The Startups Series

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STARTUP INDIA SEED FUND SCHEME - SWITCHING UP THE STARTUP GAME?

In a move that endeavors to foster growth and development in the startup sector, the Central Government recently notified a sector agnostic 'Startup India Seed Fund Scheme' ("**SISFS**"). The SISFS will take effect on April 1, 2021 and will be in force for a period of four years. The objective of the SISFS is to establish a structure that provide monetary benefits to eligible startups[1] ("**Startups**") for proof of concept, prototype development, product trials, market entry and commercialization. The SISFS is projected to disseminate approximately INR 945,00,00,000 (Indian Rupees Nine Hundred and Forty Five Crores) into the startup ecosystem.[2]

BACKGROUND

The SISFS was drafted to address the primary obstacle faced by up and coming startups, which is the lack of access to adequate capital particularly at the product trial/ proof of concept stage. The SISFS is just one in a series of measures being implemented by the government to bolster the startup sector, for instance, the recent union budget extended the eligibility period for startups to March 31, 2022 to avail the tax exemption under Section 80-IAC of the Income Tax Act, 1961. Similarly, last month, the Social Alpha and Small Industries Development Bank of India ("**SIDBI**") undertook to establish the Swavalamban Divyangjan Assistive Tech Market Access fund to offer financial grants to incubated startups operating in the assistive technology sector[3]. SIDBI also entered into a memorandum of understanding with the National Stock Exchange to discuss potential arrangements for providing a debt capital platform to micro, small and medium enterprises[4]. The implementation of such measures is of utmost importance given the prevailing market scenario where it is difficult for most startups to raise capital particularly in light of the slowdown caused by the pandemic.

Accordingly, the enforcement of the SISFS comes at the most opportune time and we identify some of the key takeaways from the SISFS:

KEY TAKEAWAYS

1. **Establishment of an Experts Advisory Committee ("EAC") –** The SISFS envisages the establishment of an EAC which will oversee the implementation and management of the SISFS. The primary responsibility of the EAC will be to assess and select incubators (who fall within the eligibility criteria specified in the SISFS) with the objective of granting seed funds. After the incubators have been selected, the EAC will supervise the process of dissemination of the seed funds to the selected incubators. The seed fund will be disbursed by the EAC to the incubators on the condition that certain targets relating to the utilization of the funds are met. In addition, the EAC is also expected to ensure that the incubators are on the right track in relation to achieving the milestone-based objectives as set by the EAC.

2. **Assistance to Incubators –** The EAC shall disseminate INR 5,00,00,000 (Indian Rupees Five Crores) to the selected incubators over a series of milestone-based installments (as determined by the EAC). The installments will only be disbursed to the incubators upon submission of proof to the EAC that the milestones have been accomplished. In excess of the seed fund, the incubator will also be provided with a management fee (5% of the total commitment granted to the selected incubator) which is to be utilized for the operational expenditure incurred by the incubators in conducting due diligence and shortlisting Startups. The seed fund grant provided to the incubator is to be used in full, within three years from the date of receipt of the first installment by the incubator.

3. **Incubator Seed Management Committee ("ISMC") –** The selected incubators that are participating in the SISFS will need to establish an ISMC. The ISMC is an organ that will assess and shortlist suitable Startups for the provision of seed support. The ISMC shall comprise of a nominee from the incubator who will act as chairman; representative from the State Government's Nodal Team; representative of a venture capital fund or angel network; a domain expert from the industry; a domain expert from academic; two successful entrepreneurs and any other relevant stakeholder as deemed appropriated by the incubator.

4. **Disbursement of Seed Funds to Startups –** The incubators may onward disburse the seed fund to the Startups selected by the ISMC in the following manner: (i) Up to INR 20,00,000 (Indian Rupees Twenty Lakhs) (milestone based payments) as grant for validation of proof of concept, or prototype development, or product trials; (ii) Up to INR 50,00,000 (Indian Rupees Fifty Lakhs) of investment for market entry, commercialization, or scaling up through convertible debentures or debt or debt-linked instruments. There also seems to be an express prohibition on the Startups to use the seed fund for any purpose for which it has not been granted for.

   The amount disbursed by the incubator to the Startup shall not exceed 20% of the total grant provided to the incubator. Apart from monetary assistance, the incubators shall also equip the Startups with the physical infrastructure and equipment required to develop, research and test product prototypes and offer networking

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opportunities to the Startups by providing a marketing platform for the Startups to display the products developed to potential investors.

5. **Indicators of Successful Implementation –** The parameters for measuring the success of the Startups as assessed by the incubator will include progress of proof of concept; progress of prototype development; progress of product development; progress of field trials; progress of market launch; quantum of loan, angel or venture capital funding raised; jobs created by the Startup; turnover of the Startup and any other parameter as established by the incubator. The status of progress under each of the above-mentioned parameters will be relayed from the Startup to the incubator and subsequently to the EAC. The incubator will also prepare a report on return on investment for each Startup and submit the same to EAC.

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ANALYSIS & CONCLUSION

The SISFS has been structured to operate as a well-oiled machine with each component (the EAC, the incubator and the Startups) playing a pivotal role in the holistic game plan. The efficiency of the sector agnostic scheme in attaining its objective of bolstering the startup sector will entirely depend on how well the respective organs functions in synchronization.

The primary issue with SISFS is that there exists ambiguity with respect to several facets of the implementation of the SISFS. For instance, one of the eligibility criteria for Startups as established by the SISFS is that the “Startup must have a business idea to develop a product or a service with market fit, viable commercialization and scope of scaling.” However, the SISFS does not establish the thresholds for what is to be considered as “market fit” or “viable commercialization.” This is indicative of a larger problem with the SISFS which is that a lot of discretionary power is wielded by the EAC and the incubators in shortlisting “suitable” incubators and Startups respectively.

Similarly, the milestone thresholds to monitor progress will be established solely at the discretion of the EAC. If the milestones are set too high, this will make attainment of the objectives impracticable and block future disbursements of the seed fund to the incubators, and accordingly the Startups – thereby throwing a wrench in the works.

At the moment, the initiatives being ushered in by SISFS should be welcomed, however, the success of the SISFS will depend entirely on the administration and operation of the EAC, the incubator and the Startups which is yet to be seen.

– Aarathi Das & Harshita Srivastava
You can direct your queries or comments to the authors

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[1] The eligibility criteria for a Startup to apply under the SISFS shall be as follows: a) A Startup, recognized by DPIIT, incorporated not more than 2 years ago at the time of application; b) Startup must have a business idea to develop a product or a service with market fit, viable commercialization, and scope of scaling; c) Startup should be using technology in its core product or service, or business model, or distribution model, or methodology to solve the problem being targeted; d) Preference would be given to Startups creating innovative solutions in sectors such as social impact, waste management, water management, financial inclusion, education, agriculture, food processing, biotechnology, healthcare, energy, mobility, defence, space, railways, oil and gas, textiles, etc.; e) Startup should not have received more than Rs 10 lakh of monetary support under any other Central or State Government scheme. This does not include prize money from competitions and grand challenges, subsidized working space, founder monthly allowance, access to labs, or access to prototyping facility; f) Shareholding by Indian promoters in the Startup should be at least 51% at the time of application to incubator for the scheme, as per Companies Act, 2013 and SEBI (ICDR) Regulations, 2018 and g) Any Startup will not receive seed support more than once each as per provisions of guidelines.

[2] https://pib.gov.in/Pressreleaseshare.aspx?PRID=1695466.

[3] https://www.thehindubusinessline.com/money-and-banking/social-alpha-sidbi-join-hands-to-launch-a-fund-for-startups-in-assistive-technology-space/article33931234.ece

[4] https://www.financialexpress.com/market/nse-joins-hands-with-sidbi-for-debt-capital-platform-for-msmes/2205147/
