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A Study on Factors Affecting Startup Setup and Closure in India

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Abstract

Startups are the vehicles of growth in economy and engines for job creation. The western countries such as USA have realized this very early and have refined their startup policies and legal frameworks over a period of time. They have recognized the need to start the setup quickly and get on with innovation. Equally important is the need to shutdown the startup when it is not achieving its product goals or becoming financially unviable. "Fail fast" is the mantra they have adopted, to encourage a quick idea-to-product journey. Even if there are a few failures, the idea gets refined and finally they reach a viable product. The precious resources are not kept locked up in failed startups, but are allowed to flow into the more promising ones. This encourages venture capitalists and other funding agencies to move resources to the best use of the same. It also frees the time of the entrepreneur who can move on to other new ventures and new ideas whose time is tomorrow.This paper is based on the discussions held with startup entrepreneurs who are running their first startup or entrepreneurs who have moved to a serial entrepreneur role. It also makes use of the various documentation available about startup policies and programs in the country.

The entrepreneurs and those hesitant to startup have long realized this challenge. The policy makers and other legal functionaries have also realized the need for change in systems. Some have voiced about the need for change, but nothing much has changed. So, there is a long way to go, to make it an entrepreneur-friendly system. The need of the hour is to simplify the entry and exit procedures for the startups. The closure of startups is currently a lengthy process in India. The bureaucratic approach calls for example filing of empty GST (Goods and Services Tax) reports to show that there is zero revenue. . Annual tax filings are required to be submitted even with no revenue. There are many other statutory reports that have to be submitted to the authorities on a regular basis, even for the now defunct company. While this generates services revenue for the chartered accountants, it is a drain on time and money of the entrepreneur.

Various aspects of setting up startups have been discussed and published in academic research. The current literature focuses on encouraging entrepreneurs to get started. Very little research has been done towards helping entrepreneurs to close operations and move on to new ideas/products etc. Hence this is an original attempt at solving a genuine issue faced by startup owners and entrepreneurs. Based on discussions with industry stakeholders, in this paper we intend to discuss how the same journey is done in India and how significant changes are needed to be done in the legal and financial systems of the country.

Keywords: Startup, Entrepreneurship, legal, financial, products, exit procedure

Introduction

Startups are the vehicles of growth in economy and engines for job creation. The western countries such as USA have realized this very early and have refined their startup policies and legal frameworks over a period of time. They have recognized the need to start the setup quickly and get on with innovation. Equally important is the need to shutdown the startup when it is not achieving its product goals or becoming financially unviable. "Fail fast" is the mantra they have adopted, to encourage a quick idea-to-product journey. Even if there are a few failures, the idea gets refined and finally they reach a viable product. The precious resources are not kept locked up in failed startups, but are allowed to flow into the more promising ones. This encourages venture capitalists and other funding agencies to move resources to the best use of the same. It also frees the time of the entrepreneur who can move on to other new ventures and new ideas whose time is tomorrow.

Literature survey

India has a great opportunity to improve its economy, by using startups as the vehicle for growth. Post-independence saw the establishment of large scale enterprises under the public sector. These units laid the foundation stone of independent India. There were private sector enterprises such as Tata steel, established even prior to independence. So the public sector and private sector grew simultaneously. Government policies were incorporated to assist the growth. The liberation of laws in 1991 added an impetus to the economic growth. It led to the establishment of new enterprises and startups. The startupIndia policy that followed also helped in giving a boost to the startups in the country.

Srivastava & Ahmed(2024) studied the startup situation in India. They focused their research paper on ways to make the startup environment more sustainable in India.

Salamzada & kawamorita(2015) in their paper, mention that these startup entities are mostly formed based on brilliant ideas and grow to succeed. They reviewed the lifecycle of startups, and the challenges faced at each stage.

Bharadawaj et al(2025) in their study mention that while India has witnessed a boom in startups following reforms that improved the ease of doing business, many ventures struggle to survive and scale due to structural and contextual challenges. They have developed a model for startups, the model emphasizes the need for inclusive, innovation-led, and resilient entrepreneurship as a means to promote sustained economic growth, productive employment, and robust industrial infrastructure in India.

Hara, Masatoshi(2023) studied the Indian economy and states that The key solution to India economic challenge lies in enhancing the ease of doing business (EDB), primarily by promoting startups. India has witnessed substantial growth in promoting startups since 2010. Despite favorable conditions for economic advancement, India has remained in the lower-middle income bracket for more than 15 years since 2007.

Mathur & Agarwal(2022) in their article explain that most of the startups failed during the first year of starting its operation. One of the most common reason is the lack of funding. Money is life and blood of business. Startup cannot survive without adequate financial support.

Sivaprakash & Joseph(2016) in their journal article point out that Ease of doing business index highlight the important role of the government policies in the day-to-day life of domestic, small and medium-size firms. The regulations must be efficient, accessible to all who use them and simple in their implementation. Where regulation is burdensome, it diverts the energies of entrepreneurs away from developing their businesses

Sahu et al(2025) in their research study point out that e-governance initiatives and ease of doing business and its variables dealing with construction permit, starting a business, e-taxation and e-banking have positive correlation.

Kalyanaraman et al (2020) studied both successful and failed startups and came out with their analysis of distinctive features of startups. They compared successful startups and failed tech startups. They studied the profiles of startups and its founders, and studied its impact on success or failure of startups across its lifecycle stages.

Barki & Nagaraju(2025) opine that startups face challenges including difficulty securing financial resources and funding, finding and retaining skilled talent in a limited local pool, navigating complex government regulations and bureaucratic hurdles, building strong brand awareness and understanding market needs, and establishing supportive infrastructure.

Patel et al (2025) in their study found that Key challenges faced by startups include educating consumers about innovative technologies, navigating complex government support programs, and transforming creative concepts into market-ready products.

Mankani(2022) in his article opines that start-up entrepreneurs are highly optimistic in their approach while starting their enterprises. The adrenaline rush of starting something new based on their own creative ideas, usually results in overlooking of important basic ground rules which are associated with every business idea. Moreover unforeseen challenges become unsurmountable due to limited resources & over-dependence on inhouse management expertise.

Dr Gupta, Amit kumar(2022) studied startup failures and came to the below conclusions - because of some challenges like lack of capital for expansion, wrong pricing, and management issues. Lack of market need is another major challenge for startups. Sometimes, the team fails to come up with the right business model to solve real-world issues.

Dr Gupta, Rajendra(2025) identifies key factors contributing to failure of startups, including operational mismanagement, governance issues, inadequate market research, and poor financial discipline. In his study, he emphasizes that honesty, integrated operations, rigorous market research, and frugal spending are critical for achieving sustainable growth and reaching break-even within three years.

Khairajani et al(2024) in their research have identified factors that leads to failure of startups. They highlight the factors such as lack of proper planning and execution, poor market research, lack of innovation, lack of funds, lack of customer focus, lack of communication with customers, poor customer acquisition, lack of marketing strategy, team composition of startup founders etc.

It can be seen from the above literature survey that there are many factors that affect the startup growth and or failure resulting in closure of startups.

Government has taken these factors into consideration and have come up with number of policies and programs to facilitate setup, growth, and closure of startups where necessary.

Design/Methodology/Approach:

This paper is based on the discussions held with startup entrepreneurs who are running their first startup or entrepreneurs who have moved to a serial entrepreneur role. It also makes use of the various documentation available about startup policies and programs in the country.

Government policies that facilitate startup setup, growth and closure of startups

Registration of startup has also been made easy in the government policy. Registration as a startup needs minimal documents. The documents required are Proof of Legal existence of entity, Permanent Account number(PAN), brief of business, details of directors/partners of the business, the entity Digital signature certificate(DSC) for the director/Partner or authorized signatory applying on behalf of the entity. The registration can be done online by creating a login account, and uploading all the documents mentioned. Some of the declarations have to be made in stamp paper and uploaded. Overall it is a simplified process.

Government of India has realized the need for “faster exits”. They have included it in the startup playbook document released by the Department for promotion of industry and internal trade, Government of India. In this policy document, they have outlined the exclusive benefits for startups recognized.

The recognized startups are eligible for a host of benefits ranging from access to Government funding schemes, regulated funding instruments and avenues, tax exemptions, and other regulatory relief and exemptions for ease of doing business.

The policy also provides operational relaxations under companies act 2013 and rules thereunder for Recognised startups. Some of the relaxations include – cash flow statement is not required to include with financial statements, signing of annual return can be signed by director of the company. In terms of board meetings, 1 board meeting in each half of a calendar year with a gap between two meetings of not less than 90 days is sufficient.

The recognized startups also enjoy relaxations and exemptions for direct and indirect taxation for recognized startups. There is 100% tax exemption on profits for three years under section 80-IAC of the income-tax act 1961. Relaxation is allowed for carry forward and set-off loss by startup under section 79 of the income tax act 1961. Relaxation is also given in terms of Goods and Services tax(GST). GST exemption on taxable services provided or to be provided by Technology Business Incubator (TBI), science and technology entrepreneurship parks or bioincubators. Further for the benefit of recognized startups, deferring deduction in respect of income pertaining to employees stock option plan is allowed. Relaxation is also provided in the form of GST exemption on services provided by an incubate as defined for the purpose of GST.

Startups notified as "Fast track firms" enabling them to wind up operations within 90days vis-à-vis 180 days for other companies. The challenge lies in the implementation of this well thought out policy.

Experience from startups in America

It is good to get a comparative picture from other countries such as United states. Pattnaik et al (2024) explain that understanding the intricate factors that influence startup success is vital for investors, policymakers, and entrepreneurs alike. From a dataset of 923 US startups founded between 1984 and 2013, we determined that 80 percent of the firms can be considered successful in terms of having belonged to the 500 Global group of high-potential and fast-growing firms receiving specific, competitive venture capital funding. Additionally, from the dataset, 65 percent of firms were eventually acquired. Their three key findings emerged are (1) startup and acquisition rates declined and start-up closures increased after each financial crisis; (2) startups funded by VC received higher amounts of funding than those funded by angel investors; and (3) successful startups had received approximately twice as much funding, 30 million USD compared to 15 million USD, as those that failed.

The above aspects give us an idea on what changes to implement in India, for startups.

Startup closure in America

Startup closure in USA has to be done carefully, following the due process. Other-wise it has consequences for the founders. It is seen that every year, numerous entrepreneurs decide to exit their startup businesses hastily.

They would have potentially received venture capital funding. If they decide to close hastily, they will leave behind a trail of financial obligations. They might leave taxes unpaid. The registered company agents resign and disappear. Filings with the government are neglected. These oversights can turn into serious legal and financial consequences for the founders.

Pedrassa, Jessica(2024) identifies the following six potential business closure mistakes in USA. They are 1) not following legal protocols, 2) Ignoring tax obligations 3) Overlooking outstanding debts 4) Neglecting employee rights 5) Poor asset management and distribution 6) Mishandling intellectual property.

Due process has to be followed in each country and state within the country, in which the startup operates.

Startup closure in India

India has also a well laid-out process for startup closure. Similar to startup company incorporation, due process has to be followed while closure also. It helps to avoid financial fines, and legal risks of non-filing of annual compliances. It is important for the founder to take professional help and be aware of the closure process which includes required documents, advantages of proper closure, fees, timeframe etc. For Indian startup companies, The company closure is administered by the Section 248 of the Companies Act, 2013. Moreover, such companies should also comply with the Companies (Removal of Names of Companies) Rules, 2016. There are many steps to follow – 1)seek consent of members of the company 2) Check annual filing status 3) closure of bank accounts 4) surrendering other registrations and licences 5)Indemnity bond and affidavits of all directors, 6) Preparing statement of accounts 7) Applying for striking off company name etc. The necessary fees has to be paid depending on the factors such as share capital of the company. The startup founder cannot do all this without professional help which involves cost and time. The duration can take 1-3 years depending on the size of the business.

Experience from startups in India

Krishnamurthy(2025) studied the closures of startups and came out with this observation. He examined the unprecedented wave of startup closures that swept through India's entrepreneurial ecosystem between 2023-2024, resulting in the closure of 28,538 startups-representing a staggering 9.3x increase from the previous three-year period. The analysis reveals nine critical failure factors, with funding winter and unsustainable business models emerging as primary drivers of this massive ecosystem correction. The other failure factors are c) high cash burn and growth-at all costs mentality, d)Lack of product-market fit e) poor financial planning and cash flow management f) Leadership, Team and Governance weakness g) Regulatory and compliance hurdles, h) inefficient scaling strategies i) Customer retention challenges j) Macro-economic and global shocks.

Case study from startup founder experience in India

Ease of doing business for startups' is one big overarching reform India needs today, says an AI firm founder(name of startup and founder's name not disclosed for their safety), who shared how he lost more than $100,000 due to 'poor processes/laws in India. He had incorporated his startup in USA with an Indian subsidiary to have R&D team in India doing the research work. It is commonly done in the startup world to attract funding from global investors. The new laws introduced Overseas Direct investment (ODI) process, makes it difficult to raise from Indian investors and also hire advisors. It took more than 7 months to try to raise funds from Indian Angel investors under the ODI process. At the working level, the officials handling the paper work were not fully aware of the process. They were making him produce documents on a continuous basis. It is part of the sarkari culture and process of government officials. These document requirements were made on the fly. Such a painful process makes it difficult to attract investors to startups. In addition the Good and services tax (GST) process also makes it harder for the tech startups. Many startup founders have to resort to bribery to get things done in India. He has compared the process followed in silicon valley bank(SVB) vis-à-vis Reserve Bank of India (RBI)in India. He found that it is much easier to raise funds in USA. It is also easier to onboard advisors in USA. For such US-incorporated entities which want to do R&D with team in India, it is difficult to welcome Indian advisors. The reason cited was that it is difficult to allot shares to advisors who are not full time employees. It led to multiple advisors backing out as the paper-work was never finished. It leads to both time and money loss for the startup founder.

Findings:

The entrepreneurs and those hesitant to startup have long realized this challenge. The policy makers and other legal functionaries have also realized the need for change in systems. Some have voiced about the need for change, but nothing much has changed. So, there is a long way to go, to make it an entrepreneur-friendly system. The need of the hour is to simplify the entry and exit procedures for the startups.

Practical/theoretical implications:

The closure of startups is currently a lengthy process in India. The bureaucratic approach calls for example filing of empty GST (Goods and Services Tax) reports to show that there is zero revenue. . Annual tax filings are required to be submitted even with no revenue. There are many other statutory reports that have to be submitted to the authorities on a regular basis, even for the now defunct company. While this generates services revenue for the chartered accountants, it is a drain on time and money of the entrepreneur.

Originality/Value:

Various aspects of setting up startups have been discussed and published in academic research. The current literature focuses on encouraging entrepreneurs to get started. Very little research has been done towards helping entrepreneurs to close operations and move on to new ideas/products etc. Hence this is an original attempt at solving a genuine issue faced by startup owners and entrepreneurs.

Conclusion:

Based on discussions with industry stakeholders, in this paper we have briefly discussed how the same journey is done in India vis-à-vis America and how significant changes are needed to be done in the legal and financial systems of the country. Some of them are: (a) The changes should allow fail-fast which is needed for tech start-ups in particular. (b) The legal and financial system should allow for quick shutdown of startups when the situation arises. (c) Funding is a challenge for startups in general and changes should be done to make VC and Angel investments accessible for the larger set of startups. (d) while the government policies and programs are drafted in excellent manner, the implementation through the bureaucracy reduces their impact. The bureaucratic approach needs to be changed.

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