Invest More

Changes in law force startups to divert attention from growth

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In the Bengaluru office of financial-technology company Perfios this week, former Reserve Bank of India deputy governor R Gandhi was fielding questions from executives of about 30 fintech firms on recent regulations in the sector. A spate of regulatory and policy changes has led to a certain degree of upheaval in the startup and internet space across sectors such as fintech and ecommerce.

Among these: RBI requiring payment companies to store data locally and mobile wallet providers to collect detailed information on their customers (full know-your-customer), and potential regulations for the ecommerce sector from the commerce ministry and the consumer affairs department. This has forced members of internet companies in India into frequent meetings and discussions with authorities and industry bodies in recent months.

The monthly industry session organized by the India Fintech Forum at Perfios's office was focused on regulations in the space after increasing queries within the community about the purpose and impact of these policy changes, Perfios director VR Govindarajan said.

Representatives of ecommerce companies have also been in a number of meetings with the consumer affairs department to discuss its upcoming rules under the Consumer Protection Act, as well as its rules mandating ecommerce platforms to reflect key product information. While the government had given companies six months till December for the latter, several companies are still not fully compliant citing the millions of products listed on their marketplaces, and some have also started receiving notices warning of penal action.

"This is like the License Raj where we keep getting new notices from different parts of the government," said Sanjay Sethi, CEO of ecommerce company ShopClues.

But this turbulence is just the beginning, according to some industry watchers. India's data landscape is on the cusp of change, said Sharad Sharma, cofounder of software policy thinktank iSPIRT. "New regulations to empower and protect the data of our citizens are on their way," Sharma said, referring to the upcoming policies on data privacy, account aggregation under RBI, and new rules around data use in the telecom sector.

iSPIRT is ramping up its 'Policy Hacks' initiative for disseminating policy information to startups. It will soon be announcing a hotline and launching a microsite to support startups with policy insights related to upcoming regulations in the country as well as global ones such as the General Data Protection Regulations in Europe, Sharma said.

Bracing for regulatory changes

Startups are bracing themselves for the policy waters to get rougher by either setting up their own policy teams or engaging with law firms for advice. Law firm Khaitan & Co. has been getting a surge of queries through emails and calls from startups and internet companies around recent regulations. "Over the past year, we have got about 25-30% more such queries on regulations and compliance," said Sanjay Khan Nagra, principal associate at Khaitan & Co. "While earlier, one of the startup founders or the finance head would look at compliance, now even early-stage startups are appointing at least one person to look at regulatory and policy developments."

PharmEasy, an e-pharmacy startup, has put in a policy team and appointed a legal counsel to represent it on various platforms to engage with the authorities. "Most e-pharmacy companies are doing the same," said cofounder Dharmil Sheth. Wealth management platform Fisdom's cofounder SV Subramanya has been personally meeting with industry members to be aware of policy changes in the sector, especially as the capital market regulator, Securities and Exchange Board of India, puts forth new guidelines for the mutual fund sector. In October, Sebi's move asking mutual funds to hold only one product per asset category led to some confusion as it was expected to force asset managers to merge similar schemes.

“Given the various changes that are happening or could happen, I have to spend much more time to keep my ears to the ground on the potential changes and the adjustments we have to make,” said Subramanya. “That’s a cost because that’s the time away from building the product or getting more customers.”

Several startup industry members have lamented that the rise in regulation is making the environment less friendly for innovations. “We have been telling the government that if the next Google has to come from India, they have to simplify doing business in India, and that means reducing the cost of compliance,” said Vaibhav Parikh, partner at Nishith Desai Associates. The law firm recently held a webinar on RBI‘s policy on data localisation mandating that payment companies keep their data systems only within the country. “We were getting a lot of queries around the regulation and its impact, and nearly 80 people joined the webinar,” Parikh said.

Skewed impact

The full-KYC guidelines for mobile wallets have hit most players badly, including large ones such as Paytm and Amazon Pay. ET reported last month how some mobile wallets said they saw a drop in wallet loads by up to 90% after RBI mandated full KYC from March. RBI data show the number of transactions through mobile wallets fell 13% to 268.79 million in March from 310.01 million in February, and the value of money settled through wallets dropped 23% to Rs 10,000 crore.
While individual companies have been impacted, the move may also result in an unhealthy trend in the industry, experts say. “The KYC norms can create a situation of monopoly since it favours and enables large players at the expense of smaller players having an opportunity,” venture capitalist Vani Kola, managing director of Kalaari Capital, said. “It is skewed in favour of a monopoly and that is not in the larger interest.”

As for crypto-currency companies, several have decided to move to friendlier markets after RBI banned banks from working with them.

For the ecommerce sector, guidelines being drafted by the consumer affairs department are expected to have a significant impact on companies, likely increasing the liability on them for ensuring the quality of products. RBI’s data localization rules for payment firms have forced global companies to bring their data centres within the country, pushing up costs, which is expected to go into millions of dollars.

RECENT REGULATIONS THAT HAVE THROWN KEY INTERNET SECTORS OFF GEAR

Fintech

FULL E-KYC FOR MOBILE WALLET USERS: EFFECTIVE FROM MARCH (EXTENSION OF 12 MONTHS ON MINIMUM KYC)

For: Some industry members say the move is meant to bring mobile wallets on par with banks.

Against: The move has dragged wallet loads down by 80-90%. Number and value of mobile wallets transactions dropped in March

> It seems contradictory to the desire to accelerate digital payments
>
> AMIT AGARWAL, country head, Amazon India

DATA LOCALISATION, REQUIRING PAYMENT COMPANIES TO STORE DATA WITHIN THE COUNTRY

For: Paytm and PhonePe say the rule is aimed at ensuring more control and monitoring over financial data.

Against: Global payments firms Visa, MasterCard and American Express have raised concerns with the regulator, saying the rule will have significant impact on them.

> Our recommendation is that data replication be allowed outside India for better exchange of innovations and best practices
>
> AMRISH RAU, CEO, PayU India

Ecommerce

DIPP GUIDELINES BARRING ONLINE MARKETPLACES FROM GETTING MORE THAN 25% OF THEIR SALES FROM A SINGLE VENDOR OR THEIR GROUP COMPANIES

For: Several industry players as well as online vendors have felt this will ensure ecommerce players do not route much of the goods through a few sellers

Against: Industry players say implementation has been weak. Seller associations have also complained of non-compliance by ecommerce companies.

> It is harmful to have regulations that only some players follow. The spirit of DIPP guidelines was to create a level-playing field, but that is not being followed
>
> SANJAY SETHI, CEO, ShopClues

Crypto-currency

RBI HAS DISALLOWED BANKS FROM DEALING WITH CRYPTO-CURRENCY PLATFORMS

For: Given the volatile nature of crypto-currency and a with lack of rules governing them, some industry members feel the move will help safeguard investors.

Against: IAMAI and several companies have filed petitions against RBI's decision. Some say the move could push crypto-currency exchanges into the cash system, making it more difficult to track transactions.

> These rules have been put in place without talking to the stakeholders
>
> SUBHO RAY, president, IAMAI

UPCOMING POLICIES

Shouting to be heard

Several industry members have been voicing opposition to some recent regulations, either vocally or through official communication. Some feel that while the authorities have brought forth regulation, the implementation has been weak, causing further confusion. “It is harmful to have regulations that only some players follow. The spirit of DIPP guidelines was to create a level-playing field, but that is not being followed,” said Sethi of ShopClues.

The Department of Industrial Policy and Promotion has mandated that ecommerce marketplaces cannot directly or indirectly influence the price of goods and services and that they cannot have more than 25% sales coming from a single vendor or their group companies. The issue was brought up before the government during a recent meeting with ecommerce companies, according to some industry members.

Several angel investors and startups have been critical of the ‘angel tax’, which is a tax on funds raised by startups in excess of their fair value. While the government has introduced modifications to exempt some startups from the tax, several members have said the criteria are too strict, especially since this involves a costly affair of getting a valuation certificate by a merchant banker as well as the net worth of each angel investor. On data localization, tech industry body Nasscom sent a communication to the central bank last week taking a position against the rule.

Industry associations have also criticized the lack of consultation on several policy decisions.

The Internet and Mobile Association of India (IAMAI) and several other parties have filed petitions in recent weeks against RBI’s move to block banks from working with crypto exchange platforms. “These rules have been put in place without talking to the stakeholders,” said Subho Ray, head of IAMAI.

Even when the commerce ministry did call on several ecommerce companies for a meeting to discuss a future policy for the sector, several large global companies felt left out despite holding considerable market share in their respective sectors and have reached out to the government to be included in the discussions.

In some sectors, such as digital lending, several companies have come together to create industry associations to work with the government on policymakers while also establishing best practices for the industry.

The tax collection at source clause under the Goods and Services Act also brought together industry rivals such as Amazon and Flipkart to challenge the policy, which industry experts also deemed as unfair to the online ecommerce sector over the offline players.

The larger good

All said, many of the recent regulations have been brought forth with consumer interest in mind, and for critical issues such as data privacy and security. “When the issue is about national interest, we cannot always consult with the companies before taking a decision," said Gandhi, the former RBI deputy governor, referring to the data localization policy. While the central bank has been concerned about a lack of control on data held beyond Indian shores and the potential misuse, the Facebook-Cambridge Analytica story was the "proverbial last straw" in the push towards creating data localization rules, Gandhi said. "Most countries are moving towards such norms. In India, we have to be aligned with the Prevention of Money Laundering Act (PMLA)," Gandhi said.

This has also meant that the central bank has not incorporated everything that the Ratan Watal committee prescribed in its report for the fintech sector. One recommendation was that transactions permitted in cash without KYC should also be permitted on prepaid wallets without KYC. "The RBI is only a regulator and it can do only what the PMLA rules allow," Gandhi said.

iSPIRT's Sharma said the approach by the industry towards policy has to change. "It is necessary for good policymaking that technology, policy and market participants come together. The old approach of putting pressure on the government as a trade body isn't very effective anymore," he said.

Kola said it is important to keep consumer interest as the main priority when it comes to policies. "Anything that affects society, not just the interest of venture capitalists and entrepreneurs, requires collective debate and the policy should be in that context," she said. "A lot of the rules coming up are around consumer data and privacy. We all need to rethink data, especially in the light of the Cambridge Analytica case. As an investor, I want companies to do the right thing by the consumer, even if it means in the short-term certain companies need to relook at their operations and adapt."