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Indian Start-ups Relocating to Singapore: Who Benefits?

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Summary

A significant cohort of start-ups from India has relocated to Singapore and elsewhere. This has raised concerns in some quarters in India about the 'loss' of business and investment to overseas start-up hubs. Are these concerns valid? Who benefits when start-ups relocate?

The Context

Over the past few years, a growing number of start-ups from India have relocated to other established and emerging start-up hubs such as Singapore, the Silicon Valley and London, and to less obvious locations such as Mauritius, Estonia, Lithuania and Israel, among others. These new enterprises are usually at an early stage of product development. The migration of such enterprises has led to a growing chorus in sections of the media and, to an extent, in policymaking circles about the 'loss' of business and investment to overseas locations, reflected in headlines such as "*Singapore poaching Indian Startups"*[1] or "*Grofers is Shifting to Singapore: Can't we Stop this Exodus*".[2] The belief underlying these viewpoints is that the migration of start-ups will result in the loss of businesses, employment opportunities, tax revenue and other benefits that come with location and growth of hi-tech business, placing pressure on policymakers to reverse the flow. It should be noted that despite their prominence in the media, start-ups account for a small part of the economy.

Why are Indian start-ups migrating to Singapore and elsewhere? What does this imply for the Indian start-up sector? Does it result in a loss of funding, jobs, entrepreneurial talent, tax revenues, in other words a slow hemorrhaging of the economy? Who benefits from the shift in location?

Why Do Firms Relocate Overseas?

Facilitated by deregulation, especially of the flow of foreign direct investment and capital and the proliferation of free trade agreements over the past four decades, firms have been crossing national borders in increasing numbers. The fundamental reason for moving overseas is to enhance efficiency and value creation in the firm. Companies shift not only from developing to developed economies, but also across developing and developed economies.

Firms relocate for a number of reasons. The consequences for the home country/state/city and the new location vary widely. As a class of firms, start-ups are distinct. Many incur negligible fixed costs and are extremely nimble and mobile. They start with simple ideas that

1 https://www.techinasia.com/singapores-poaching-indias-startups-modis-plan-stem-exodus
2 https://trak.in/tags/business/2015/09/23/grofers-shifting-singapore-exodus-digital-startups-india/

fill market gaps and if successful can quickly scale up. Start-ups may locate away due to push or pull factors. The ‘pull’ factors inducing the start-up to shift to another location include better infrastructure, the ease of doing business and a superior ecosystem with incubators and accelerators that catalyse the growth of the young enterprise. Tax policies play an important role as do the regulatory burdens and easier and transparent compliance regimes. Other factors drawing start-ups are economic competitiveness, the support from administrative authorities, a central location, an excellent infrastructure, an attractive tax system and a high quality of life. Evidence suggests that the outcomes of migration are of mutual benefit for the home and host country stemming from improved prospects for the start-up. Conversely, the ‘push’ factors inducing the start-up to shift could include an unpredictable and burdensome regulatory and compliance structure, poor infrastructure, challenges in finding skilled workers, poor infrastructure and more broadly, the difficulties of doing business. For policymakers, the challenge is to create conditions to induce firms to stay at home and attract new business.

Indian Start-ups Relocating Overseas

India ranks among the top 20 destinations for launching start-ups, with steady improvements in the ecosystem over the years. Today, it is home to several thousand start-ups spanning various stages of development from all major domains of enterprise. Despite several policy proposals and initiatives aimed at encouraging start-up activity in India, tax laws, regulatory complexities, including some as basic as the process of defining a start-up, limited funds for start-ups in the the (Business-to-Business) B2B space, and the imperative of eventually having to deal with the issues that continue to make it relatively difficult to invest in India compared to registering a start-up in Singapore, Silicon Valley and other locations.

Many Indian start-ups that go on to raise venture capital, incorporate outside India with their headquarters in Singapore and operations in India. These include Flipkart, Grofers, Druva, InMobi, Capillary Technologies, Near, TonBo Imaging, Mobikon, U2opia Mobile and Milaap.

Start-ups may relocate in several forms. Some establish just a legal presence. Some others shift a few key operations. At some, the senior management may shift to Singapore while operations continue in India and, for a small cohort, a majority of the company’s employees may be based in Singapore. The nature of the move depends on the needs of the start-up.

Rationale for Shift to Singapore

For a start-up in a developing economy at the formative stage, the first two to three years are crucial. Funding is tight, the administrative and regulatory burden cumbersome, and intellectual property rights weak. Resources are scarce and a tax benefit can go a long way in boosting working capital. Most start-ups also prefer applying for patents in other countries like the United States for a variety of reasons. The Indian government has taken initiatives to make the intellectual property rights (IPR) procedure transparent for start-ups and expedited the processing of patent applications with an 80 per cent rebate on charges for filing patent charges.

Of the start-ups that relocated to Singapore, most are service-oriented in the Business-to-Consumer segment filling a gap, but not offering a new product. A significant number are in

B2B segment, where it was difficult to raise funds in India, though over the past two years the funds flow into this segment has accelerated. The composition of start-ups from India reflect the core competencies of Indian start-ups: service-based, drawing upon artificial intelligence (AI), big data, deep learning or machine learning. The areas where Indian start-ups coming to Singapore can find synergies include bio-engineering; medtech, fintech, AI and big data as these are areas that are prioritised in Singapore.

Singapore has consistently remained one of the easiest locations to do business, ranking at the top of the World's Bank's[3] list. From incorporating a company to dealing with the regulatory permissions needed, to the eventual 'exit' or even dissolution of a company, Singapore offers ease and convenience. It is among the most innovative, competitive and popular investment destinations, with strong institutions, a highly skilled labour force, research and development facilities, infrastructure, the availability of sophisticated business services as well as a transparent and easy to meet regulatory burden.

As one of the most open economies in the world to trade and investment, there are few barriers impeding transactions. Public sector agencies work actively with enterprises to ease their operations in Singapore, communication with investors is open with quick resolution of any problems. Its trade-friendly regulations and a business-enabling environment place it at the top of the World Economic Forum's 2014 Global Enabling Trade report.

Singapore has developed a vibrant and active ecosystem to nurture start-ups. The government has launched schemes to assist early stage start-ups. It is much quicker and cheaper to set up an enterprise in Singapore. Under the National Framework for Innovation and Enterprise, the government offers liberal funding with the option for the promoter to buy back the government's stake after three years. Singapore provides access to a developed eco-system of start-up funding, including the likelihood of higher valuations if they go for an initial public offering (IPO).

Most tech companies find it difficult to get an optimal valuation during IPOs in India. Higher valuations overseas can be attributed to more developed financial systems, a larger pool of risk capital, greater scrutiny and confidence in overseas listings, lower tax rates and a simpler tax code and smoother compliance norms.

Other Factors

Strong intellectual property (IP) protection laws with credible enforcement is essential for stimulating technical innovation. While India has laws to protect IP, weak enforcement and judicial delays weaken the protection. Singapore has the best IP protection in Asia and is ranked second globally, allowing Indian start-ups with a presence here to protect themselves. Consequently, most start-ups prefer applying for patents in other countries. The announcement was that the government will make IPR procedure transparent for start-ups. There will be a Fast Track mechanism setup for patent applications for faster examination and disposal. Adding to that is the benefit of 80 per cent rebate on patent filing charges which is welcoming.

[3] https://www.doingbusiness.org/en/rankings

Singapore levies a low corporate tax rate with a marginal corporate income tax rate of 17 per cent. For newly incorporated companies, the start-up tax exemption scheme reduces the effective corporate tax rate to below nine per cent for annual profits of up to S$300,000.

Unlike India, Singapore levies zero capital gains tax upon exits, requiring a holding period of a year to qualify for long-term capital gains, which means that proceeds from sale of shares will be exempt from tax. The Indian corporate tax rate is a flat 33 per cent. However, new companies registered after 1 March 2016 will be exempted for three years. The holding period for lower long-term capital gains tax is three years, else a higher short-term capital gains tax is imposed, deterring investors from funding start-ups due to higher risks.

Indian-origin investors set up a fund in Singapore or Mauritius, where the venture capitalist is exempt from taxes, and then route the funds to India, complicating the funds mobilisation exercise. Start-ups that are gaining scale and looking to raise funding beyond Series A and eventually an IPO as an exit option for investors, move overseas.

Singapore has achieved start-up exit velocity. Some start-ups plan ahead and domicile in Singapore from early on in their development. A steady increase in the number of exits can trigger a virtuous cycle of innovation and entrepreneurship in India, as the broader market becomes increasingly aware of the success of Indian startups.

Access to a new set of customers in the vast, growing Southeast Asian markets, a broader regional perspective, the availability of complementary talent in Singapore and improved operational metrics are other factors that draw Indian start-ups to Singapore.

Not a Zero-sum Game

The debate on relocation has long been clouded by misperceptions that India loses and the overseas location gains when start-ups relocate abroad. It is erroneous to see the move as a zero-sum game. Unlike the brick and mortar firms that relocate to avoid taxes or lower labour costs, start-ups generally relocate in response to different factors. The move is mutually beneficial – to both countries, and above all to the firm.

Consider an obvious counterfactual scenario. What happens if a country imposes restrictions on relocation of a firm overseas? While the actual execution of such a policy is extremely difficult and unlikely, if implemented it is likely to reduce the value of the enterprise, further reducing the supply of capital, depriving enterprise of the opportunity to benefit from locating in a high-value centre, raise the risk premiums on external funds, eliminate access to technological support or institutional support, such as research and development incentives, a sandbox, technical and institutional assistance through incubators and accelerators, etc.

Should Indian policymakers be concerned? The Start-up India action plan, and subsequent initiatives are steps in the right direction. But institutions that attract and nurture start-ups do not evolve overnight, nor is the start-up ecosystem independent of the broader ecosystem for investment and doing business. There is no country where the start-up ecosystem is conducive to new start-ups, while the country itself scores poorly on doing business. Long before a successful exit, the firm will have to deal with obstacles in the business environment that motivated the move in the first place. A shift to a new location is a zero-plus move, with overall benefits outweighing any notional loss. Jobs are generated in both locations, most of the work is in India. For companies that elect to conduct operations in other countries, it raises the profile of the Indian startup ecosystem. Icertis, the latest Indian Unicorn, has main offices in Pune and Seattle, and already counts dozens of Fortune 500 companies among its clients.

The environment for start-ups is improving steadily, but if start-ups choose to relocate, they do so because it benefits the main stakeholders – the promoter and the funding institutions. The main operations of many of the start-ups are still in India as are sales, jobs, income generation and taxes paid.

Rather than a loss for India, this migration of entrepreneurs to Singapore and other start-up hubs can offer long-term dividends for India's digital economy, in a manner similar to the cohorts that moved to Silicon Valley. Many of those immensely successful returned to India or provide funds and technical advice and links to Silicon Valley and the immense benefits it offers. Singapore is also an ideal staging post for expansion into the vast ASEAN market.

Reframing the Argument: Mutual Benefits

The initiatives policymakers need to take are well known – address impediments to incorporation, fund raising, operations, taxation, exits, closure, payments, and intellectual property rights, as well as high taxes that make it difficult for start-up founders to conduct operations in India and dissuade new ones from entering the fray.

Measures to rationalise the tax structure and ease conditions for incorporation are steps in the right direction. The launch of a start-up fund by the government of India is a step in the right direction.

India needs to make it easier for start-ups to obtain venture debt without needing collateral from a banking sector that is saddled with a large non-performing loan overhang.

We are in a period of rapid technological change and innovation, and uncertainty in the multilateral trading system. Can start-ups work in relative isolation? The answer is an unequivocal no. The government can work as a catalyst in boosting this sector. To do that, it needs to reframe and reinforce its role as a collaborator and not just a regulator. Aside from nurturing start-ups, there are lessons India can draw from the experiences of Silicon Valley, Israel, Singapore and other successful start-up hubs. Investment in skills is an utmost priority, as are initiatives to nurture and incentivise an environment of collaboration between universities and industry. With its vast pool of entrepreneurial talent, India holds great potential in this rapidly growing and promising sector.

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