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From the beginning of India’s independence, the tradition of carrying a leather bag to the Parliament on Budget Day has been a part of India’s political culture. This tradition dates back to the first Finance Minister, RK Shanmukham Chetty, who presented the first Budget on November 26, 1947. Since then, the tradition of carrying the ‘leather budget bag’ has continued, with variations and shades of this practice being carried forward by subsequent Finance Ministers.

However, in 2019, Finance Minister Nirmala Sitharaman decided to break from tradition by carrying a red cloth with the national emblem instead of a leather bag. This move was part of Sitharaman’s illustrious career, which includes being the first full-time woman Finance Minister in India’s history. Prior to this, she had also been the first full-time woman Defense Minister.

Sitharaman’s Budget speech was the longest in history, lasting two hours and 17 minutes, surpassing the record set by former Finance Minister Jaswant Singh in 2003. Her Budget aimed to turn India into a $3 trillion economy by 2020 and a $5 trillion economy in the years following.

Kalaari, in collaboration with YourStory Media, presents this report to demystify Nirmala Sitharaman’s maiden Budget and discuss its potential impact on the Indian startup ecosystem on both macro and micro levels. We hope this report is insightful for anyone interested in investing in India.
Executive Summary

The Union Budget is one of the most awaited annual economic events for the country and this year’s Budget provided the much-needed booster shot for the Indian startup ecosystem.

With a stable Government that has economic reforms on top of its agenda, hopes have certainly risen. Confidence of different stakeholders in the Indian startup ecosystem are also at an all-time high. During its first five years, the present Government had initiated several economic reforms like the goods and services tax (GST), The Insolvency and Bankruptcy Code, to name a few. At the same time, the Government was looking ahead with the ideas and programmes like Digital India, Startup India or the cleanliness initiative Swachh Bharat Mission. All these actually increased expectations from the cross-section of society - be it ordinary citizens, corporates, investors, and even startups.

The Budget also broke many grounds by laying out a broad roadmap on how the Government plans to steer the economy in the next five years. These were not only matters related to economic issues of the country but also included social and cultural aspects. It gave a powerful indication of what areas the Government would like to emphasise.

- Angel tax and other reforms
- Electric vehicles
- Digital infrastructure
- Digital payments
- Frontier technologies

The Finance Minister drove home the point that India is strongly embedded with the global economy, so foreign capital is a must. The Government has made proposals for FDI in sectors such as aviation, media and insurance sectors to be opened further after a multi-stakeholder examination. Tax on ESOPS, the government’s stance on cryptocurrency are some of the other areas of concern that were either omitted or not adequately addressed.

This year’s Budget signalled that the Government is now welcoming capital into the startup ecosystem with adequate scrutiny - but not intense scrutiny from the tax department anymore. During its first five years, the Modi Government set structures in place. Now, it is time for India to grow using these structures. And the Union Budget of 2019 has just laid out the vision - a $5 trillion economy by 2025.
Impact on the Indian Entrepreneur and VC Community

“Startups in India are taking firm roots and their continued growth needs to be encouraged,” said Finance Minister Nirmala Sitharaman during her Budget speech. The Union Budget of 2019-20 eased regulations around Angel Tax, pushed for further digitising financial transactions, faster adoption of Electric Vehicles and emphasised a focus on upskilling the population in emerging technologies.

Angel Tax and Other Reforms
Angel investors often provide the first cheques that startups need to validate their ideas, before going on to raise larger cheques from institutional investors. In recent times, many founders have received notices from the Income
Tax department to pay up as much as 30 percent of their angel funding as tax. The Budget categorically stated that Indian startups would not come under the purview of Angel Tax.

Further, the new method of e-verification for investors should go a long way in pushing the startup ecosystem forward. Every year, an estimated 300-400 startups raise angel funding and these reforms should encourage more entrepreneurs to startup and also more angel investors to invest in the Indian startup ecosystem.

Besides, the Budget also brought other changes like broadening the scope of the Alternative Investment Fund (AIF), allowing for a carry forward of losses or provision for real estate proceeds to be invested in startups. These measures would not only help spur investment momentum into the country but also facilitate larger investments in startups.

**Electric Vehicle Adoption**

The adoption of Electric Vehicles has time and again met with restrictions due to inadequate infrastructure and high costs. Niti Aayog, the think-tank chaired by Prime Minister Narendra Modi, has been crucial in policymaking for EVs. The Union Budget has provided an overall direction on how the Government plans to steer the economy in the next five years. Indeed, building the EV charging infrastructure is top of the agenda, and startups will be active participants in this endeavour.

The EV segment in the country has the participation of both established automobile companies and startups. The Budget compounded the demand, supply, and enabler environment through a confluence of complementary initiatives between the supply-side and demand-side to push the EV adoption.

To further boost this segment, the Budget proposed incentives on the purchase of these vehicles by reducing the CST on EVs from 12 percent to 5 percent along with a tax exemption of up to Rs 150,000 per year on EV loans. These initiatives have been supportive of demand-side interventions.

Lowering the customs duty on lithium-ion cells would further reduce the cost of batteries and help local battery manufacturers to scale-up the business and also drive the domestic assembling of EVs. Additionally, the Budget’s incentive scheme for solar photovoltaic cells and lithium storage batteries manufacturing plants and solar electric charging infrastructure would enable the supply-side interventions.

The proposals include converting taxi operators to electric vehicles along with scrapping all fossil fuel-based vehicles by 2030. We believe these are incentives for investments from the OEMs in this sector and can see a considerable increase in the funding volume. These initiatives have provided the impetus needed for India to emerge as a global manufacturing hub for EVs.

Bhavish Aggarwal, Co-founder and CEO of Ola, says, “The Government’s focus on electric mobility and EVs in Budget 2019 is inspiring. Lower GST rates, interest subvention for EV loans and the commitment of Rs 10,000 crore towards FAME II are encouraging. This further reinforces Ola’s mission to build electric mobility for India and the world, and contribute toward making our nation the global hub for innovation in this space.”
Transforming Digital Infrastructure

Numerous proposals and funds allocated, along with a focus on making India a digital economy, clearly illustrate the Government’s dedication and push towards making India a digital superpower.

The internet user base in India has exceeded the 500 million mark and is likely to reach 627 million by the end of 2019. The growth was led by a decrease in mobile data prices and access to affordable smartphones. Over 200 million 4G enabled devices were sold in 2018, a 50 percent increase from 2017.

The need to go beyond just the urban areas was addressed with initiatives to bridge the rural-urban divide – an allocation of $1.45 billion (Rs 10,000 crore) for the development of telecom infrastructure, a scheme to establish 5 lakh Wi-Fi hotspots and the aim of connecting 250,000 villages in 2019. Bharatnet (the telecom setup by the Government) allocations will assist in the expansion of internet access in rural areas and bring in an enormous amount of digital inclusion of the rural sector. These initiatives demonstrate numerous opportunities for Internet companies to expand their customer base outside large metros and reach the next billion consumers.

Also, the Government’s flagship rural entrepreneurship-focused ASPIRE Scheme - 80 livelihood and 20 technology business incubators were proposed to be set up to skill 75,000 entrepreneurs in agro-rural industries. With a $14.58 billion allocation for infrastructure along with these reforms, we see tremendous potential for startups to disrupt the digital infrastructure in this space.

Flipkart Group CEO Kalyan Krishnamurthy said, ‘It is good to see the Government renew its commitment to boost ‘Digital India’ in the Budget presented by Finance Minister Nirmala Sitharaman. The government’s vision of bridging the rural-urban divide with internet penetration will be pivotal in transforming India into a $5 trillion economy.’

Digital Payment Push

The rise of digital payments in India is closely aligned with the country’s internet penetration, which has led to a vibrant Fintech startup ecosystem.

With a clear intent on enhancing the convenience and reach of digital payment platforms, the Budget allowed the interoperability of PAN and Aadhaar card for taxpayers while simultaneously discouraging business payments in cash by levying a TDS of 2 percent on cash withdrawals over $0.29M (or Rs 2 crore). Additionally, the Budget allows establishments with an annual turnover of over $7.3M (Rs 50 crore) to offer low-cost digital modes of payments to customers. This ensures further transparency in financial transactions, and curbs black money.

As Bhavin Turakhia, Co-Founder and CEO of Zeta, said, “The digital push also reflects in the tax filing process as with the launch of a scheme of faceless assessment in electronic mode involving no human interface. The Government has introduced several measures that are in line with the ‘Digital India’ vision and we welcome the same.”

In line with the theme of ease of doing business, the Government has proposed e-governance initiatives across ministries and departments to transform the method of disposal and single window online market using technology. Unified Payments Interface (UPI) based digital payments clocked 754.54 million transactions worth $21.3 billion (Rs 1.46 trillion) in June. At present, 144 banks are on the UPI platform, which is one of the most preferred payment options. Incidentally, just like UPI, AePS (Aadhaar Enabled Payment System) transactions in the country also improved to 194.33 million in June from 192.11 million in May 2019.
As with digital payments, the Government also plans to bring more functional capabilities to Aadhaar - the face of the identity of India’s population. With more than 1.2 billion Indians on the Aadhaar platform already, and the availability of India stack, the door is open for further innovation from startups. Several startups have already leveraged Aadhaar to come out with various services and the Government’s thrust to bring more functionality gives an understanding of its plans to leverage this digital platform.

Along with this, a payments platform for Micro, Small and Medium enterprises (MSMEs) will also be set up. There are 63.38 million unincorporated non-farm MSMEs in India across sectors, including manufacturing and trade activities and employs more than 49.77 million people. This sector contributes significantly to job creation and productivity in the economy. The platform will not only bring MSMEs under the formal economy but also facilitate them to thrive in the highly competitive digital space, providing an opportunity for startups to increase their exposure to the MSME segment and expand their client base.

Relief for FinTech Startups

One of the pressing matters ahead of the Budget was the liquidity squeeze in the economy, which had severely impacted Non-Banking Finance Companies (NBFCs). This, in turn, had affected Fintech startups in the country, especially those in consumer lending space. Acknowledging this crisis, several new initiatives were proposed to bring relief to both the NBFCs and the FinTech startups.

The Finance Minister also proposed a reduction of corporate tax for businesses with a turnover of below $58.3 million (or Rs 400 crore) from the earlier limit of $37 million (or Rs 250 crore). Imposing tax liability on the interest of bad and doubtful loans for deposit-taking NBFCs and taxing income on receipt basis have been met with appreciation by the players in the financial services sector.

The Government has urged public banks to move lending to an online loan sanctioning facility for MSMEs and lending startups. Additionally, there was a push to move doorstep banking and interoperability among public banks online for the general public.

Refinancing policy and eligibility criteria set by MUDRA will be reviewed for better refinancing of NBFCs and lending startups and will help increase their exposure to the MSME sector. The move to announce measures for addressing the non-performing assets and stressed accounts of MSMEs will help the players significantly in growing their customer base and reducing losses.

Along with easing the way of conducting businesses for the startups in the Fintech space, we believe these initiatives provide numerous opportunities to disrupt the banking sector with innovations in technology.

Pushing Frontier Technologies Forward

The Budget was also in line with current trends and spoke about developing skills in areas such as Artificial
Intelligence (AI), Internet of Things (IoT), Big Data, 3D Printing, Virtual Reality (VR), and Robotics. Initiatives include skilling 10 million people in emerging technologies in the next 3-5 years. This will enable the IT sector to ride the digital transformation wave. The Government also understands that people with enhanced skills will naturally get higher remuneration and could, in the medium to long run, address the issue of shortage of such personnel in these areas. This solves for the skill crunch faced by the startup ecosystem and empowers them with more personnel for talent. We can see this lead up to more tech startups serving the global markets.

The proposal to invite global companies to set-up mega manufacturing plants in sunrise and advanced technology sectors will positively impact the economy combined with the skills development. This provides opportunities not just for the startups in the sunrise sectors but also to adjacent sectors, such as edtech, IoT.

Expectations that were not met

While the Budget included a slew of bold reforms and measures to push the Indian startup ecosystem and the Indian economy forward, there were some pressing issues that were not addressed sufficiently.

**Tax on ESOPs**
Some of the other critical issues which were not addressed – how Employee Stock Ownership Plan (ESOPs) come under the tax bracket, exemption from long term capital gains tax, and so on. Cash strapped, early-stage startups often recruit talent through ESOPs. Many employees take salary cuts to work on challenging problems hoping to cash in on ESOPs once the startup goes into hyper-growth mode. Lack of clarity on how ESOPs are taxed, exemption from long term capital gains tax among others are detrimental to the growth of the startup ecosystem.

**Cryptocurrency**
Various stakeholders in the ecosystem had expected the Government to elaborate on their stance on
cryptocurrencies but it didn’t find any mention in Sitharaman’s maiden Budget speech.

Industry insiders had been worried about legal consequences since the Bill on Banning of Cryptocurrencies and Regulation of Official Digital Currencies was circulated in April 2019. There were also media reports that selling or dealing in cryptocurrencies such as Bitcoin could entail 10 years in jail. While the lack of credible information and potential for misuse of frontier technologies may have pushed the Government to take this stance, the startup ecosystem expected a more open stance to encourage innovation.

“I’m happy that there was no hasty crypto-related announcement. Since our FM and PM were involved in the recent G20 meetings where the FATF crypto standards were shared with all the participating nations, I’m sure India is on its way to bring about a positive change in crypto regulations,” said Nischal Shetty, Founder of crypto exchange WazirX.

The Seed Fund Corpus

One of the key expectations from the startup ecosystem was that the Government-owned seed fund corpus would be increased from the current $1.45 billion (or Rs 10,000 crore) to $2.9 billion (or Rs 20,000 crore). In fact, this was one of the biggest plus points of the BJP’s manifesto. However, there was no mention of it in Sitharaman’s speech.

Job Creation

Startups in the country are making their contributions in terms of job creation, especially the gig economy. This will continue as the internet economy continues to expand. Job creation is a crucial task for the Government and an urgent need of the hour. While the Budget talked about bringing in reforms in labour laws, the expectations were on bringing back and creating more jobs in the market.

Investing in the Indian Opportunity

The Economic Survey 2018-19 noted that despite moderation in real GDP growth by 40 basis points in 2018-19 over 2017-18, the Indian economy remained the fastest growing major economy along with macroeconomic stability. India has emerged as an important player in the world and the medium-term growth prospects of the economy are bright, mainly on the back of the important structural reforms initiated in the last few years.

As India marches towards a $5 trillion economy, the Economic Survey 2019 has rightly recognised that the economy can grow through the empowerment of people using data for decision-making and laid down the path to a virtuous cycle of savings, investments, demand, and exports to facilitate this transformation.

Ranked third in the world in the startup ecosystem, there are 16,578 startups in India, as of March 2019. The last decade
was characterised as the first phase of VC-led startup innovation in the country, laying the foundation for the startup ecosystem. Now a decade later, we see more than 90,000 jobs created and funding of $35 billion into those startups creating more than $90 billion in value.

We believe stable policy rates, political conditions, and consolidated labour reforms along with securitisation of future cash flow for investors will provide global investors with an opportunity to invest in regular yielding investments. Evolved tax systems along with consumer behavioural change are functions of innovation and additional investment, and integration of these elements into policymaking is significant.

With a strong focus on the improvement and development of infrastructure, various reforms taken by the Government have helped boost manufacturing, employment generation, financial inclusion and improve ease of doing business. India is on course to be a global superpower and now is a great time to invest in the Indian opportunity.

Since 2006, Kalaari has been investing in the Indian startup ecosystem and been a part of the growth journeys of multiple high-growth companies and seen the ecosystem mature. Now in 2019, we believe that the Indian startup ecosystem is moving at its highest momentum and we are excited to boost the startup ecosystem further and continue to invest in the next generation.