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A study on the ground reality of startup India and the legal and compliance challenges faced by startups

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Abstract:
Startup India is an initiative that started in 2016 and the focus is to improve innovation and entrepreneurship through policy point incentive and ease of regulations. The difference between the promise of the policy and the reality is very huge even though the organization has been in a position to identify more than 2 lakh startups as of the beginning of 2026.

The paper shall focus on the insight and application of the Startup India benefits and the massive legal and compliance issue of the Indian startups in 2026. As per primary data derived on the basis of representative sample of tech-based start-ups in the early-stage, the level of awareness about the DPIIT recognition and benefits are moderately high, but intellectual property, labour laws, GST and the DPDP Act 2023 compliance burden is high.

It is time and cost intensive that is disproportionately true to both early and Tier 2/3 start-ups. The proposed study is based on one digital portal, sector-specific toolkit, and subsidized assistance as the means of eradicating the policy-practice gap and benefits the Indian ecosystem of startups.

Keywords:
Start up India, compliance issues, DPIIT recognition, DPDP Act, regulatory burden.

1. Introduction:
The project that was implemented by the Department of Promotion of Industry and Internal Trade (DPIIT) in 2016 under the process of impacting the innovation, entrepreneurship and employment was called Startup India. It is advantageous as it is identified by DPIIT, as tax-exempt in section 80-IAC, self-certified in labor and environmental clauses, speedy in the registration of IPR and subsidies such as Fund of Funds of Startups. Over 2 lakh registered startups in DPIIT already provided millions of people with a job, and, on top of that, such sectors as IT/software, fintech and healthtech have increased exponentially by the turn of 2026.

But the fact in the field, and more so in urban and semi-urban India is that larger proportion of the founders, namely in the early days, lacks a correlation between the promise and the practice in the matters of policy. The burning policy (including the Digital Personal Data Protection Act 2023, revised RBI regulations of fintech, health data structures) introduced new compliance costs, but the already existing issue of multi-agency filing and red tape did not change. This paper will be anchored on experience of the representative sample of Indian startups and how the issues surrounding the legal and compliance-related matters affect their survival and growth in 2026.

2. Problem statement:
Even with the great changes that are proposed by Startup India and the advancements that have been reported (e.g., the possibility of tax holidays until March 2025, the removal of angel tax since April 2025), even at the initial level of its formation, startups need to get the problem of higher legal and compliance costs out of the way. Expensive compliance, meager industry-specific guidance and ignorance of the advantages and duplication of regulations (GST, labor regulations, DPDP, industry licensing) incur a cost to the short-term operations, funding issues and coercive closures. It is a serious crisis when we are facing the resource-intensive and tech-intensive investments to the Tier 2/3 destinations in which the professional legal advice is quite sparse. The following work will answer one of the main questions: What is the actual performance of Startup India in the sphere concerning the assistance in terms of decreasing the legal and compliance problem of the modern Indian startups?

3. Objectives:
1. To research the awareness of the population on the Startup India initiative.
2. To determine the discrepancy between the government policies and the reality on ground.

4. Research gap:

The existing literature and the governmental reports rely on the macro-level performance in terms of the number of recognitions, the creation of jobs, and the redefinements of the policies. Even though this is an indicator of the success rate (e.g., over 2 lakh startups established by 2026), minimal empirical and primary research will record the extent to which the ground reality at the micro-level will exist beyond 2023. It has certain loopholes: it did not focus on the recent changes in the regulations (DPDP Act, abolishment of the angel tax); it did not include an adequate number of early-stage (pre-seed/ seed) and Tier 2/3 startups; it lacked experience in the industry (fintech and healthtech) and the way founders perceive the cost and benefits of compliance. This gap will be bridged by the research by offering first-hand survey data in 2025-2026 cohort offer of giving actionable data to complement the aggregate statistics.

5. Review of literature:

The Startup India plan by the department of promotion of industry and internal trade (DPIIT) was one of the initiatives that have been mostly regarded to encourage entrepreneurship with DPIIT recognition, tax incentives, self-certifications and expedited processing of IPR that was introduced in 2016. According to the official distributions, such initiatives have contributed to the development of more than 200 thousand recognised startups, to be more specific, IT/software, fintech, and healthtech (Department for Promotion of Industry and Internal Trade, 2025).

Along with these accomplishments, there are studies that also indicate the general incompatibility between policy making and the ground level actions. In the article which can as well be called an analytical essay, i.e., Comparative Analysis of Legal Challenges Faced by Startups in India and Bangladesh: The Way Forward by Singh et al. (2024), it has been stated that following the reforms in the Startup India, four main problems affecting startups are identified, i.e. regulatory uncertainty, excessive compliance costs, intellectual property, and a variety of issues associated with taxation and data privacy.

New regulatory pressures have also been discussed in the most recent literature. According to the article Startups and the Digital Personal Data Protection Act, 2023 and the Draft Rules 2025: Compliance and Challenges, Nigam (2025) stated that the DPDP Act 2023 places a heavy burden on resource-intensive startups (especially fintech and healthtech startups) to comply with the conditions under the act including consent management, data audits and breach-notification requirements.

According to Khaitan and Co. (2025) in the India Startup Law and Policy Guidebook, although angel tax was eliminated in 2025, there are still many funding issues of early-stage venture connected with the excessive number of filings (GST, labour, MCA) and high compliance costs. Similarly, in the article Start-up Ecosystem and Company Law in India, Pathak (2024) has identified the variations between regions, in which Tier 2/3 startups are less aware and more bureaucratic.

Combined, the reviewed literature shows that even though the macro-level ecosystem has become more resilient due to the initiative called Startup India, micro-level problems, such as the cost of compliance, lack of industry-related guidance, and gaps in implementation continue to undercut the sustainable growth of early-stage ventures.

The provided research relies on these findings and examines the awareness, usage and effectiveness of the Startup India benefits in contrast to the actual situation of legal and compliance with which startups will work in 2026.

6. Research methodology:

The research is descriptive and exploratory.

Primary data: Online questionnaire - structured questions questionnaire, which will be sent to 100 founders/co-founders of startups (purposive sample selection of startups through LinkedIn, Startup India Hub and incubator networks). The sample gives the demographics: IT/Software (41%), Fintech (18%), Healthtech/Biotech (12), E-commerce (11), Edtech (7), Cleantech (6), Others (5); Stage: Seed/MVP (40%), Pre-seed/Idea (30%), Early Growth (24%), Mature/Growth (10); Location: Tier 1 (55) Tier 2 (35), Tier 3/Rural (10);

Secondary data: The official reports on DPIIT, Start-Up India portal, RBI/SEBI rules and provisions of the DPDP Act and recent policy announcements (2024-2026).

7. Analysis and interpretation:

Demographics of the respondents:

The profile of a startup in India is represented in the sample of this research. Most of the startups belong to the technology sector with IT/Software topping 41 followed by Fintech 18 then Healthtech/Biotech 12. The majority of them are in their initial stages, 39% of them are in Seed/MVP phase and 27% are in the Pre-

seed/Idea phase. This analysis has been made to fit in the geographical terrain with 55 percent being in the Tier 1 cities, 35 percent being in the Tier 2 cities and 10 percent being in the Tier 3 or rural regions. Regarding the team size, 39 percent of them have less than 5 employees and 32 percent have 5 to 10 employees. Concerning the year of incorporation, 40 percent had been initiated in 2021- 2023 and 30 percent in 2024-2026. This sample provides a clear idea of the fact that the Indian startup ecosystem is dominated by young and small and technology-oriented companies.

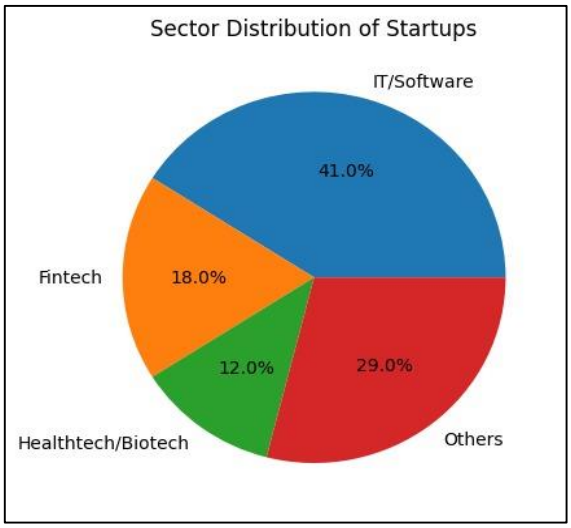


CHART 1

Startup India awareness and ground reality:

Only 51% of the startups had been recognized by DPIIT. Startups in the Early Growth stage (67%) had been identified as more opposed than Pre-seed stage (41%). The average score of Startup India on effectiveness were 3.32 of 1-5 which is a moderate rating. Many founders welcomed the accelerated incorporation and tax incentives, however they reported that other problems such as bureaucratic slow down and awareness especially in the Tier 2 and Tier 3 cities were experienced. The benefits include some of the following. Various startups took advantage of tax exemptions and self-certification but the amount of funding schemes was small because the requirements to join the schemes were complex.

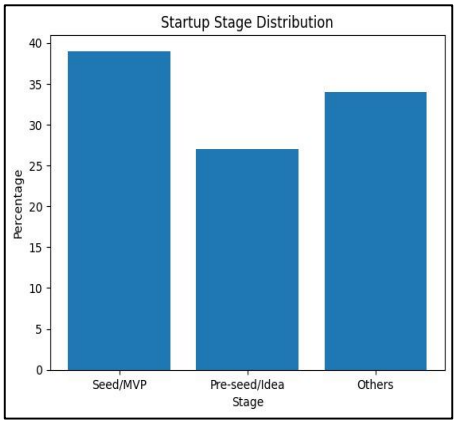


CHART 2

Legal and compliance issues:

The biggest issue was on the protection of the intellectual property, whose average score of severity was 3.85 out of 1-5. This went in line with labour laws and employment compliance (3.61) and taxation and GST compliance (3.59). Data privacy in DPDP Act 2023 had a moderate score of 3.18. Many startups have testified that compliance activities are consuming a lot of time of the founders. Further,the percentage of those who had been penalized or noticed by the government in the last two years was 27 percent, small teams of less than five employees were faced with more difficulties. The average cost of compliance per year sample was 1.35 lakh and up to less than 50,000 to 2 lakh per year was expended by nearly half of the startups. This pressure was

more felt on the startups that are in their early stages as the revenue of startups in their early stages is usually minimal.

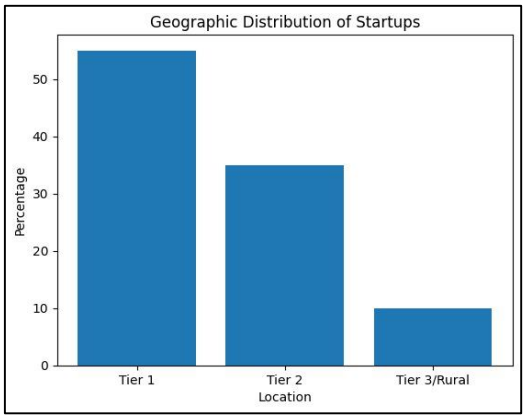


CHART 3

Comparison between DPIIT- Recognized and non- recognized startups:

The recognized startups (3.78) ranked Startup India as more effective than non-recognized (2.81). They also recorded a lower score of severity in most of the compliance areas especially incorporation and registration. However, intellectual property, labour and taxation were still to be the bane even to the known startups. This shows that in spite of DPIIT recognition, which will alleviate some of the burden, the compliance burden will not be entirely removed.

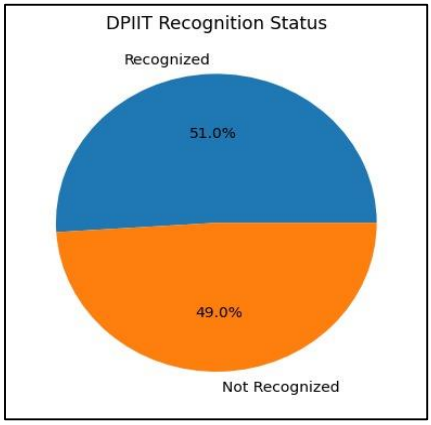


CHART 4

Impact on startups:

The compliance requirements are taking up a significant amount of time and money to the business. The majority of the founders confirmed that they spend more than 30 percent of their time on regulatory matters. Pre-seed startups and seed-stage startups are particularly sensitive to financial pressure. The issues are more likely to result in premature failure and expansion lag of a promising venture. The findings make it clear that in spite of certain convenient changes already introduced such as simplified incorporation and the elimination of angel tax in, some other reforms are still necessary. At the level of policy intention and the actual reality on the ground, there is a massive mismatch, as experienced by the entrepreneurial efforts of most early-stage startups and especially in small cities and within new industries like fintech and healthtech.

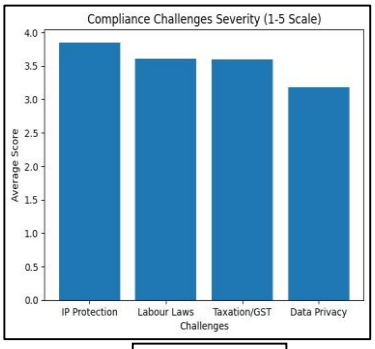


CHART 5

8. Findings:

1. Low Recognition rate of DPIIT - DPIIT recognition rate among startups in the surveyed groups was at a low point 51%. The stage with the highest recognition was the Early Growth stage (67%); it was almost two times greater than the Pre-seed stage (41%).
2. Average Impact of Startup India - The Startup India program has been rated as medium regarding its general effectiveness at 3.32 out of 5. Founders were having faster incorporation but regretted the Tier 2 and Tier 3 cities foot-slowness and lack of knowledge.
3. Material Compliance- The conflictual was the greatest in the Intellectual Property (mean score 3.85), the labour laws (3.61) and the GST/taxation compliance (3.59).
4. Time - Compliance is a time consuming process and a large percentage (more than 30 percent) of the respondents actually devote to a higher percentage of time in compliance.
5. The compliance cost was 1.35 lakh per annum on average. Far less than half a million start-ups spent between 50,000-2 lakh almost equally in piling a titanic load upon young business.
6. Fine/warning - at least one-fourth of the startups have been fined or received a warning in the past two years with the most probable being small teams(less than 5 employees).
7. Biased Benefit of DPIIT Recognition - The benefit also had fewer compliances in DPIIT-recognised start ups compared to non-recognised start ups which claimed to be having several issues in IP, labour and taxes.
8. Status Quo PolicyGap -The presupposition of the real benefits of Startup India policy is inconsistent with the situation on the ground even in pre- seed/ seed firms or even in Tier 2/3 cities firms.

9. Recommendations:

1. Single Digital compliance portal Single web based portal in which the MCA, GST, DPIET and the industry regulators and assisted checklists exist where the filing is possible.
2. Heavy Self Certification Self certifying fintech and healthtech startups of the add-on law and regulation sandboxes.
3. Awareness and Training Programmes- involve the introduction of regular web based and industry specific compliance tool kit with certain emphasis on the start-up in the level 2 and level 3 cities.
4. Compliance Financial Support- The compliance financial support will be a one year legal and compliance cost of start ups in their early times and are DPIIT-recognized.
5. Ease of Eligibility- simplify the DPIIT recognitions and simplify the introduction phase when it comes to development phase of the start up.
6. Periodical Ground Reality Audit - To ensure that the plan of Startup India will be alleviated on a regular basis, make regular audits (in the form of feedback).
7. To Additions To Combinations of State Rankings In Startup Ranking Framework of the States Compliance facilitator index and implementation index.
8. Law- Tech start ups and Mentorship support - Law firms and Incorporation ought to enable pro-bono mentorship and Legal start up.

10. Conclusion:

Startup India in literal sense as a matter of fact has been the catalyst of the Indian entrepreneurial ecosystem in accordance with which 2 lakh startups will be established and millions of jobs will be generated in India by the year 2026. At ground reality with the majority of entry stage founders, but majority of the rest in the fintech and healthtech and Tier 2/3 destinations namely is that of high compliance friction that provides an excessive uptick to the excessive policy. This can be extrapolated as the actual driver of sustainable development and not a recognition scheme as it has given the policymakers the necessary knowledge gaps re-architect their work

and assist them in the face-off with the reality of the stage and industries. The paper suggests the implementation process by the flows of information based implementation as a continuous process of ensuring that the vision of start up of India is converted to the scaled up, compliant and globally competitive business ventures. The policymaking gap is not the most desirable thing that might have occurred, yet the key to the decade of innovations and job creation of the ecosystem.

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