FACTORS THAT HOBBLE THE GROWTH OF B2B START-UPS AND STREAMLINING START-UP FUNDING

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ABSTRACT

In India, the concept of "start-up" was introduced in the company law by the Ministry of Corporate Affairs (MCA).It defined "start-up" as a private company incorporated under the Companies Act, 2013 and recognised as a "start-up" in line with the notification issued by the Department of Industrial Policy and Promotion. Mumbai has emerged as the hub of B2B start-ups in the country. But Mumbai trails Bengaluru and Delhi-NCR when it comes to startups. Bengaluru has its share of unicorns in the start-up space – names like *Flipkart*, *Inmobi* and *MuSigma* need no introduction. Bengaluru also boasts of its share of innovative start-ups. Some of the leading players are *Team Indus*, *Ather Energy*, *Explara* and *Fabulyst* (Bizztor, 2017). Several factors hobble the growth of startups in the country, though. The issue of funding B2B start-ups is to be streamlined. Angel investors too need to be motivated to invest in B2B startups. The researcher's investigations reveal that the assumption that any investment in excess of fair market value is taxable income is rather a simplistic assumption on the part of the tax administration. The researcher also concludes that conforming with the definition of start-up is an involved exercise for the startups. The start-up regulations are typically cluttered. The researcher recommends that regulations which raise the financial burden of the start-ups be withdrawn. B2B Start-ups' appeal process against the tax regime should be simplified and resolved within a pre-defined and short time frame. A B2B start-up at the funding stage needs to conserve all the capital it can to address more immediate and more precious requirements. It is nobody's contention that the start-ups especially B2B startups should be fully exempted from income tax for ever. But it is grossly unfair to demand tax when the start-up is at the pre-revenue stage. It amounts to rubbing salt into the wound!

Key words: *Angel investor; cluttered; hobble; hub; simplistic; B2Bstart-up; streamline; unicorn.*

1.1 Introduction

In India, the concept of "start-up" was introduced in the company law by the Ministry of Corporate Affairs (MCA), which is the administrative ministry concerned (Srivats, 2017).The MCA defined "start-up" through an executive order issued under the provisions of the Companies Act, 2013. The order permits a few operational and compliance relaxations to a "start-up company". Accordingly, a start-up company is a private company incorporated under the Companies Act, 2013 and recognised as a "start-up" in line with the notification issued by the Department of Industrial Policy and Promotion.The relaxations relate to allowing start-ups to raise deposits from members (shareholders). They are exempted from procedural compliance for five years. Start-ups need not prepare cash flow statements. Relaxation has been allowed in respect of board meetings too. A company secretary of a start-up or a director can now sign the annual return.

It is believed in informed circles that the government's move is a positive development, providing psychological comfort and giving a boost to start-ups in the country. This may be viewed as the first of several steps aimed at optimising the start-up ecosystem. The government could go a step further and define a threshold below which they will not be required to shoulder certain compliances.RBI has already been covering the aspect of start-ups in its circulars covering FEMA-related notifications. However, according to another school of thought, the few simple exemptions the government has allowed are not material. The government has not said what needs to be done for the startups.

1.2 Statement of the problem

Well-intentioned though is the country's evolving start-up regulatory regime, certain factors do seem to hobble their growth. Fiscal policy, corporate foibles, funding issues and motivational strategies, among other things, seem to slow down the growth of B2Bstart-ups in the country. This scenario requires that the factors that hobble the growth of start-ups be identified. The issue of funding B2Bstart-ups too needs to be addressed since capital is the Achilles heel of the start-up industry. This implies that the angel investors too should be motivated to invest in B2B start-ups – not just venture capitalists and foreign investors.

1.3 Review of literature

1. With over a thousand start-ups in 2017, India's start-up ecosystem has never looked brighter (The Financial Express, 2017). The mortality rate is as high as 35 percent though. All the same, according to a Nasscom presentation, India boasts of the world's third-largest start-up base -- almost the same as Israel. Since start-ups are at the cutting edge of technology and innovation, half the start-ups in 2017 were in the B2B space. Almost all IT majors in India, are inclined to fund start-ups. Data analytics, IoT, AI and block chain are the areas most of them are interested in. But the funds available to early-stage start-ups are showing a decline.

2. Consolidating its position as the third largest start-up ecosystem across the world and facing rising competition from countries like UK and Israel, India's growth momentum in the start-up space

continues (NASSCOM, 2017). It added over 1000 tech start-ups in 2017, taking the total number of tech start-ups to 5000-5200. The country is witnessing a swift rise in the B2B tech start-up space. It is focused on verticals like health-tech, fintech, and ecommerce/aggregators. While Bengaluru, Delhi/NCR and Mumbai retained their position as the key start-up hubs in India, 20 percent of the start-ups originated from tier II/III cities.

3. After nearly a decade of e-commerce and ride-hailing dominating the ecosystem, business-to-business (B2B) startups in India are finally having their day in the sun (Sushma, 2017).Nearly 50 percent of the firms founded in India in 2017 so far operate in the B2B space, according to a November, 2017 report filed by the IT industry lobby Nasscom and consulting firm Zinnov. In all, B2B startups now account for around 40 percent of the Indian start-up ecosystem.

4. India will soon have its first start-up district with incubation centres and about 20 tinkering labs for schools(Ruchika, 2017). They will encourage the creation of innovative solutions in agriculture, health and education. The Commerce & Industry minister wants the entire cluster to come up in Mangalore.The government will fund the effort and ensure that roads, electricity and digital networks are provided for. It will be one of the largest upcoming incubation facilities in the country.While the cost has not been assessed, government will put all its weight behind it in terms of making resources available, according to a government source. The intention is to take up the start-up drive in cities beyond Bengaluru and Hyderabad too.

5. An upsurge in business-to-business (B2B) startups and the emergence of deep tech were among the highlights from Indian software industry body Nasscom's annual report on the startup scene, released on November 2, 2017 (Malavika, Home: TechinAsia.com, 2017). Over 1,000 new startups sprang up in India in 2017. Almost half of them were in the B2B segment, according to the report. Considering only the tech companies incorporated from 2012 to 2017, India now has over 5,000 startups, making it the world's third-largest startup ecosystem.B2B's share of overall tech startup funding has risen to almost a third. Corporates have escalated their involvement with startups, especially in fintech, partly fuelling this growth. This involvement assumes different formats -- ranging from collaboration programs to accelerators and investments. Over 50 M&A deals in the first half of 2017testify to an uptick in global corporate interest in Indian startups.The rise of B2B is significant because it leverages India's tech talent base, built up over decades of delivering software solutions and services to the world. The SaaS (software-as-a-service) model of startups targeting large enterprises as well as small businesses has received most of the B2B funding.

1.4 Research gap

The reviewed literature has done well to trace the advent and evolution of the B2B start-up space in India. However, the impact of the evolving regulatory regime on the various stakeholders associated with the start-up space like the start-ups themselves and the various categories of investors like venture capitalists and angel investors, has not been dealt with adequately. It is this gap the present study seeks to address.

1.5 Scope of the present study

The study will cover 30 start-ups and 30 practising consultants .

1.6 Objectives of the study

The objectives of the study are to:

1. Ascertain the factors that hobble the growth of B2B start-ups

2. Identify measures to streamline start-up funding

3. Suggest measures to motivate the angel investors to invest in B2B start-ups

1.7 Hypothesis proposed to be tested

The study proposes to test the following hypothesis:

"Patronising attitude from large corporates fearing disruption of age-old corporate practices is a factor that hobbles the growth of B2B start-ups in India "

1.8 Research design

1.8.1 Research methodology

The study is descriptive in nature and has used the 'fact-finding' survey method

1.8.2 Sources of data

Data required for the research has been collected from both primary and secondary sources.

Primary data has been collected by administering Interview Schedules to the respondents, namely, startups and consultants.

Secondary data has been collected from books relating to the topic, articles, reputed journals, the financial press, government publications, websites and company annual reports.

1.8.3 Sampling plan

B2B Startups: Given the constraint imposed by resources like time and the limited number of B2B startups operating in the area where the researcher is based, purposive or judgement sampling under the non-probability method was adopted to select the start-ups. The researcher selected 30 B2B startups that she regarded as the most appropriate ones for the study. This criterion, according to the researcher, is ideal for the present study. What is important is the typicality and the relevance of the sampling units to the study and not the overall representativeness to the population. Thus, it guarantees inclusion of the relevant elements in the sample. Probability sampling plans cannot give such a guarantee.

Consultants: Given the limited availability of consultants with exposure to start-up investments and operating in the area where the researcher resides, purposive or judgement sampling under the non-probability method was adopted. The researcher selected 30 consultants that she regarded as the most appropriate ones for the study. This criterion, according to the researcher, is ideal for the present study. What is important is the typicality and the relevance of the sampling units to the study and not the overall representativeness to the population. Thus, it guarantees inclusion of the relevant elements in the sample. Probability sampling plans cannot give such a guarantee.

1.8.4 Data collection instruments

Interview schedules, specially designed for the purpose, were administered to the respondents for collection of primary data.

1.8.5 Data processing and analysis plan

Non-parametric statistical units were used to test the association between some qualitative characters and conclusions will be drawn based on formation of H_0 and H_1. To be specific, chi-square test will be applied to test the hypotheses.

1.8.6 Limitations of the study

Primary data could sometimes be deduced through constant topic-oriented discussions with the respondents. A certain degree of subjectivity, even if negligible, could have clouded their views. However, the researcher is confident that the subjectivity will be too insignificant to affect the accuracy of the findings of the study.

1.9 Start-ups

In the following paragraphs, the primary data collected from the 30 start-up respondents is analysed.

1.9.1 Factors that hobble the growth of start-ups

Received opinion has it that a host of factors hobble the growth of B2B start-ups in the country. Hence the researcher sought to know from the respondents the factors that hobble the growth of B2B start-ups in the country. Their replies to the query appear in the following Table.

Table-1

Factors that hobble the growth of start-ups

Factors	Number of respondents
Any investment in excess of fair market value is reckoned as income, by default	27
B2B Start-ups receiving angel funding are not exempted from tax	26
Start-ups chasing capital are constantly cautioned by the tax regime that capital inflows will be taxed	24
Patronising attitude from large corporates fearing disruption of age-old corporate practices	22

Any investment in excess of fair market value is reckoned as income, by default and 27 respondents cite this as a factor that hobbles the growth of B2B start-ups. B2B Start-ups receiving angel funding are not exempted from tax and 26 respondents cite this as a factor that hobbles the growth of B2B start-ups. Start-ups chasing capital are constantly cautioned by the tax regime that capital inflows will be taxed, and 24 respondents cite this as a factor that hobbles the growth of B2B start-ups. Patronising attitude from large corporates fearing disruption of age-old corporate practices and 22 respondents cite this as a factor that hobbles the growth of start-ups.

1.9.2 Measures to streamline B2B start-up funding

It is argued in informed circles that start-up funding can be streamlined with a few focused measures. Hence the researcher sought to know from the respondents the measures needed to streamline B2B start-up funding. Their replies to the query appear in the following Table.

Table-2

Measures to streamline B2B start-up funding

Measures	Number of respondents
Angel investors should be entitled to the same tax treatment as venture capital firms and foreign investors	27
B2B start-ups' appeal process against the tax regime should be simplified and resolved within a pre-defined, short time frame.	26
The angel tax regime concerning investments in unlisted companies must be streamlined	25
An angel investor-friendly regulatory regime should be put in place	23

Angel investors should be entitled to the same tax treatment as venture capital firms and foreign investors, is the measure suggested by 27 respondents. B2B Start-ups' appeal process against the tax regime should be simplified and resolved within a pre-defined, short time frame. is the measure suggested by 26 respondents. The angel tax regime concerning investments in unlisted companies must be streamlined, is the measure suggested by 25 respondents. An angel investor-friendly regulatory regime should be put in place, is the measure suggested by 26 respondents.

1.9.3 Motivating the angel investors to invest in B2B startups

One school of thought holds that with the right motivation, angel investors could be led to invest in B2B startups. Hence the researcher sought to know from the respondents the measures needed to motivate the angel investors to invest in B2B startups. Their replies to the query appear in the following Table.

Table-3

Motivating the angel investors to invest in start-ups

Motivation	Number of respondents
Put the angel investors on the same footing as venture capital firms and foreign investors vis-a-vis taxation of investment	27
The mandate that the B2B start-up must be certified either by a government body or must be listed with an approved incubator should be withdrawn	27
The government's definition of start-up in terms of its year of incorporation and turnover cap must be watered down	27
The mandate that the valuation of a B2B start-up during its funding round must be done by a SEBI registered merchant banker and not a chartered accountant should be withdrawn	27
Factors like net income or net worth should not restrain angel investors from investing in B2B start-ups.	27
To grant income tax relief, the government should content itself with a mere request for ratification from the start-up post facto, instead of insisting on prior approval from the inter-ministerial panel.	25
The level of documentation associated with the claim for tax exemption should be minimised	25

Put the angel investors on the same footing as venture capital firms and foreign investors vis-a-vis taxation of investment, suggest 27 respondents, by way of motivation. The mandate that the B2B start-up must be certified either by a government body or must be listed with an approved incubator should be withdrawn, suggest 27 respondents by way of motivation. The government's definition of start-up in terms of its year of incorporation and turnover cap must be watered downsuggest 27 respondents, by way of motivation.The mandate that the valuation of a B2B start-up during its funding round must be done by a SEBI registered merchant banker and not a chartered accountant should be withdrawn, suggest 27 respondents by way of motivation. Factors like net income or net worth should not restrain angel investors from investing in start-ups,suggest 27 respondents by way of motivation. To grant income tax relief, the government should content itself with a mere ratification request from the start-up post facto, instead of insisting on prior approval from the inter-ministerial panel, suggest 25 respondents by way of motivation.The level of documentation associated with the claim for taxexemption should be minimised,suggest 25 respondents by way of motivation.

1.10 Consultants

In the following paragraphs, the primary data collected from the 30 consultants is analysed.

1.10.1 Factors that hobble the growth of B2B start-ups

Received opinion has it that a host of factors hobble the growth of B2B start-ups in the country. Hence the researcher sought to know from the respondents the factors that hobble the growth of B2B start-ups in the country. Their replies to the query appear in the following Table.

Table-4

Factors that hobble the growth of B2B start-ups

Factors	Number of respondents
B2B Start-ups receiving angel funding are not exempted from tax	27
Government's insistence on the inter-ministerial committee certifying the start-up	27
Patronising attitude from large corporates fearing disruption of age-old corporate practices	26
Any investment in excess of fair market value is reckoned as income, by default	24

Start-ups receiving angel funding are not exempted from tax and 27 respondents cite this as a factor that hobbles the growth of B2B start-ups. According to 27 respondents, government's insistence on the inter-ministerial committee certifying the start-upis a factor that hobbles the growth of start-ups. Patronising attitude from large corporates fearing disruption of age-old corporate practices is cited as a factor that hobbles the growth of B2B start-ups by 26 respondents.Any investment in excess of fair market value is reckoned as income, by default and 24 respondents cite this as a factor that hobbles the growth of B2B start-ups.

1.10.2 Measures to streamline B2B start-up funding

It is argued in informed circles that start-up funding can be streamlined with a few focused measures. Hence the researcher sought to know from the respondents the measures needed to streamline B2B start-up funding. Their replies to the query appear in the following Table.

Table-4

Measures to streamline start-up funding

Measures	Number of respondents
Angel investors should be entitled to the same tax treatment as venture capital firms and foreign investors	27

B2B Start-ups' appeal process against the tax regime should be simplified and resolved within a pre-defined, short time frame.	27
An angel investor-friendly regulatory regime should be put in place	23

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1.10.3 Motivating the angel investors to invest in B2B startups

One school of thought holds that with the right motivation, angel investors could be led to invest in startups. Hence the researcher sought to know from the respondents the measures needed to motivate the angel investors to invest in startups. Their replies to the query appear in the following Table.

Table-6

Motivating the angel investors to invest in start-ups

Motivation	Number of respondents
Put the angel investors on the same footing as venture capital firms and foreign investors vis-a-vis taxation of investment	27
The government's definition of start-up in terms of its year of incorporation and turnover cap must be watered down	27
The mandate that the valuation of a start-up during its funding round must be done by a SEBI registered merchant banker and not a chartered accountant should be withdrawn	27
Since the merchant banker that issues the valuation certificate is not necessarily knowledgeable about the sector the start-up belongs to or its potential, such certification should not be prescribed.	27
To grant income tax relief, the government should content itself with a mere request for ratification from the start-up post facto, instead of insisting on	26

prior approval from the inter-ministerial panel.	
Factors like net income or net worth should not restrain angel investors from investing in B2B start-ups.	26
The mandate that the B2B start-up must be certified either by a government body or must be listed with an approved incubator should be withdrawn	25
The requirement that the angel investor must report an average income of INR 25 lakh for the last three years, or a net worth of INR two crore at the end of the previous financial year should be withdrawn.	25
The level of documentation associated with the claim for taxexemption should be minimised	24

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1.11 Summary of findings

In the following paragraphs, a summarised version of the findings arrived at in respect of the three categories of respondents is furnished.

1.11.1 B2B Start-ups

1. Any investment in excess of fair market value is reckoned as income, by default and 27 respondents cite this as a factor that hobbles the growth of B2B start-ups. B2B Start-ups receiving angel funding are not exempted from tax and 26 respondents cite this as a factor that hobbles the growth of B2B start-ups. Start-ups chasing capital are constantly cautioned by the tax regime that capital inflows will be taxed, and 24 respondents cite this as a factor that hobbles the growth of start-ups. Patronising attitude from large corporates fearing disruption of age-old corporate practices and 22 respondents cite this as a factor that hobbles the growth of start-ups.

2. Angel investors should be entitled to the same tax treatment as venture capital firms and foreign investors, is the measure suggested by 27 respondents. B2B Start-ups' appeal process against the tax regime should be simplified and resolved within a pre-defined, short time frame. is the measure suggested by 26 respondents. The angel tax regime concerning investments in unlisted companies must be streamlined, is the measure suggested by 25 respondents. An angel investor-friendly regulatory regime should be put in place, is the measure suggested by 26 respondents.

3. Put the angel investors on the same footing as venture capital firms and foreign investors vis-a-vis taxation of investment, suggest 27 respondents, by way of motivation. The mandate that the B2B start-up must be certified either by a government body or must be listed with an approved incubator should be withdrawn, suggest 27 respondents by way of motivation. The government's definition of start-up in terms of its year of incorporation and turnover cap must be watered downsuggest 27 respondents, by way of motivation.The mandate that the valuation of a start-up during its funding round must be done by a SEBI registered merchant banker and not a chartered accountant should be withdrawn,suggest 27 respondents by way of motivation. Factors like net income or net worth should not restrain angel investors from investing in start-ups,suggest 27 respondents by way of motivation. To grant income tax relief, the government should content itself with a mere request for ratification from the start-up post facto, instead of insisting on prior approval from the inter-ministerial panel, suggest 25 respondents by way of motivation.The level of documentation associated with the claim for taxexemption should be minimised,suggest 25 respondents by way of motivation.

1.11.2 Consultants

4. B2B Start-ups receiving angel funding are not exempted from tax and 27 respondents cite this as a factor that hobbles the growth of start-ups. According to 27 respondents, government's insistence on the inter-ministerial committee certifying the start-ups a factor that hobbles the growth of start-ups. Patronising attitude from large corporates fearing disruption of age-old corporate practices is cited as a factor that hobbles the growth of start-ups by 26 respondents.Any investment in excess of fair market value is reckoned as income, by default and 24 respondents cite this as a factor that hobbles the growth of start-ups.

5. Angel investors should be entitled to the same tax treatment as venture capital firms and foreign investors, is the measure suggested by 27 respondents. B2B Start-ups' appeal process against the tax regime should be simplified and resolved within a pre-defined, short time frame, is the measure suggested by 27 respondents. An angel investor-friendly regulatory regime should be put in place, is the measure suggested by 23 respondents.

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1.12 Conclusions

Conclusions relate to the hypotheses. They are answers to the research questions.

1.12.1 Hypothesis testing

As explained, the following is the hypothesis proposed to be tested:

"Patronising attitude from large corporates fearing disruption of age-old corporate practices is a factor that hobbles the growth of B2B start-ups in India"

Hence H_0 and H_1 are as follows:

H_0: Patronising attitude from large corporates fearing disruption of age-old corporate practices is not a factor that hobbles the growth of B2B start-ups in India

H_1: Patronising attitude from large corporates fearing disruption of age-old corporate practices is a factor that hobbles the growth of B2B start-ups in India

Based on the primary data collected from the respondents, vide Tables: 1 and 6, a chi-square test was applied to ascertain the association, if any, between the two variables. The following Table reveals the computation made using MS-Excel:

	Observed Values		
Category	*Yes*	*No*	*Total*
B2B Start-ups	22	8	30
Consultants	26	4	30
Total	*48*	*12*	*60*
	Expected Values		
Category	*Yes*	*No*	*Total*
B2B Start-ups	24	6	30
Consultants	24	6	30
Total	*48*	*12*	*60*
	Agree	*Disagree*	
o-e	-2.0000	2.0000	
	2.0000	-2.0000	
(o-e)^2	4.0000	4.0000	
	4.0000	4.0000	
((o-e)^2)/e	0.1667	0.6667	
	0.1667	0.6667	
CV	*0.3333*	*1.3333*	*1.6667*
TV			*3.8415*
P			*0.7968*

The calculated value of χ^2 is 1.6667, lower than the table value of 3.84145 for an alpha of 0.05 at one degree of freedom. Hence the research hypothesis / alternate hypothesisH_1 isrejected. p=0.7968 is the inverse of the one-tailed probability of the chi-squared distribution.

1.13 Researcher's recommendations

1. Assuming that any investment in excess of fair market value is taxable income is rather a simplistic assumption on the part of the tax administration. A B2B start-up at the funding stage needs to conserve all the capital it can for more immediaterequirements. It is nobody's contention that the start-ups should be fully exempted from income tax for ever. But it is grossly unfair to demand tax when the start-up is atthe pre-revenue stage. It would almost amount to rubbing salt into the wound!

2. Presently angel investors qualify for full exemption on their investments in B2B start-ups, but such exemption comes with a lot of riders. Virtually, one may even conclude that the government did not want to oblige the investors in spirit. Hence it obliged them in letter making it almost impossible for them to avail of exemption.

3. If an angel investor wants to benefit from tax exemption, the investee B2B start-up must have been recognised as a B2B start-up by an inter-ministerial panel. This requires the investors, inter alia, to

provide their know-your-customer (KYC) documents, essentially complicating what is already an involved exercise! Government should content itself with a mere request for ratification from the inter-ministerial panel.

4. Additionally, the start-up must have been certified by a government body or must have been listed with an approved incubator. It must also conform with the government's definition of a start-up, which means it must have been incorporated in the last seven years (if it belongs to the biotechnology sector, it must have been incorporated in the last ten years) and boast ofa turnover that is below INR 25 crores (or USD 3.7 million). However, there is a silver lining -- the exemption will be retroactively implemented from April 2011. This is a typically cluttered Indian government regulation, which could do with plenty of de-cluttering.

5. If conforming with the definition of start-up is going to be such an involved exercise, the next step, namely raising money, is sure to leave the start-ups daunted: startups cannot raise money until they are certified!

6. One is inclined to question the wisdom behind the government's insistence that the valuation of a B2B start-up preceding its funding round must be undertaken by a SEBI-registered merchant bank and not by any chartered accountant. The government seems to have forgotten for a moment that when one invests in a B2B start-up, one is investing in a pre-revenue, innovation-driven and disruptive proposition. There are no cash flows for the start-ups to tap into,to settle the bills of the likes of merchant bankers. Worse, for all one knows, the merchant banker may not be knowledgeable about the sector the start-up belongs to or the potential that the sector promises to the start-up concerned! The start-up concerned can least afford to throw good money after bad! Merchant bankers, after all, work for a price and as a result, the cost of funding will go up for the start-up!

7. The requirement that the angel investor must report an average income of INR 25 lakh for the last three years, or a net worth of INR two crores at the end of the previous financial year should be withdrawn. This rider may discourage genuine angel investors form foraying into the start-up space. Worse, the rider will keep out the tech-savvy, risk-taking but not cash-rich angel investors who believe that the investment will prove lucrative. For example, an IIT product may not have deep pockets but is better placed to take a technology call than one with deep pockets but not tech-savvy. The former will be more useful to the start-up and the country's economy than the latter.

8. B2B start-ups' appeal process against the tax regime should be simplified and resolved within a pre-defined, short time frame. Otherwise, start-ups may prefer to shift overseas.

9. To motivate the B2B start-ups, the government should put the angel investors on the same footing as venture capital firms and foreign investors.

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