Current Status and Key Gaps of Entrepreneurship in India – A View

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Abstract

In this paper attempted has been made to set out the key issues related to entrepreneurship gaps in India. This study further has expressed that, while the economic and social benefits of thriving entrepreneurship and innovation are evident, it is critical to recognize that these benefits will only accrue if the key gaps in the ecosystem are addressed. The researcher has identified five key areas that an entrepreneur would need addressed on a priority basis to be able to grow unfettered. Catalytic government policy and regulatory framework: Easy access to equity capital and debt, Businesses as entrepreneurial hubs, fostering a culture that encourages entrepreneurship over careerism, Adequate and effective collaboration forums.

Key words: Entrepreneurial hubs, Ecosystem, Fostering.

Introduction

India was second among all nations in Total Entrepreneurship Activity as per the Global Entrepreneurship Monitor Report of 2002. But after several years of data, India appears to have a TEA level rather close to the world average. India is ninth in the Global Entrepreneurship Monitor (GEM) survey of entrepreneurial countries. It is highest among 28 countries in Necessity based entrepreneurship, while 5th from the lowest in opportunity based entrepreneurship. The liberalization, which was started in 1991, and the Information Technology boom of the mid-late 90's, has been significant factors, leading to a wave of entrepreneurship sweeping through the country. Indians have entrepreneurial capacity. However the society and government are not very encouraging towards entrepreneurship. To a large extent, the Indian society is risk averse. People usually seek secure and long-term employment, such as government jobs. The physical infrastructure needs to be improved. Social Attitudes, lack of capital, inadequate physical infrastructure and lack of government support are major factors of hindrance. India is the fifth largest economy in the world (ranking above France, Italy, the United Kingdom, and Russia) and has the third largest GDP in the entire continent of Asia. It is also the second largest among emerging nations. The liberalization of the economy in the 1990s has paved the way for a huge number of people to become entrepreneurs. Over the years India and China have followed opposing strategies for development. While China's growth has been fuelled by the heavy dose of foreign direct investment, India has followed a much more organic method and has concentrated more on the development of the institutions that support private enterprise by building a stronger infrastructure to support it. Its corporate and legal systems operate with greater efficiency and transparency than do China's. The Government has encouraged entrepreneurship by providing training and also the facilities to succeed, particularly in the rural areas. One style of innovation that really works in a country as large and diverse as India, is grassroots innovation: this includes inventions for a milieu that is quintessentially Indian.

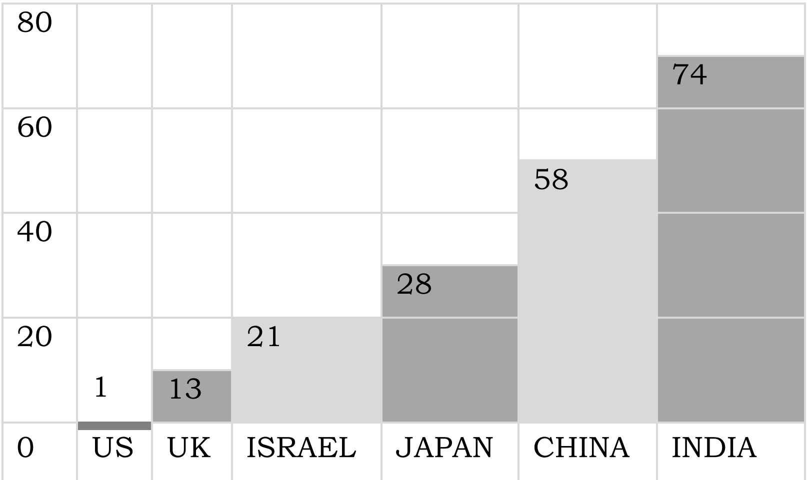
Moreover, in India, the post-liberalization and globalization era has brought with it a growing middle class – roughly estimated to be 250 million – and rising disposable incomes. This presents a huge potential, which if tapped can be a veritable gold mine. Entrepreneurs can make the best of this by catering to various demands of this segment. India, with its abundant supply of talent in IT, management, and R&D, has become the hot bed of outsourcing of services from all parts of the globe where companies can reduce their costs, but not their quality [If the foreign company chooses the right Indian partner].

In terms of improvement, there needs to be an increase in the quality and quantity of VC / Angel Investors in India. Also, the Governments need to still continue reducing the administrative burden on entrepreneurs, and coordinate among their agencies to ensure that the necessary resources are directed where they are needed.

The physical infrastructure needs to be improved. Socially, the Indian society is adapting to a more risk friendly environment and also looking for jobs in the private sector.

Chart No. 1

Ranking of Entrepreneurship among Countries



*Higher Rank denotes poor on Entrepreneurship

Parameters	**Rank**
Entrepreneurial Attitudes	69
Entrepreneurial activity	77
Entrepreneurial aspiration	68

Source: The global entrepreneurship and development Index (GEDI) 2012 Report. Centre for entrepreneurship and Public Policy, The global Innovation index 2011 Report INSEAD

India is placed very low on entrepreneurship with a rank of 74 among 79 countries. On innovation too, India does only marginally better (ranked 62 out of 125 nations). As a consequence, India has lagged on promoting early stage investments, both in absolute terms as well as a proportion of GDP. Currently, around 500 companies are incubated in India annually as compared to about 8,000 in China. Less than 150 start-ups are promoted by venture capital or angel investors annually in India as against over 60,000 angel investments alone in the US.

C. Angel Investors

Angels are generally high net worth individuals (HNWIs), successful serial entrepreneurs or senior professionals. Such angels operate either individually or through formal or informal networks. They not only provide capital but they also act as great scouts of emerging ideas, helping them scale at a stage where institutional seed and venture funds would typically not invest. They are viewed as a very critical element of the entrepreneurial eco-system and perform a number of different roles:

i. Provide High Risk Capital

Angel investors tend to play an even bigger role than institutional investors in funding new businesses. They typically have a higher risk appetite as they provide smaller ticket investments at earlier stages in the life of a venture well before formal venture capital funds show interest in the venture. It is important to note that angel investors are often among the first "external" capital providers i.e. providers not related to the entrepreneurs and hence their investment provides the business model much needed credibility.

ii. Mentor Entrepreneurs:

Angel investors tend to invest in industries that they are well-versed with. They are also either senior professionals or entrepreneurs themselves and are thus able to guide emerging businesses. As individual investors, they are also able to establish personal rapport with the entrepreneur and become an active friend, philosopher and guide.

Policy and Regulatory Environment

Supportive and proactive policies are needed to encourage entrepreneurial activity. These policies include those that help provide easier finance to entrepreneurial ventures as well as those that improve the overall business climate. At present, we find many gaps in the policy and regulatory framework which inhibits rather than promotes entrepreneurship.

A. Supply of Funds: Early-stage investing as a distinct class of investments is not formally recognized in India. Multiple regulations hinder establishment of domestic venture funds that can access domestic capital for venture investments. Angel investors are hampered by issues such as inefficient financial structures for investments and exits. Debt providers too do not feel encouraged to specifically allocate funds to emerging businesses (part of a larger priority sector definition). VC funds are also severely restricted from providing debt. Extensive procedures and compliance requirements for M&A and restrictions on IPOs, along with regulations on liquidation are key deterrents to exits for venture capital investors. The government also acts as a provider of funds, especially through grants and seed funding programs such as Technopreneur Promotion Programme (TePP), proof of concept funds and Technology Development Board (TDB). However, these are often available after extensive paperwork, slow processing and inconsistent procedures followed by different departments.

B. For Businesses

According to the World Bank "Doing Business 2012" Report, India ranks 132 out of 183 countries in ease of doing business. Starting a business and securing construction permits are especially difficult. India is placed at almost the last position in enforcement of contracts. First-generation entrepreneurs are significantly affected by such an environment where the cost and time involved in establishing business can be significant and can become deterrents especially to business ideas that need a first-mover advantage. Exiting a business takes even longer. Many processes especially at the State Government level still remain extremely complex and resource consuming. Governments and regulatory bodies facilitate and promote Entrepreneurship in multiple ways such as;

Facilitate Collaboration with over all Ecosystems

- Participation in dialogue with all stakeholders to ensure consultative policy formation
- Facilitate effective provision of services by incubators
- Creation of accreditation frameworks for certifying quality of start_ups

Procedural and Regulatory Reform for all Stages of Business

- Entry: single window clearance, information availability, industrial clusters etc.
- Operations: labour laws, IP laws etc.
- Exit mechanisms and modalities including paperwork and restrictions

Enabling Venture Capital Funds, Angel Investors and Businesses to Provide Equity

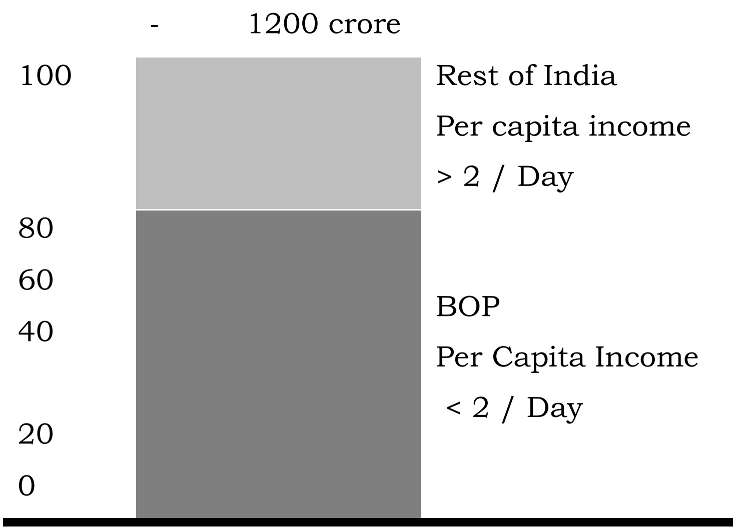
- Fiscal policy initiatives
- Regulatory reform affecting fund raising, operations & exit, especially domestic capital raising
- Creation of innovative products for providing non_collateralized debt

End Consumers

India's large and diverse population offers a unique customer base for businesses. It is critical for nascent businesses to design business models aligned to the idiosyncrasies of this market. "Me-too" ideas that are copied from international successes often fail. Online retailing businesses in India, for example, have used cash-on delivery innovation to successfully target an Indian population that has low possession and usage of credit-cards. This approach, however, is not used by many upcoming entrepreneurs leading to early failures in business models.

Majority of India's population lies at base of the pyramid (BoP)

Indian start – ups must keep in mind the local market conditions



Source: census of India 2011, the fortune at the bottom of the pyramid by CK Prahalad and Stuart L Hart; http: // www.selco-india .com/.

Supply of Risk Capital:

The flow of capital to entrepreneurial businesses is restricted due to various reasons.

A. Angel Investors

Despite a growing population of high net-worth individuals (HNWIs)50, angel investments are at a nascent stage in India with less than 500 angel investors and investments of around Rs 100 crore (about $22 million) annually. Most investments are accomplished through angel groups such as Indian Angel Network and Mumbai Angels51. This is around 7 to 8% of the total annual early stage investing – negligible in contrast to over Rs 1 lakh crore (approximately $27B) of venture capital and angel investing in the US annually, of which around 75% comes from angels. It is noteworthy to mention that angel investing is already beginning to show some success in India.

B. Venture Capital Funds:

i. At around Rs 5000 crore over the last five years, early-stage venture capital investment in India is very small compared to global peers. For example, during the same time frame, US invested nearly twenty six times as much at around Rs 1.5 lakh crore54, **almost three times as a percentage of cumulative GDP in that period**.

ii. India also has a significantly large share of offshore funds55 - these funds arguably have a limited understanding of the local environment, both in terms of markets and working with local regulations and are thus tend to focus more on growth stage capital. Fund raising is much lower than global benchmarks. Over the last five years, domestic funds that focus on early, growth and late stage venture capital investing raised around Rs 27,000 crore in India whereas funds in China raised around Rs 2 lakh crore, **or more than two times as a percentage of cumulative GDP in that period.**

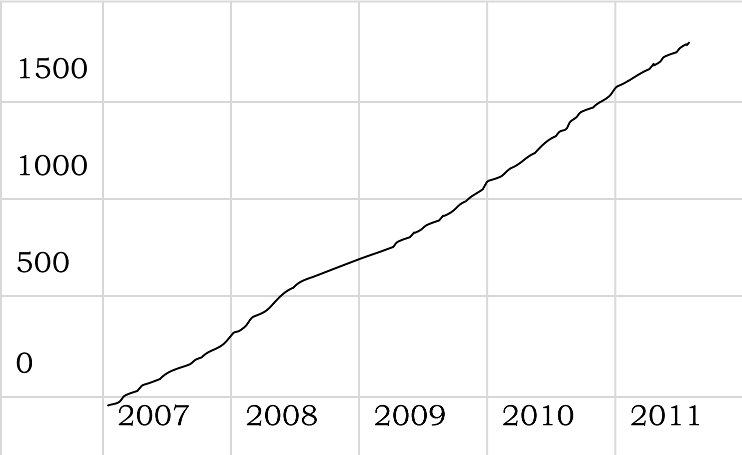
iii. Investments in India seem significantly biased towards services, especially technology and e-commerce56. These investments have however already started showing success.

C. Impact investors

Impact investing that focuses on social as well as financial outcomes, is still at a nascent stage in India. While many global and local funds have presence here, we have only seen investments to the tune of around Rs 1,200 crore (or around $260 million) in the last 5 years by such funds. This area of investing does see a substantial in-flow of new ideas but quality and scalable models that capital providers find attractive are limited.

Impact investing is growing in India but still nascent

Cumulative value of impact investment deals in India Rs in crores



Source: VCCEdge Dataqbase; Bain india PE / VC database

D. Debt

Access to debt is constrained for small and early-stage firms in India, banks and FIs are wary to lend due to the lack of robust credit ratings and collateral. Such institutions rarely use innovative solutions like venture debt, hybrid instruments and factoring. The skills and culture required to lend without collateral (which is the case with most emerging businesses) are found lacking in the banking system. While schemes such as the credit guarantee scheme by SIDBI have been very useful, they are unable to address this gap completely.

E. Demand for Funds

While India has seen a growing class of entrepreneurs in last five years, the quality and number of such entrepreneurs is still behind most global benchmarks. This is reflected in the low ratio of applicants to funded ventures at angel groups (1-2% invested in India versus 15-20% in the US)66. India thus sees around 150 investments by angels and VCs annually versus over 60,000 angel investments alone in the US in 2010. The quality of entrepreneurs is affected by the lack of business training even in case of viable ideas.

F. Hard Infrastructure

While this is a broader issue that affects not just entrepreneurial ventures, and is not the focus for this report, the absence of quality hard infrastructure– roads, utilities, real estate, logistics–increases the transaction costs disproportionately for new businesses. Lack of this supporting infrastructure causes greater cash burn and distraction of management from core business operations. This is even more acute for businesses operating in semi-urban areas and in rural areas.

G. Culture Supporting Entrepreneurship

Despite changes in the last 5-10 years, entrepreneurship and working in start-ups is considered very risky in India. Stigma attached to failure is a deterrent both for starting businesses and for recruiting talent for new ventures. The Committee believes that while culture is a critical enabler, it would change as more success stories become visible and funding becomes more accessible.

H. Collaboration and Mentor Networks

Collaboration and mentor networks are beginning to establish presence in India. These are critical to ensure cohesive functioning of the ecosystem and enable access of resources (material and non-material) to entrepreneurs. Information availability through comprehensive portals is particularly lacking.

Conclusion

In this paper attempted has been made to set out the key issues related to entrepreneurship gaps in India. This study further has expressed that, while the economic and social benefits of thriving entrepreneurship and innovation are evident, it is critical to recognize that these benefits will only accrue if the key gaps in the ecosystem are addressed. The researcher has identified five key areas that an entrepreneur would need addressed on a priority basis to be able to grow unfettered. Catalytic government policy and regulatory framework: Easy access to equity capital and debt, Businesses as entrepreneurial hubs, fostering a culture that encourages entrepreneurship over careerism, Adequate and effective collaboration forums. In this paper it is concluded that Government policies have an impact on the entire lifecycle of the entrepreneur as well as on all the other elements of the entrepreneurial ecosystem. In order to create a supportive policy and regulatory environment, it is important that

Governments—central, state and local —and regulators recognize the distinct nature of first generation entrepreneurs and early-stage investors. Considering the Capital, both equity and debt, is the life-line of new ventures. Finally, Entrepreneurs need support from other stakeholders to be successful. The current ecosystem in India suffers from issues of lack of co-ordination and coherence between different stakeholders. There is an urgent need to bring stakeholders together through both virtual (portals) and physical (innovation labs) networks to provide better mentoring and networking for entrepreneurs across the country.

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