Start-up Perspectives

India start-up deals tracker Q3 CY22

pwc

01 Executive summary

Dear readers,

Funding winter continues in India's start-up ecosystem as well as globally, and it's uncertain until when this will last. Start-up funding in India during Q3 CY22 hit a two-year low at USD 2.7 billion across 205 deals. Although it has been argued that there is substantial committed capital waiting to be deployed (dry powder) in the Indian start-up ecosystem, it is becoming clearer that selectivity in dealmaking will increase, with a focus on path-to-profitability, especially in growth- to late-stage companies. This edition of the newsletter summarises our discussions with several leading investors in the Indian start-up ecosystem on the current funding environment and outlook.

While decline in funding is noted across all stages of investment – early, growth and late – we note that the decline has been the least in early-stage deals, where the average ticket size is between USD 4–5 million. This indicates that venture capital (VC) firms continue to back the Indian start-up ecosystem. Funding in growth- and late-stage deals continued to decline, with an average ticket size of USD 13 million in Q3 CY22. The FinTech and SaaS sectors continued to attract the most capital in Q3 CY22, in line with previous quarter trends.

In this edition, we have included an analysis of global dry powder in the venture capital ecosystem – a metric often discussed in start-up investing circles these days. We find that a significant accumulation of this dry powder has happened from capital committed in 2021 and 2022. The Government of India has also launched various seed fund schemes, credit guarantee schemes and mentorship programmes to support the Indian start-up ecosystem. Further, we have provided our views on how start-ups can integrate environmental, social and governance (ESG) into their business early and create value in the short and long term. ESG is gaining prominence with around 4,500 institutional funds committing to the UN Principles for Responsible Investment (PRI).

I hope you find this edition to be a good and insightful read.

Regards,
Amit Nawka
Start-ups Leader and Partner, Deals
PwC India

~USD 2.7 billion raised by Indian start-ups in Q3 CY22

Average ticket size per deal in Q3 CY22 was USD 13 million

FinTech, SaaS and EdTech are the top invested sectors in Q3 CY22

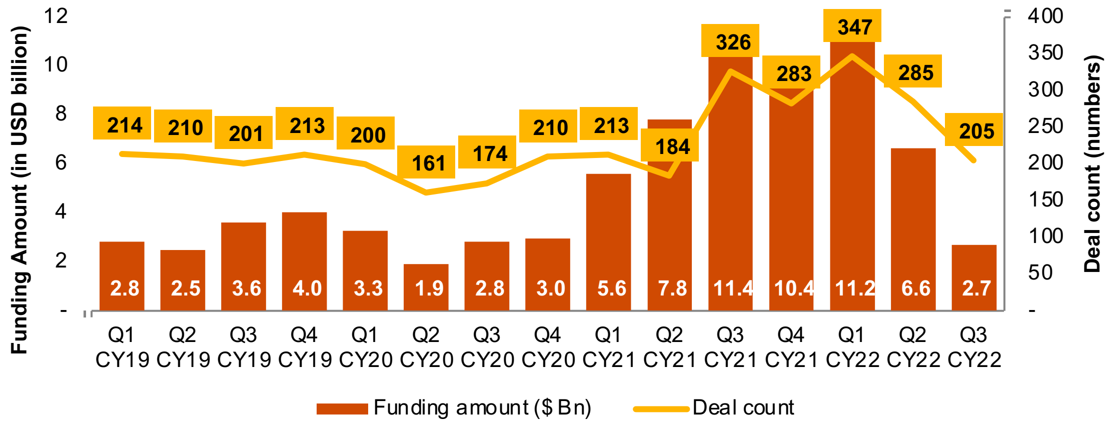
205 successful VC/private equity (PE) deals closed in Q3 CY22

Growth- and late-stage deals comprise around 79% of the total funding

Two start-ups attained unicorn status in Q3 CY22 and the total count of active unicorns is 84

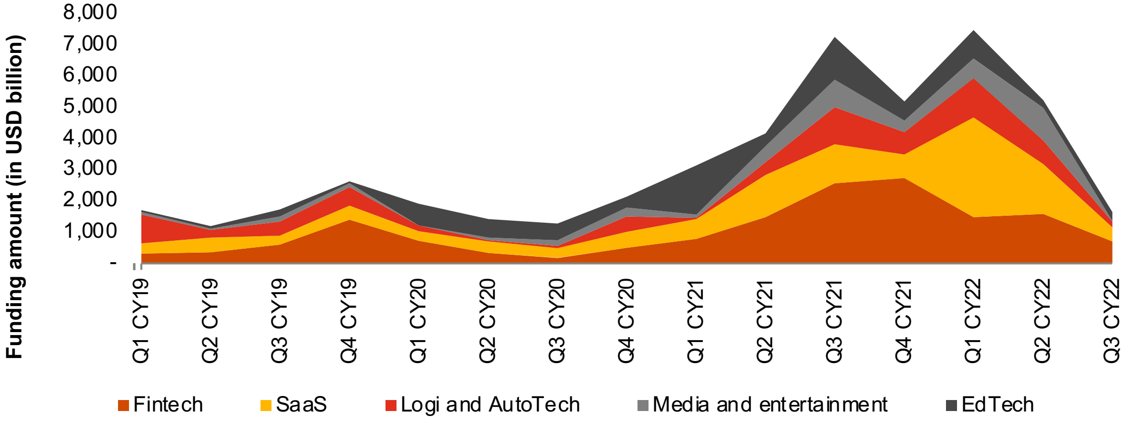
02 Significant decline in value of funding activity during Q3 CY22 (USD 2.7 billion) compared to Q2 CY22 (USD 6.6 billion) and Q3 CY21 (11.4 billion)

Funding and deal count



Source: Venture Intelligence

Top five* sectors (funding trends)



Source: Venture Intelligence

*Based on funding in all three quarters of CY22

- Decline in funding activity noted in Q3 CY22 (USD 2.7 billion) compared to Q2 CY22 (USD 6.6 billion). The decline was both in terms of value (59%) as well as volume (28%).
- Barring EdTech and e-commerce B2B, funding activity declined across all sectors during Q3 CY22.
- The average deal ticket size declined from USD 23 million in Q2 CY22 to USD 13 million in Q3 CY22.

- The top five* sectors contributed approximately 67% of funding activity – FinTech, Logi and AutoTech, SaaS, Media and entertainment, and EdTech.
- The key deals across these were sectors during Q3 CY22 were (a) FinTech – OneCard, EarlySalary, Fi.Money and Jai Kisan; (b) Logi and AutoTech – Yulu Bikes, Shiprocket and XpressBees (c) SaaS – CleverTap, Skyroot, PriceLabs; (d) Media and entertainment – KuKuFM and (e) EdTech – UpGrad, Sunstone.

India remains a top start-up hub which offers top tech talent, a huge consumer base, an economy with strong fundamentals and stable geopolitics. Thus, new funds and capital will keep flowing into India and that's only bound to increase. Will it be democratically distributed? Unfortunately, not. We will see an era of 'consolidation' that follows. The companies that execute their vision efficiently will garner market share, revenue, profits and cash flows. When consolidation plays out, such companies will attract more investments and become more valuable.

While it is great to see such capital flowing into India, founders must remember that fundraising is just a milestone, and not an accomplishment. It is not a moat, but a means to buy resources such as skilled manpower, technology and time. It does not guarantee great execution, which is the secret sauce for the success of start-ups.

Based on their execution, companies that create strategic moats by learning fast, pivoting if necessary, and creating multiple revenue streams will ace the 3C framework with a distinctive check on Cash flow, Communication and Culture. Prudent investors will keep an eye on such companies and will invest and flourish along with them.

Since start of 2022, we have seen that the market has already started distinguishing companies that have toiled from the ones that got lucky. Markets have separated the process-driven unicorns from the rest. It is all about the balance you need while walking the tight rope of entrepreneurship, and this is exactly where investors are distinguishing the best funambulists from the ones that may fall off. Founders who are focused on creating robust processes and a culture of growth and development, will ensure that the learning curve across their organisation is better. They will manage upturns and downcycles efficiently.

Ashish Dave, CEO of Mirae Asset Venture Investments (India)

03 Decline in funding activity, both in terms of deal value and deal count, across all sectors barring EdTech and E-commerce B2B

	Funding value (in USD million)			Deal count (numbers)	
	Q2 CY22	Q3 CY22		Q2 CY22	Q3 CY22
FinTech	1,585	797	↓	57	36
SaaS	1,600	469	↓	85	55
EdTech	235	305	↑	13	10
D2C	352	259	↓	36	23
Logi and AutoTech	759	208	↓	15	14
HealthTech	150	270	↓	10	17
E-commerce B2B	64	70	↑	7	9
E-commerce B2C	425	26	↓	12	7
Media and entertainment	1,046	21	↓	14	2
Real estate Tech	33	18	↓	6	5
FoodTech	115	7	↓	3	3
Online gaming	170		↓	4	
Others	102	250	↓	23	24

Source: Venture Intelligence

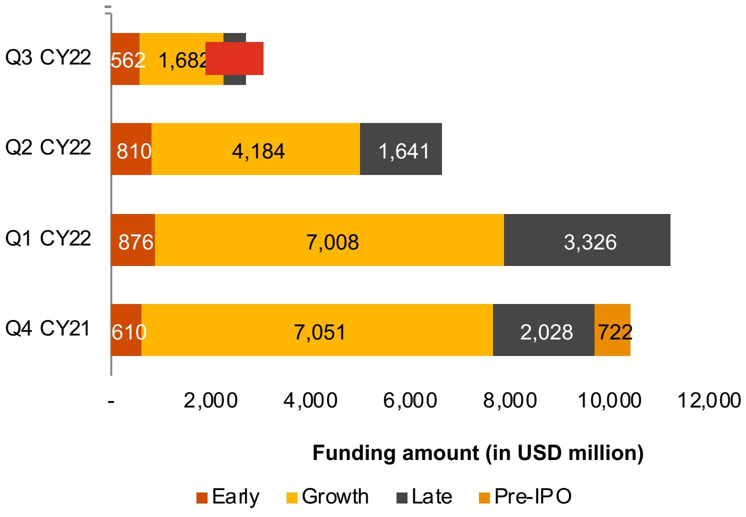
Funding insights into key sectors

- The FinTech sector contributed to 30% of the total funding during Q3 CY22. There has been a decline by 60% in the funds raised for FinTech start-ups in Q3 CY22 compared to the previous quarter. Five companies raised over USD 50 million in Q3 CY22 – OneCard, EarlySalary, Servify, Fi.money and Jaikisan. OneCard attained unicorn status in Q3 CY22. We note that in terms of deal count, around 50% of the total deals in this segment are growth-/late-stage companies, indicating increasing maturity in this segment. Further, we also note that the average ticket size of investments in early-stage companies was USD 5.6 million (based on the last seven quarters), which is among the highest across all segments.
- SaaS: Decline noted both in value as well as volume terms in Q3 CY22 compared to Q2 CY22. While six companies raised more than USD 100 million each in Q2 CY22, only CleverTap raised USD 100 million+ in Q3 CY22. More than 75% of the deals (in terms of deal count) in this space were driven by early-stage funding rounds, with a low ticket size of USD 4 million each in Q3 CY22.
- EdTech: Funding in this segment has shown a positive trend in Q3 CY22 compared to the previous quarter (in value terms). In Q3 CY22, 81% of funding activity was contributed by UpGrad, which raised USD 225 million, followed by Sunstone, which raised USD 35 million.
- D2C: Decline noted in funding activity both in value (~36% decline) as well as volume terms (~50% decline). Out of the total funding worth USD 226 million raised, approximately 73% was driven by Lenskart, which raised USD 166 million. In terms of deal count, 16 out of 19 deals in Q3 CY22 were driven by early-stage companies. The average ticket size of investments in early-stage companies was USD 3.3 million (based on the last seven quarters).
- Logi and AutoTech: Yulu Bikes and Shiprocket were the only two companies that raised more than USD 30 million each in Q3 CY22. Shiprocket attained unicorn status in Q3 CY22.
- HealthTech: While deal count increased in the HealthTech space, total funds raised showed a declining trend. Small-ticket deals took place in Q3 CY22, though MedGenome raised USD 50 million.
- E-commerce B2B: Minor increase in funding activity noted in this sector. VeGrow and Bizongo raised more than USD 20 million each in Q3 CY22.
- Media and entertainment: Dailyhunt raised over USD 800 million in Q2 CY22 and hence the funding value was significantly high. Only one deal took place in Q3 CY22 in this sector (KuKu FM).

04 Growth-stage deals represented 62% of the total funding value in Q3 CY22 (USD 1.7 billion) – average ticket size per deal has declined in the last four quarters

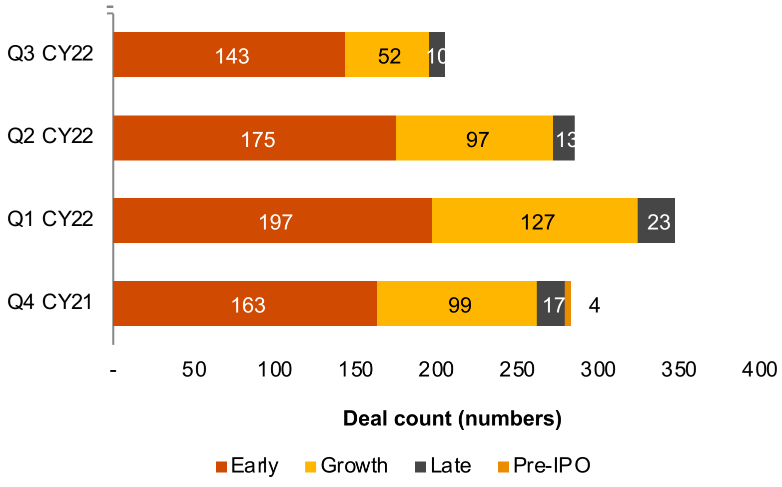
- Growth- and late-stage funding deals accounted for 79% of the funding activity in Q3 CY22 (value terms). These represented 30% of the total deal activity (count terms). Average ticket size in growth-stage deals continued to decline and was USD 32 million during Q3 CY22. The average ticket size of late-stage deals declined significantly in Q3 CY22 – this was on account of minimal funds/low-ticket size raisec by established start-ups such as Innoviti, XpressBees and PriceLabs.
- Early-stage deals accounted for 70% of total funding in Q3 CY22 compared to their 60% share in Q2 CY22 (in volume terms). Average ticket size per deal ranged from USD 4–5 million per deal. In value terms, early stage deals contributed around 21% of the total funding in Q3 CY22 compared to around 12% in Q2 CY22.

Funding trends (USD million)



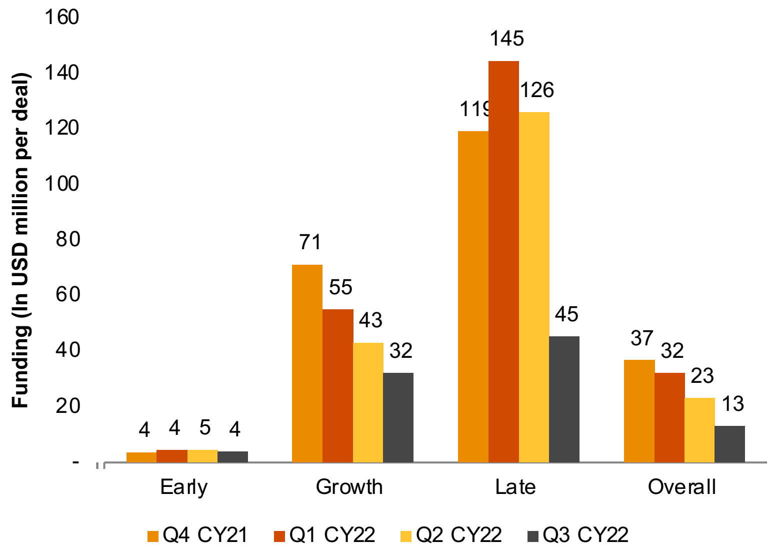
Source: Venture Intelligence

Number of deals (count)



Source: Venture Intelligence

Average ticket size per deal



Source: Venture Intelligence

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After a year of step-function growth, India is now the third-largest start-up ecosystem globally. The post-COVID emergence of India’s start-up economy catalysed a series of inflection moments across sectors, leading to 40+ unicorns being added just in 2021. It was, of course, a year that saw record allocations to tech and PE globally, which meant that privately held tech start-ups enjoyed an extraordinary year of available capital chasing the best growth stories. However, industry observers will also agree that India’s internet total addressable market (TAM) correspondingly saw rapid and welcome expansion.

As a result of the pie growing demonstrably, the market leaders in every segment were also valued more appropriately at unicorn levels. A hyperactive year of exits, M&A, and IPOs further sustained the thesis that India can now support large-scale returns as private companies reach mainstream size. With over USD 17.4 billion returned by tech exits and USD 7.3 billion raised by tech IPOs this year, global allocators are now encouraged to assign more capital to be reinvested in the next cycle of tech being built out from India.

Of course, as global markets correct after a series of macro and geopolitical events over H1 2022, Indian start-ups have needed to prepare for a new season of selectivity from investors. Now is the time to introspect, build the connective tissue to align their leadership and organisations, and focus their aggression on becoming not just the most valuable but also the best-run companies in their sectors. The combination of high governance and a focused path towards sustainability must serve as the fundamental substrate for the ecosystem this decade. Additionally, if the early signals of recession in developed markets do strengthen, this preparation will serve the ecosystem well as a response.

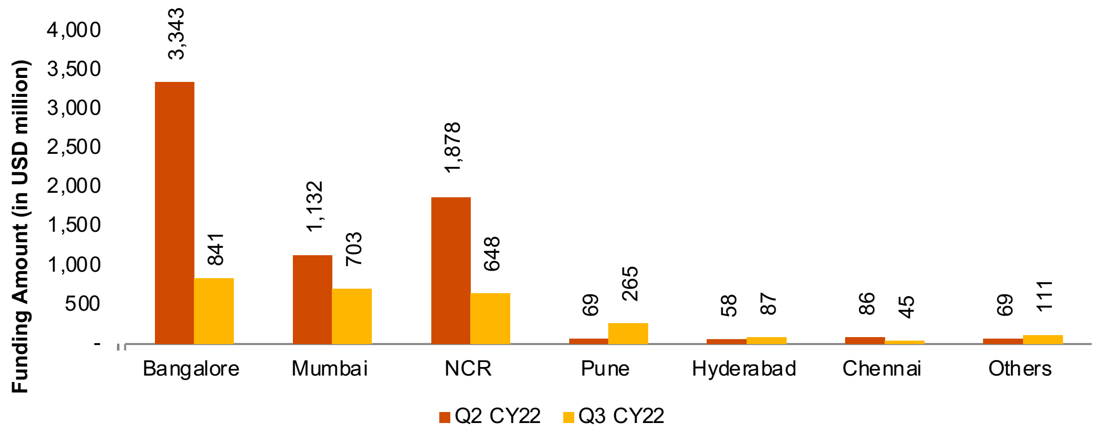
We expect more capital to be available from January 2023. However, it is almost certain that selectivity in dealmaking will increase, and start-ups will have to prove a path to sustainable growth. IPOs will also resume from 2023, and pricing is expected to be far more moderate as well. The demand for Indian market leaders and category creators will continue over the medium and long term as markets recover from these corrections next year.

Pranav Pai, Founding Partner and CIO at 3one4 Capital

05

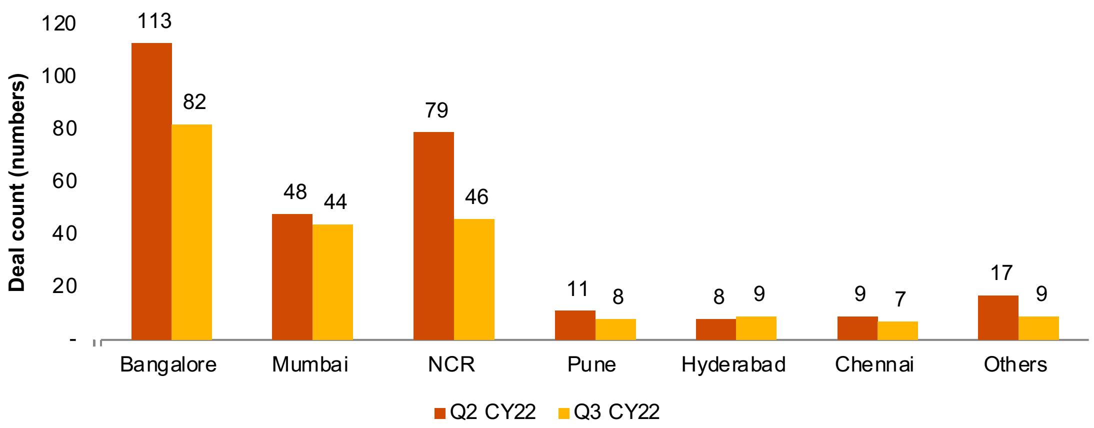
City-wise trends – Bengaluru, Mumbai and NCR continue to be the key start-up cities in India, representing around 81% of the total venture capital (VC)/private equity (PE) funding activity in Q3 CY22

City wise trends – funding



Source: Venture Intelligence

City wise trends – deal count



Source: Venture Intelligence

Bengaluru, Mumbai and NCR continue to be the key start-up cities in India, together contributing around 81% of the total funding activity in Q3 CY22, followed by Pune and Hyderabad.

Bengaluru:
More than USD 30 million was raised by six companies each in Q3 CY22 – Accion Labs, Yulu Bikes, Fi.Money, MedGenome, Innoviti and NiYo.

NCR:
Six companies – Lenskart, Zopper, DotPE, Tata 1mg, Sunstone and Shiprocket – raised more than USD 30 million each in Q3 CY22.

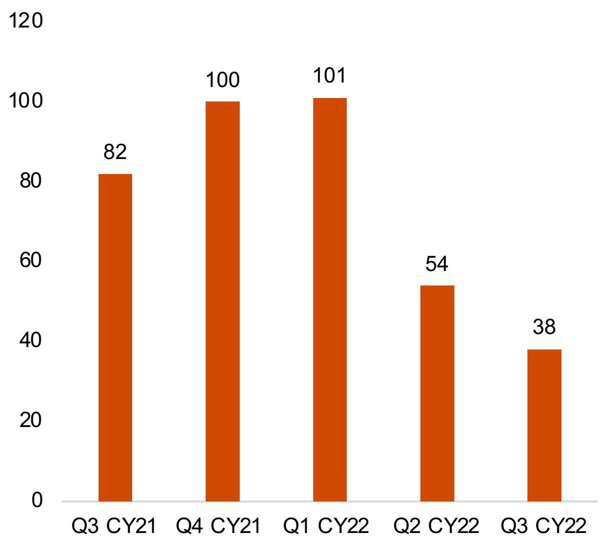
Mumbai:
More than USD 30 million was raised by four companies each in Q3 CY22. These include upGrad, CleverTap, Servify and Jai Kisan.

06

38 M&A deals involving start-ups were executed in Q3 CY22

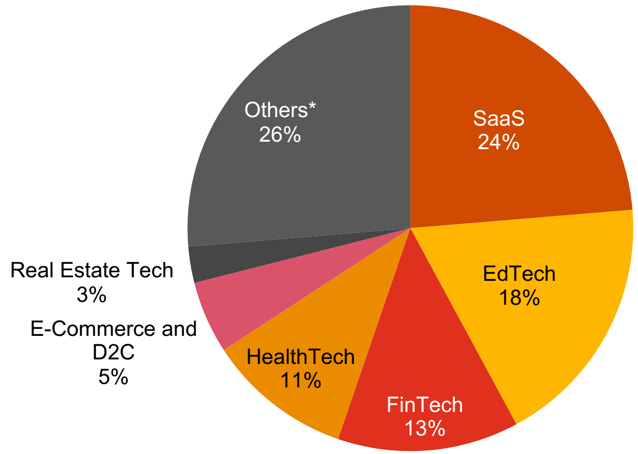
- This quarter saw 30 domestic, five inbound and three outbound deals. SaaS and EdTech witnessed the highest number of M&A transactions during Q3 CY22 – nine in SaaS and seven in EdTech.
- Edtech company upGrad has been the top acquirer this quarter with four acquisitions – Wolves India, Harappa Education, Exampur and Centum Learning.
- The largest deals was executed in the HealthTech space –Torrent Pharmaceutical's acquisition of Curatio Health for USD 263 million.

M&A deal count



Source: Venture Intelligence

Sector split of deal count in Q3 CY22



*Including Logi and AutoTech, FoodTech, media and entertainment and online gaming

Source: Venture Intelligence

Few notable acquisitions in Q3 CY22 by deal value

Target	Acquirer	Sector
Centum Learning	upGrad	EdTech
Curatio Healthcare	Torrent Pharmaceutical	HealthTech
Digi2L	Onsitego	E-commerce B2C
Gate Academy	Unacademy	EdTech
Little Black Box	Nykaa	Media and entertainment
SenseHawk	Reliance Industries	SaaS

Source: Venture Intelligence

07 Two start-ups attained unicorn status in Q3 CY22 – Shiprocket and OneCard

Unicorn count	Before CY18	CY18	CY19	CY20	CY21	Q1 CY22	Q2 CY22	Q3 CY22	As of Sep 2022
FinTech	-	-	-	3	9	2	1	1	16
SaaS	2	-	2	2	8	5	1	-	20
E-commerce B2C	-	-	-	1	4	1	-	-	6
LogiTech and AutoTech	1	-	2	-	1	2	-	1	7
EdTech	-	1	-	1	3	1	1	-	7
D2C	-	-	1	-	6	-	1	-	7
E-commerce B2B	-	1	-	-	4	-	-	-	5
Media and entertainment	1	-	-	2	1	1	-	-	5
HealthTech	-	-	-	-	3	-	-	-	3
Real estate Tech	-	1	-	-	1	1	-	-	3
Online gaming	-	-	1	-	1	1	-	-	3
FoodTech	-	1	-	-	1	-	-	-	2
Total	**3**	**4**	**6**	**9**	**42**	**14**	**4**	**2**	**84**

Source: Venture Intelligence

Note:

Several reports peg the total count of unicorns at 105 as of 30 September 2022. In the table alongside, we reconcile this number with the count of 84 considered in the table above.

Total number of unicorns as of 30 September 2022	105
Acquired	(4)
Listed	(10)
Fall in valuation	(5)
Start-ups not reported to have raised external institutional funding before reaching unicorn status	(2)
Active unicorns as of 30 September 2022	84

Early-stage winter is over – unofficially, anecdotally but globally! Let the games begin – hopefully saner this cycle but not holding my breath given all the VC dry powder!

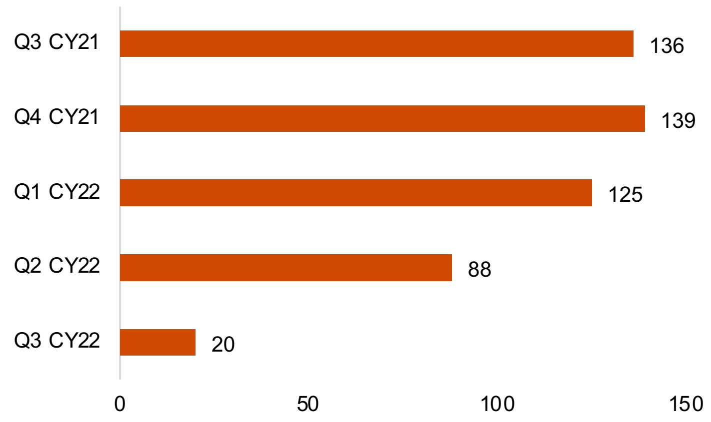
Potential founders watching from the sidelines – time to get on the field and play!

Late-stage might take more time – bid ask spread still too wide, companies are well capitalised and executing to likely convergence at some point in 2023!

Avnish Bajaj, Founder and Managing Partner at Matrix Partners

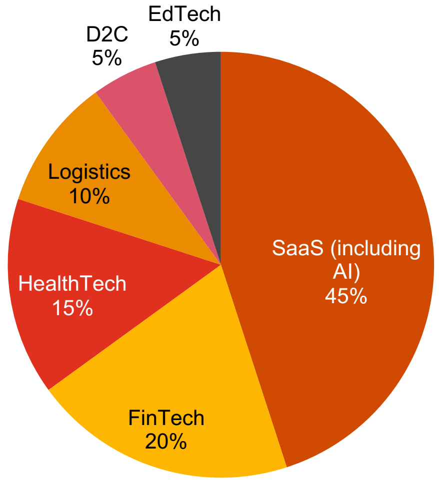
08 Globally, Q3 CY22 produced only 20 new unicorns, mirroring a global slowdown in venture funding – 45% of these are from the SaaS space

Number of unicorns added during the last five quarters



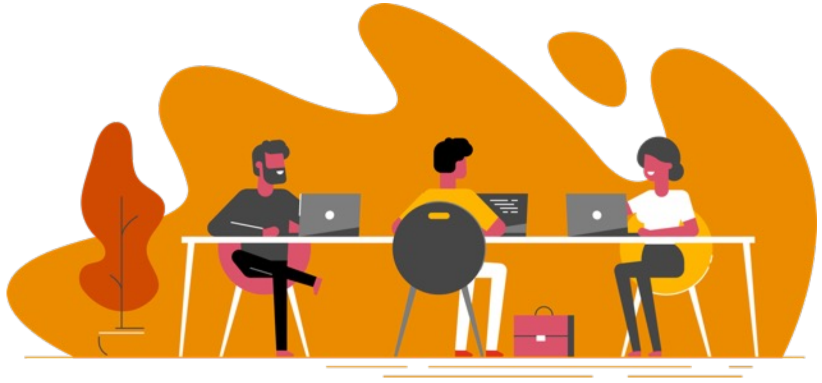
Source: CB Insights (13 Sep 2022)

Sectoral distribution of unicorns in Q3 CY22



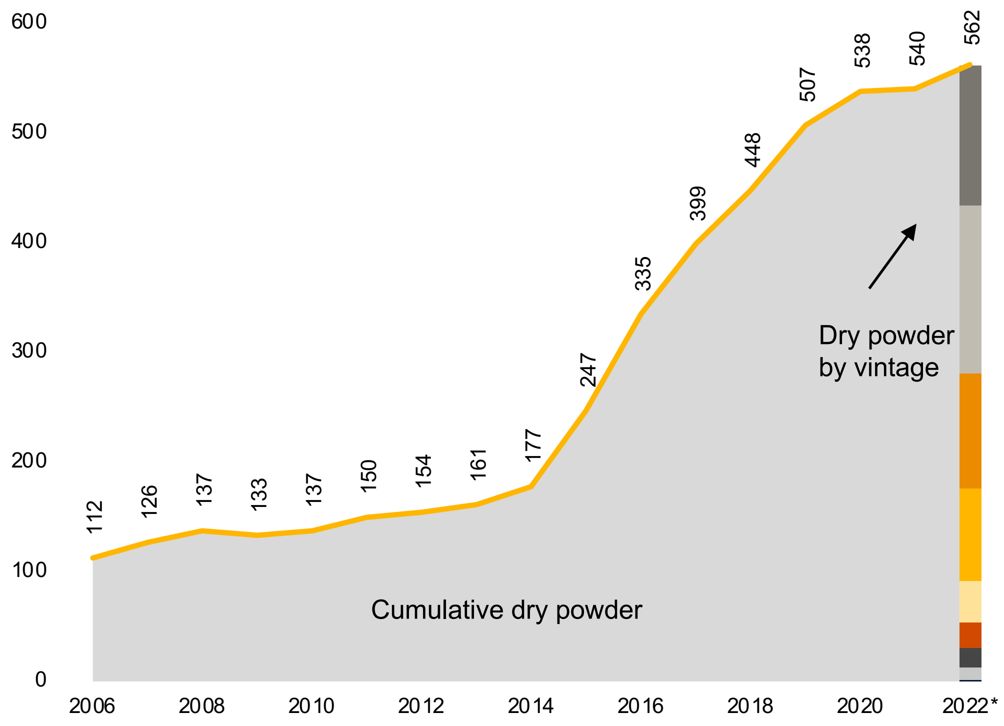
Source: CB Insights (13 Sep 2022)

- Unstable macro conditions and tightening of venture funding resulted in the emergence of only 20 unicorns globally in Q3 CY22, a significant decline as compared to previous quarters.
- 55% of the new unicorns this quarter are from the US (11). India, South Korea and the UK each added two.
- SaaS has dominated this quarter, with around 45% of the new unicorns emerging from the sector.
- No new decacorns were added this quarter. There was a significant drop in the valuation of some decacorns, with companies not having enough cash being forced to raise funds at a significant discount.



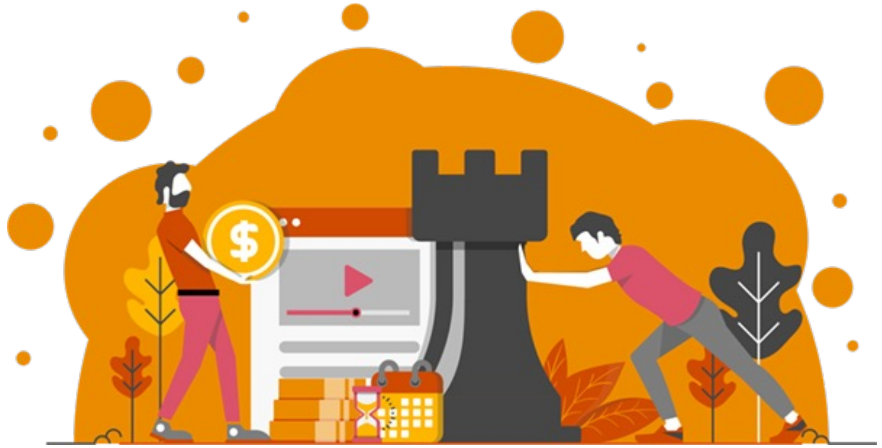
09 Globally, USD 562 billion of dry powder is available with venture capital firms. When will the floodgates open?

Cumulative dry powder by year (in USD billion)



Source: Pitchbook Data, Inc. (as at 30 Jun 2022)

- For VC and PE firms, dry powder refers to the amount of committed but unallocated capital a firm has on hand. It is an unspent cash reserve that is waiting to be invested.
- The buildup of dry powder is due to a market pullback by VC funds that are being picky about their investments. The focus is on companies that have strong unit economics and a path to profitability.
- There is around USD 562 billion in dry powder available for start-ups in VC funds, an indicator that we could see strong investment cycles ahead.
- Globally, the total assets under management as at 30 June 2022 is USD 2,700 billion.



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The VC industry has a distinct advantage in receiving high credit for its linkage to technological disruption. The promise of a new, fundamentally more digital world and a desire to participate in the value creation has led to higher capital allocation to VC. This expectation was fuelled by the 12-year bull market cycle and the massive digital adoption that occurred during COVID. After many warning shots, by the second quarter of 2022, the party seems to be finally over.

Start-ups with business models requiring high burn and delayed monetisation, such as those in B2C markets, have the greatest exposure to funding risk. Firms with low burn, such as SaaS start-ups, have seen less impact. Rationalisation exercises towards cash conservation undertaken by cash-rich companies have soured many acquisition transactions. Lack of acquisition activity due to valuation mismatch is expected to add to mortality of cash-starved start-ups.

There is however a silver lining. India is rich with high-potential sectors that can be disrupted, such as FinTech, agri, HealthTech, consumer internet and SaaS. Global capital allocators must choose markets to deploy, and India has emerged as a top choice given its sheer size, quality of entrepreneurship and more recent signs of a public market that allows for foreign capital to be returned to origin. Thirdly, cap-tables are in good shape simply because the last few rounds were done at high valuations. So, there is plenty of room to dilute while managing founder ownership. And lastly, there is plenty of dry powder. India VC can be at a thriving level even at USD 10 billion of capital invested per year. 2021 was USD 38 billion, and there is plenty of froth there that won’t be missed.

We estimate global committed capital of more than USD 20 billion raised for India not yet deployed. We expect this capital to trickle back to Indian start-ups by the second half of 2023.

Rahul Chandra, Co-Founder and Managing Director at Arkam Ventures

10 Initiatives by the Government of India for start-ups

Start-up recognition

Under the Startup India initiative, eligible companies can get recognised as start ups by the Department for Promotion of Industry and Internal Trade (DPIIT) in order to access a host of tax benefits, easier compliance, intellectual property rights (IPR) fast tracking and more. There are currently 78,000+ recognised start ups spread across 656 districts and at least one recognised start up in each of the 36 states and union territories.

Supporting start-ups through a fund of funds

In 2016, the Fund of Funds for Startups (FFS) was launched under the Startup India initiative by Prime Minister. As of 24 September 2022, the DPIIT has released INR 32,66 million. The scheme has committed INR 73,850 million to 88 alternative investment funds (AIFs), and INR 30,210 million has been disbursed to 64 AIFs.

Funding start-ups through seed fund scheme

DPIIT has created the Startup India Seed Fund Scheme (SISFS) with an outlay of INR 9,450 million to provide financial assistance to start ups for proof of concept, prototype development, product trials, market entry and commercialisation. This would enable these start ups to graduate to a level where they will be able to raise investments from angel investors or VCs, or seek loans from commercial banks or financial institutions. The scheme will support an estimated 3,600 entrepreneurs through 300 incubators in the period from 2021 to 2025.

Conceptualising the credit guarantee scheme

DPIIT has notified the Credit Guarantee Scheme for Startups (CGSS) with an outlay of INR 10,000 million that provide guarantee of up to Rs. 100 million against credit instruments extended by Member Institutions (MIs) to finance eligible DPII recognised startups".

Mentorship support

The Mentorship, Advisory, Assistance, Resilience, and Growth (MAARG) programme under the Startup India initiative is a digital platform that has been developed to facilitate the delivery of mentorship across India to start ups across different sectors, functions and stages.

State Bank of India start-up branch

Launched in Bengaluru in August 2022, this branch will be dedicated to funding and supporting early stage entrepreneurs in setting up new companies till they are listed on stock exchanges. The exclusive branch for start ups will provide services such as loans, deposits, transaction banking, remittances,, forex, insurance, capital market and legal advisory, structuring etc.

Increasing procurement from start-ups through Government e-market (GeM)

DPIIT recognised start ups can register on GeM to sell their products and services to Government departments. By doing so, start ups can avail exemptions on prior experience, prior turnover and earnest money deposit requirements. As of 31 March 2022, 13,130 startups have registered on GeM, receiving a total of 1,26,006 orders with a total value of INR 6,635+ crore. By 29 September 2022, 15,362 startups had registered on GeM, receiving 1,55,840 orders worth over INR 9,066 crore.

Enabling start-ups through regulatory amendments:

Continuous efforts are being undertaken to increase ease of investment, provide momentum to the start up movement and incentivise start ups and investors in India. Since 2016, 53 regulatory reforms have been initiated to enhance ease of doing business, ease of raising capital, and reduce the compliance burden

Source: Startup India

11 Start-ups can leverage ESG to create value for stakeholders

- As per the United Nations, COVID-19 has set back development by nearly a decade. ‘To change trajectory, we need to change the rules of the game,’ the UN Deputy Secretary-General, Amina Mohammed, said. ‘Relying on the pre-crisis rules will lead to the same pitfalls that have been revealed over the past year.’
- As a fallout – in a positive way – we saw the rise of digital adoption across the globe. For many start-ups, it was an opportune time to ride this digitalisation wave and plug the gaps in access and inefficiencies that existed in the market.
- Interest in ESG also accelerated. Leaders, boards, regulators, investors and customers today are aware of the linkage between E, S and G.
- While 30% of Indian CEO’s have committed to be carbon neutral, 72% of PE firms and VCs screen target companies for ESG risks and opportunities at the pre-acquisiton stage and 90% are concerned about diversity and inclusion in their portfolio companies.
- Globally, around 4,500 institutional funds have committed to the UN Principles for Responsible Investment (PRI); together, these funds hold assets worth USD 121 trillion.
- This presents a real opportunity for start-ups to integrate ESG into their business early and create value in the short and long term.

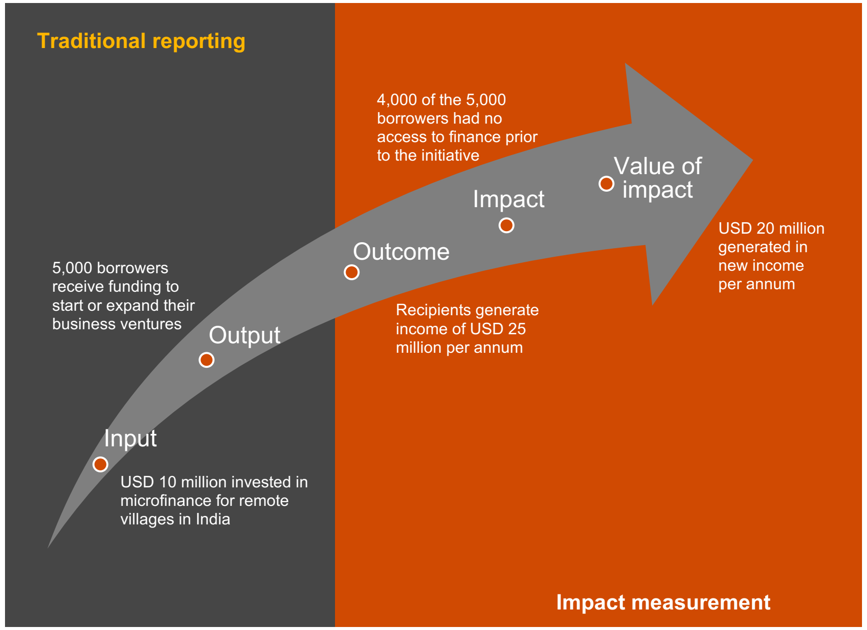
Attract investors	More PEs, VCs and financial institutions are committing to the UNPRI and aim to invest in ESG compliant companies. They are doing this by integrating ESG into their investment process.
Improve value	Increased investor demand and improved ESG ratings can improve valuations by around 400–650 basis points.
Build trust and enhance brand perception	Increased ESG disclosures – accurate information on measures and policies adopted by organisations – can foster greater trust and improve reputation.
Increase sales	Customer preferences have changed in India over the past few years. 76% of consumers surveyed across India, Brazil, US, the UK and Germany said, ‘I will discontinue my relationship with companies that treat the environment, employees, or the community in which they operate poorly.’
Improve profits	Resource optimisation can lead to cost optimisation opportunities. For example, focusing on energy efficiencies supported by energy audits to set a baseline can help companies focus on carbon abatement solutions that bring down energy costs significantly.
Lower cost of funds	Start-ups with strong ESG performance/commitments can now access over USD 1 trillion from the sustainable finance market that offers a pricing advantage of around 10–70 basis points.

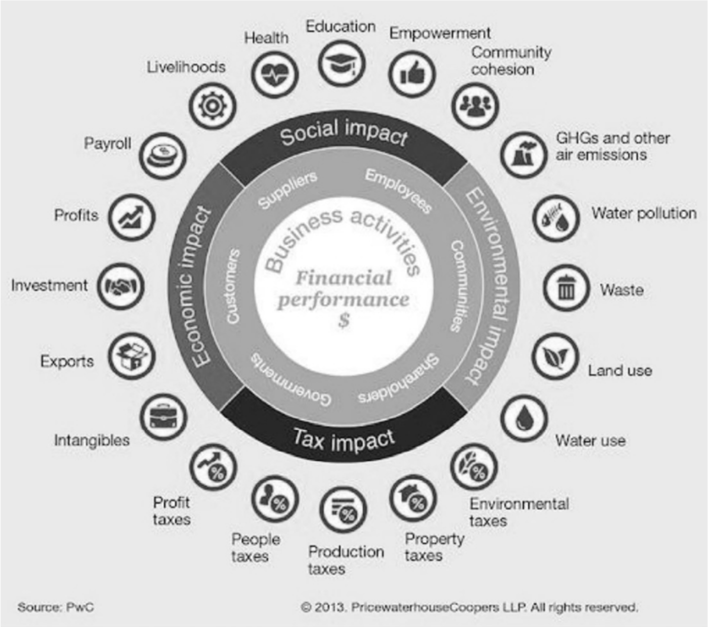
Sources: PwC’s 25th Annual Global CEO Survey
Global Private Equity Responsible Investment Survey 2021 UNPRI.org
PwC’s 2021 Consumer Intelligence Series survey on ESG
OECD

The disruption start-ups create for societal good can become the norm though which they show value to their stakeholders:

- Impact measurement is not a new approach. Companies have been using it for a long time to calculate their social return on investment. However, these can be mapped across the business activities of a start-up to show their societal contribution as a young company and quantify their impact financially.
- FinTechs, for example, can create impact through accessibility by providing affordable credit to the marginalised, focusing on empowering microbusinesses, crowdfunding for societal welfare and designing inclusive financial products for rural India.
- EdTechs, on the other hand, have an important role to play in providing access to quality education by leveraging virtual reality (VR) and augmented reality (AR), cloud technologies for content standardisation, and platforms for skill development of teachers.
- LogiTech has played a key role in keeping many safe during the COVID-19 pandemic and helping us through the waves of lockdowns the country faced. The efficiencies it has brought through automation of on-demand deliveries, optimisation of distribution centres through barcode scanning, and use of blockchain for improved transparency in tracking of orders have made our lives comfortable and easy, while providing livelihood opportunities to thousands.

If the measure of business success goes beyond financials and the value (and cost) of the social, environmental, fiscal and economic activities of a company is calculated, start-ups can see at a glance the impact they're making and the trade-offs between their strategies.





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The early-stage ecosystem continues to be quite resilient.

We had seen a slow-down in deal flow over the last few months but are starting to see early signs of recovery in seed and series A stages.

Historically, we have seen that great founders and companies are created across all types of business cycles. We at Elevation take a long-term view in our early-stage investments and from that perspective the macro tailwinds for India and tech in particular remain very positive.

Mukul Arora, Co-Managing Partner at Elevation Capital

12 Top five tax and regulatory updates impacting the start-up ecosystem

1) The new Overseas Investment Guidelines

The Government of India (GoI), in consultation with the Reserve Bank of India (RBI), notified the Overseas Investment Guidelines on 22 August 2022, which will enable Indian businesses to be carried on globally. Some of the key changes/relaxations are as follows:

- Investment in foreign start-ups: Large start-ups and family businesses in India are keen to invest in global start-ups and funds. Prior to these new guidelines, any such investments required RBI approval for global entities having an Indian subsidiary. The new guidelines clearly permit Indian corporates and **limited liability partnership (LLP) firms** to invest in overseas start-ups with Indian subsidiaries, provided the structure does not create more than two layers of subsidiaries.
- Investment in the foreign financial services (FS) sector: In the past, there were constraints on investment by unregulated Indian entities in overseas entities engaged in the FS sector. These constraints have now been removed. Any Indian entity with a three-year profit track record can invest in an overseas entity engaged in the FS sector (e.g. fund management, brokerage, portfolio management).

While the above are welcome changes, there are some areas where overseas investment rules have become more restrictive:

- Requirement for overseas investment fund to be regulated by an FS regulator of the host country: Globally, FS regulators do no regulate the funds; they regulate fund managers and owing to the new condition, investment in this space has become restricted.
- Requirement that all overseas investment transactions must happen at fair market value (FMV): Commercial pricing is typically different from the FMV and therefore, the RBI may consider this position and allow transactions happening at a value less than FMV.
- Further, restrictions have also been placed on gifts from non-relatives, etc.

2) Corporate law update – recent amendment in light of Press Note 3 (PN3)

To give further effect to the provisions and intent of PN3, which requires prior Government approval for foreign investment from countries sharing a land border with India (‘Neighbouring Countries’), the Ministry of Corporate Affairs (MCA) has imposed the requirement of prior Government approval in certain corporate law procedures:

- offer of securities by an Indian company to a body corporate incorporated in a Neighboring Country
- security clearance for directorship of an Indian company by a national of a Neighboring Country.

The above changes will help GoI closely monitor inflow of funds and control through directorship by a Neighboring Country.

3) Withholding tax on ‘benefit or perquisite’

The Finance Act, 2022, inserted section 194R in the Income-tax Act with effect from 1 July 2022. This provision stipulates an obligation on any person providing any ‘benefit or perquisite’ (of more than INR 20,000) to a resident arising from their business or exercising of profession to ensure that tax is withheld at the rate of 10%.

The authorities have also issued several guidelines to remove difficulties in the implementation of section 194R of the Act including clarifying applicability in case of non-cash benefits, sales discount, cash discount, rebates, free samples, etc. Several aspects such as the definition of benefit or perquisite and withholding tax on loyalty points, wallet money or online credit which expire, etc., remain unaddressed.

The newly introduced provisions will increase the compliance requirements and start-ups having such payouts/ distribution will need to strategise to adhere to these provisions.

4) Change in formula for claiming refund of input tax credit (ITC) under inverted duty structure (IDS)

Currently, start-ups, such as those in the electric vehicles (EV) sector, have a tax rate of 5% on their outward supplies while input, raw material and other overheads are taxed at 18%, which results in significant working capital blockage. In this regard, the current change in the refund formula for IDS takes into account utilisation of ITC on inputs and input services for payment of output tax on inverted rated supplies in the same ratio in which ITC has been availed on inputs and input services during the said tax period.

This is a welcome move as it would help those taxpayers who are availing ITC on input services, unlike the earlier approach where ITC on input services was restricted under IDS.

5) Clarifications on employer–employee issues under GST

It has now been clarified that perquisites provided by the employer to the employee as per the contractual agreement between the two will not be subjected to GST.

This relaxation would help taxpayers (including start-ups) avoid unnecessary litigation around the same.

About PwC

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