely that the traditional source of capital for the start-ups from the USA and Europe will dry out therefore Indian Start-ups will need strong support from the Government.

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Our requests herein may be kindly seen not with the perspective of the Amendment but as a set of recommendations in general to help the thriving start–up eco system ride the crisis .

Request for Start-up Aid:

(a) We understand that the Government of India has required that any investment in any form coming in from any entity situated in a country that India shares its land border with, will require a prior approval of the Government of India. This also applies to any beneficial owner situated in these countries in case investments are routed through other jurisdictions. Admittedly, India already screens investments from Pakistan and Bangladesh, and has neither seen nor expects large investments from its other neighbouring countries like Afghanistan, Bhutan, Myanmar and Nepal..

We believe that the Amendment has the potential to create certain undesired consequences for Start-ups which can be resolved.

(b) At the outset, we would like to bring out that since 2015, foreign investors through different channels including FPI, VC, and AIF etc. have infused about US$82.1 billion into Indian Start-ups. Chinese investors have also immensely supported Indian entrepreneurs and invested over US$ 8 billion in Indian Start-ups. In fact, large VC Funds from China have raised money from the USA and other global investors exclusively for investments in Start-ups in Emerging Markets, the bulk of it to be deployed in India. These are US Dollar denominated Funds raised outside of China and also domiciled in independent jurisdictions.

These investments and the ones that are already in the works or in the pipeline will significantly get affected and Start-ups which had received any kind of assurance from any foreign destination including China would now need to re-work their strategies from scratch which will cost them time and money.

We understand that the intention is largely to curb opportunistic takeovers and acquisitions of Indian companies due to the current COVID-19 pandemic. However, we understand that even VC investments emanating from China will require to undergo this scrutiny. VC investments do not concern a takeover or acquisition and are fresh investments into a freshly incorporated or an existing entity in India. More so, investment into the capital of an existing company pursuant to subscription of instruments also do not concern a takeover or acquisition.

We believe that the intention is not to include investments in units of AIFs, however, a clarity in this will be appreciated.

(c) Even those Indian Start-ups which already have investments from Chinese companies and VCs will not be able to ask for support or call for capital without the prior approval of the Government. This will cripple these already struggling Indian Start-ups. Some examples include the existing Indian Unicorns like Paytm, Zomato, Swiggy, Byju's, etc. which are playing a critical role in today's crisis.

In case of a capital call by a start-up having multiple investors including a Chinese investor, such Chinese shareholder may not be able to contribute in the absence of a prior Government approval, thus delaying the whole process of capital raise from even the other shareholders, both domestic and foreign.

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Accordingly, any Indian Start-up which is currently even partially funded from China and needs capital urgently to overcome the current crisis or pivot its business plans to align with the new emerging opportunities will not be able to do so. Such situations should be treated as exceptions where there is already an investor from China.

(d) While the trade relationship between India and China is at a staggering US$84.44 billion in 2017, there is still a large trade-deficit between these countries which stands at US$60 billion even in 2018.

A substantial portion of this capital is likely to come to Start-ups in India. Historically, of all the offshore funding received by Indian Start-ups, only a minority portion can be accredited to investors from outside Asia.

(e) Start-ups are one of the major contributing factors to creating jobs.

As per Nasscom, in 2019, Start-ups employed between 3.9 to 4.3 lac and this number could up to 12.5 lac direct jobs by 2025.

When translated to indirect jobs created by Start-ups, they are at a staggering 14 to 16 lac jobs in 2019 with a potential to go to 39 to 44 lac jobs by 2025.

It is not only that start-ups are generating large number of jobs but are at the forefront of innovation in several fields like AI & ML, HealthTech, FinTech. ReguTech, Agritech and impacting the way business is done in India.

In case Indian Start-ups are not bailed out well on time, there are likely to be significant job losses in the country, both current as well as in the future and the fast evolving culture of entrepreneurship based on innovation and cutting edge technology will lose its momentum.

(f) Unlike the UK, where their government has started a 'Future Fund' pledging about US$311 million only for Start-ups, on the contrary Indian Start-ups across sectors in comparison have bare minimum access to working capital loans worth no more than INR 2 crores through SIDBI in the current times of crisis. Additionally, the UK government has also pledged a US$933 million support for R&D intensive Start-ups

In the USA, the Congress has authorized billions of dollars in new loan guarantees, expanded disaster loans, and grants through the Small Business Administration in order to help small businesses, as per reports. The New Business Preservation Act would be used to distribute venture capital around the country. The Federal Reserve has also announced that it will finance loans that are made by commercial banks to small businesses including Start-ups as part of the government's new US$350 billion payroll lending program, part of the broader congressional stimulus package.

Similarly, Governments of France and Germany have pledged more than US$2 billion each and so have other countries for varied amounts.

We believe that in order for India to become a $10 trillion economy by 2030, start-ups will play a key role and contribute to India's GDP targets but, it will most certainly require foreign capital infusion. This is more-so since the US and European markets have been in a financial crisis since the last few years and with Covid-19, this will further worsen the flow of capital from there.

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Similarly, other countries have set out certain plans and road map to help their respective Start-up communities, however, India is yet to receive its own, which seems given India's pressing needs for various other sectors including for containment of the pandemic it may not get the necessary priority

(g) India's Start-up ecosystem has immense potential that has grown with leaps and bounds after the Prime Minister of India launched the Start-up India initiative and put the start-ups on the national agenda to fuel economic growth. The current crisis and barriers on capital inflows can significantly affect this initiative of the Prime Minister. It is therefore essential that the new guidelines creates a clear carve out for 'Start-ups'.

(h) In order to increase the capital pool for investments in start-ups from domestic investors we would like to press on the point that certain policy framework and changes can be brought about in order to incentivise the larger corporates should they be willing to invest into Start-ups. For example, Indian Start-ups will vastly benefit if CSR spends by eligible corporates into the capital of Start-ups is allowed as CSR expenditure. They can also be incentivised to invest directly into start-ups and AIF Cat I & II and allowed to amortise their such investments over a period of five years for tax purposes and their gains and returns on such investments can be taxed as per the Income Tax regulations.

(i) Extraordinary circumstances require extraordinary initiatives, In today's circumstances where majority of the start-ups are running out of cash and will be unable to raise further capital, the Government of India should on priority basis set up a 'Start-up India Fund' and contribute a corpus of Rs.15, 000 cr and transfer the SIDBI Fund of Funds to this 'Start-up India Fund'. As you are aware, out of the corpus of INR 10,000 crores with SIDBI, only INR 3798 crores has been committed out of which just INR 1,025 crores has been disbursed till June'19. The proposed Fund would then constitute a total corpus of over INR 25,000 crores. This 'Start-up India Fund' can be registered as an AIF category-II Fund on the same lines as the National Investment and Infrastructure Fund ('NIIF') and managed by professional Fund Managers as in the case of 'NIIF'. The 'Start-up India Fund' in addition, will be in a position to raise a couple of billion US dollars from sovereign funds of friendly nations as well as allow corporates to contribute to such fund through their CSR obligations or even otherwise and also Indian institutional investors and Public sector enterprises could contribute to this Fund. The said fund can continue to act as a fund of funds as SIDBI/NIIF and also directly invest in Indian Start-ups.

The Governments contribution can come over a period of three years as the sponsor of the Fund and this Fund will have the ability to become a USD 10 billion Fund over this period by raising money both domestic and foreign institutional investors and sovereign funds. This will give a huge fillip to the start-up ecosystem and reduce the near total dependence on foreign capital at the moment.

Should you require, we will be very happy to provide a detailed presentation in this respect and extend all possible help not only to structure the Fund but raise contributions to the Fund.

This will greatly contribute to and assist in salvaging the Indian Start-up ecosystem which is now likely to experience a meltdown and all the efforts and favourable policy framework for the start-ups which your Department has spearheaded all this while will not go in vain.

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Request for Clarification on the FEMA Amendment:

In addition to the above, in relation to the Amendment, we humbly request your kind consideration to the following:

1. The Amendment should create an exception for 'Start-ups'. Meaning of the term can be borrowed from what has been laid down by the Ministry of Commerce & Industry.

2. The Amendment should be made not applicable for capital calls on existing investors in ventures where they have already invested.

3. The Amendment should not impact any subsequent investment by an existing shareholder in a start-up.

4. The Amendment may allow minority stake investments in Indian Start-ups from neighbouring countries with the exception of Pakistan & Bangladesh upto certain identified thresholds like not exceeding 24% in the first round of capital raise with out prior Government approval.

5. The Amendment should exclude investments coming through investment vehicles (such as any overseas venture capital funds) in case the total assets under management or contribution or capitalisation of such funds is less than 49% from neighbouring nations, since the nationality of such funds is not possible to determine in most cases.

6. Although it is acknowledged that Hong Kong is the Special Administrative Region of the People's Republic of China, any investments (including in the case of any beneficial ownership) coming in from Hong Kong a domiciled Venture Capital Fund should be kept outside of the purview of the Amendment.

7. In order to allow continuity in access to capital, the Amendment should exclude investments that are purely financial in nature without any rights or control in any Indian Start-up.

In addition to the above we support the immediate relief sought by other Industry Associations in particular by a group of Founders and investors vide their letter of 30th March addressed to you. We are sure that the relief asked for is under active consideration by your Ministry.

In case of any questions or clarification, we would request you to please reach out to us here:

Mahendra Swarup Chairman, Start-up Association of India	**Dipti Lavya Swain** Partner, HSA Advocates
Address: 7, Paschimi Marg, Block C, Vasant Vihar, New Delhi 110 057	**Address:** 81/1, Aurobindo Towers, Aurobindo Marg, Adchini, New Delhi 110 017
Email: mahendra@swarups.com	**Email:** dipti.swain@hsalegal.com
Ph.: +91 981 0182 444	**Ph.:** +91 900 4610 900/ +91 11 6638 7000

We look forward for a favourable consideration from your good offices.

Thanking you,

Yours Sincerely,

Mahendra Swarup
Chairman

Data Sources: Andersen, Brookings India, Gateway House, HSA Advocates, KPMG, McKinsey, and others.

About Start-up Association of India (SAI):

Start-up Association of India (SAI) is a dominant collective of the Indian Start-up ecosystem though advocacy is not the primary objective it is now making endeavours to assist the policymakers, central and state governments and other domestic and international stakeholders at achieving favourable outcomes in the following spheres:

- *Legal, regulatory and tax enabling environment for entrepreneurs and Start-ups in India.*
- *Propose policies which make India a global Start-up hotspot and encourages domestic and foreign investments.*
- *Policy dialogue with decision-makers in government, institutions, regulatory bodies and other influencers on issues of concern for all stakeholders in the Start-up ecosystem.*
- *Support services based on primary research, which builds a positive image of Start-ups in society and emphasizes their importance in the India context.*
- *Brainstorming and thinking from the perspective of all stakeholders including regulators on issues faced by entrepreneurs and Start-ups.*
- *Instituting a mechanism to develop talent and spirit of innovation based entrepreneurship by organizing educational and experience-sharing activities, providing advice and support to budding entrepreneurs.*
- *Proposals that encourage culture of self-employment and reduce barriers to start a business. This includes creating a social security net for Start-up Founders and their dependents and employees.*
- *Investing in research and aggregating international best practices to instil best in class processes and governance in Indian Start-ups.*
- *Create an information-sharing platform and regularly publish reports on Start-ups and provide quality data regularly.*
- *Act as the catalyst for a favourable political and social environment for Indian Start-ups and entrepreneurs.*