Manuscript ID: TIJCMBLIR-2025-020646

Volume: 2

Issue: 6

Month: December

Year: 2025

E-ISSN: 3065-9191

Submitted: 19 Nov. 2025

Revised: 30 Nov. 2025

Accepted: 18 Dec. 2025

Published: 31 Dec. 2025

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DOI: 10.5281/zenodo.20725640

DOI Link:
https://doi.org/10.5281/zenodo.20725640

Why Indian Startups Pack Their Bags and Leave: The Flipping Phenomenon, Sovereignty Loss, and the Road Back Home

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Abstract

India is the third-largest startup ecosystem in the world. That is a fact worth celebrating. But there is a less-celebrated fact sitting right next to it — a surprising number of India's most successful startups quietly moved their legal headquarters to Singapore, Delaware, or Dubai before they ever became famous. This practice, known as "flipping," is not a tax scam or a betrayal. It is a rational decision made by founders who found that building a company inside India's regulatory maze was simply too painful. This paper examines why Indian founders flip, what India loses when they do, and why the recent "reverse flipping" trend — where companies like Razorpay, Zepto, and Pine Labs are coming back home — is more complicated than it appears. Drawing on secondary institutional data, published case studies, regulatory filings, and the broader academic framework of Institutional Void Theory, this paper argues that flipping is a symptom of a deeper disease: an ecosystem that was built to control businesses rather than enable them. Until India fixes the underlying regulatory, legal, and financial conditions that push founders abroad, reverse flipping will remain a painful, expensive process — and the next generation of founders will keep looking for the exit.

Keywords: *data sovereignty, venture capital, India, startup ecosystem, institutional voids, regulatory friction, reverse flipping, startup flipping*

Introduction

Picture a founder. She is twenty-eight years old, has spent three years building a fintech product that genuinely helps small shopkeepers in Rajasthan access credit for the first time. She has a working product. She has early users. She has a venture capital firm from Singapore that is ready to write her a cheque for two million dollars.

Then the paperwork begins.

She needs to comply with FEMA — the Foreign Exchange Management Act — which governs how foreign money enters an Indian company. She needs a valuation certificate from a Merchant Banker, a requirement under Section 56(2)(viib) of the Income Tax Act, to prove that her investors are not paying more than her company's "fair market value" — because if they are, the excess amount gets taxed as income. She needs to file FC-GPR forms with the Reserve Bank of India. She needs separate compliance for her data handling under India's evolving privacy laws. And she needs to do all of this before she can touch a single rupee of that investment.

Her lawyer tells her it will take four months and cost roughly fifteen lakh rupees in fees. Her Singapore-based investor tells her there is an easier option. Incorporate a holding company in Singapore. The Singapore entity raises the money. The Indian entity becomes a wholly-owned subsidiary. Done in three weeks. Total cost: a fraction of the Indian route.

She does it. She flips.

This is not a story about one founder. Between 2012 and 2022, thousands of Indian startups made this same choice. Some estimates suggest that more than half of India's "unicorn" companies — the ones valued at over one billion dollars — were, at some point, incorporated outside India. The companies were Indian in every meaningful sense: the founders were Indian, the employees were Indian, the customers were Indian, the problem being solved was an Indian problem. But the legal entity that owned everything was registered in Singapore, or Delaware, or the Cayman Islands.

This paper tries to understand why that happened, what it cost India, and whether the recent wave of companies choosing to come back actually solves the problem.

How to Cite this Article:
Richhariya, R., & Dubey, C. B. (2025). Why Indian Startups Pack Their Bags and Leave: The Flipping Phenomenon, Sovereignty Loss, and the Road Back Home. The International Journal of Commerce Management and Business Law in International Research, 2(6), 222–226.
https://doi.org/10.5281/zenodo.20725640

Literature Review: What We Know About Why Companies Leave

The academic research about regulatory arbitrage which involves choosing a jurisdiction based on its legal system rather than its geographic location has been thoroughly established through research about multinational corporations. Apple and Google use international tax systems to create their operational structures which reduce their tax obligations. The existence of flipping in India shows a pattern which differs from all other cases. The process does not exist because people want to decrease their tax responsibilities. The process exists because founders cannot successfully manage their businesses through the institutional structures which exist in their home countries.

Khanna and Palepu's foundational work on Institutional Voids explains the core problem clearly. The study shows that businesses in developed economies depend on various specialized intermediaries which include reliable credit rating agencies efficient legal systems transparent financial markets and clear contract enforcement mechanisms. Businesses in emerging markets encounter institutional gaps which Khanna and Palepu describe as "institutional voids" because essential intermediaries do not function or do not exist. The voids increase costs for operational activities which thus create unpredictable situations that make businesses use their resources to solve problems which should not exist.

The three institutional voids which most impact Indian startups exist within the legal and regulatory system and the capital markets and the exit ecosystem. Each of these voids, on its own, is manageable. The two factors together establish a situation which causes advanced founders to select international operations with their investors who possess advanced expertise.

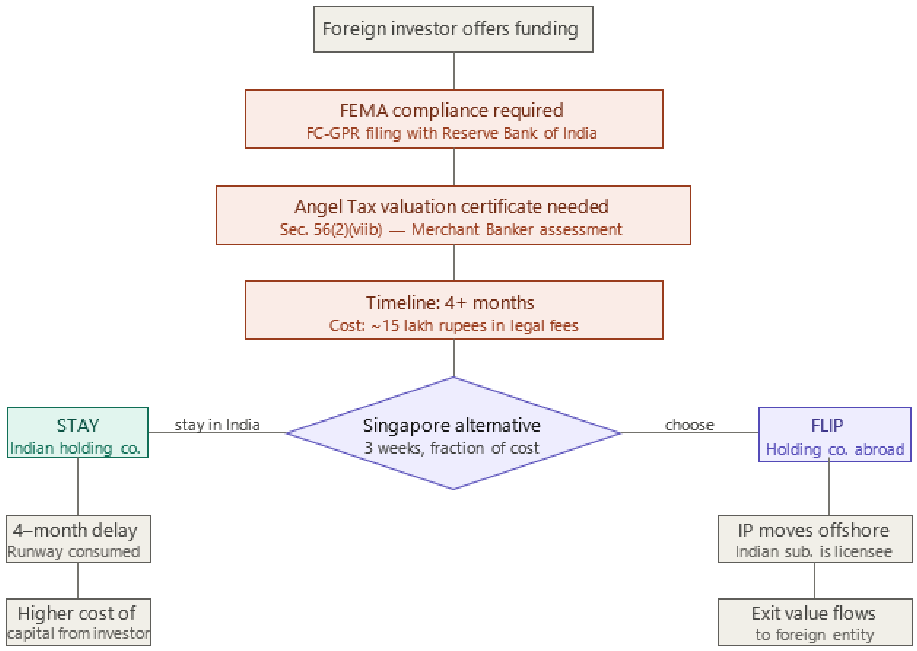
Dossani and Kenney's 2002 research about Indian venture capital markets showed that structural problems existed within the industry. The researchers discovered that Indian venture capital markets remained underdeveloped because existing equity investment laws required startups to follow rules designed for regular companies. The existing frameworks have seen improvements during the past twenty years, but they fail to match the development of the surrounding ecosystem.

Krishnamurthy's recent research about venture capital and financing innovation in India demonstrates that Indian startups depend on foreign equity because they require foreign investors to fund their growth needs. The practice of flipping leads to a mismatch between what investors expect and the actual market conditions that exist.

Research about "sovereignty risk" in digital economies has emerged as a recent field of study that continues to expand. The process of flipping a startup leads to more than just a change in its legal business location. A company transfers its intellectual property rights along with its data assets and future financial gains. The practice of permitting foreign organizations to own data collected from Indian citizens and Indian business transactions creates a real risk for national economic security in the twenty-first century which values data as its most important resource.

Why Founders Flip: A Detailed Look at the Actual Reasons

Understanding flipping requires resisting the temptation to oversimplify. Founders do not flip because they are disloyal to India or because they want to avoid taxes. They flip because the Indian regulatory environment makes certain things genuinely difficult, and the costs of those difficulties are real.



The Regulatory Predictability Problem

India's regulatory environment for startups is not just complicated — it is unpredictable. A startup can build its entire business model around a regulatory interpretation, and then find that interpretation reversed by a circular from the Reserve Bank of India or a new classification from the GST Council. This happened to digital wallet companies after the 2022 prepaid payment instrument regulations. It happened to online gaming companies when the GST classification changed. It happened to peer-to-peer lending platforms multiple times over a decade.

Singapore and Delaware, by contrast, offer something that Indian founders desperately want: predictability. Their legal frameworks for equity investment, intellectual property ownership, and contract enforcement are clear, stable, and tested. When a founder signs a shareholders' agreement under Delaware law, she knows exactly what it means and what courts will do if it is violated. The same cannot always be said for agreements governed by the Indian Companies Act in an environment where commercial courts face backlogs measured in years, sometimes decades.

This is not an abstract concern. For a startup negotiating a Series A round with an international investor, legal predictability is directly connected to the cost of capital. When investors perceive higher legal uncertainty, they demand better terms — more equity, more control rights, lower valuations. Flipping to a predictable jurisdiction is, in many cases, the only way to access capital at terms that make sense for the business.

The Exit Ecosystem Gap

Here is a question that sounds simple but is actually crucial: if a venture capital firm invests in an Indian startup, how does it eventually get its money back?

In a mature ecosystem, there are several answers. The company goes public on a stock exchange. Another company acquires it. Early investors sell their shares in a secondary market transaction. The company generates enough profit to buy out investors.

In India, the first two options have become more viable since 2021, when Zomato and Nykaa conducted their initial public offerings and demonstrated that Indian tech companies could list domestically. But for most of the decade between 2010 and 2020, the domestic IPO market for loss-making technology companies was essentially closed. The secondary market for private shares barely existed. Corporate acquisitions of startups were rare because Indian conglomerates preferred to build their own digital arms rather than acquire.

This meant that for most international venture capital firms investing in Indian startups, the only reliable exit was a sale to another fund or an IPO on a foreign exchange. Both of these options were significantly easier if the holding company was incorporated in Singapore or the US. The exit ecosystem gap, more than almost any other factor, drove the institutional pressure to flip.

The Angel Tax — A Case Study in How Not to Design Policy

The "Angel Tax" — formally Section 56(2) (viib) of the Income Tax Act — deserves special attention because it is perhaps the clearest example of how well-intentioned regulation can have devastating unintended consequences for startups.

The provision was originally designed to prevent money laundering through shell companies by taxing investments that came in at valuations above "fair market value" as income. When applied to genuine early-stage startup investments, it created an absurd situation. A startup that raised money from an angel investor at a pre-revenue stage — when valuation is inherently speculative — could find that the entire investment was treated as taxable income if the Tax Department's own valuation model arrived at a lower number.

The practical effect was to make Indian angel investors deeply reluctant to invest in early-stage companies. Why take the risk of your investment being reclassified as income for the company you are trying to help? The result was a collapse in domestic seed-stage funding that pushed founders toward foreign investors — and toward flipping their companies to accommodate those investors.

The Angel Tax was eventually modified and partially exempted for DPIIT-recognized startups, but the damage to the culture of domestic angel investment had already been done. More importantly, the episode illustrated a broader pattern: Indian regulatory systems were designed with traditional businesses in mind, and when applied to startups, they create friction that serves no legitimate public interest.

Intellectual Property and Data Sovereignty

When a startup flips, its intellectual property typically moves with the holding company. The patents, the proprietary algorithms, the data assets — all of these are owned by the foreign entity. The Indian subsidiary licenses the right to use them in exchange for royalty payments that flow back to the parent.

This has significant long-term economic consequences. When a company eventually exits — through an IPO or acquisition — the financial gains accrue to the shareholders of the foreign entity. If those shareholders are mostly foreign venture capital funds, most of the wealth created by Indian innovation flows out of India. The Indian employees may have ESOPs that generate some returns, but the primary value capture happens offshore.

The data sovereignty dimension is equally concerning. Indian users generate data while using these products. That data — purchase histories, health records, financial transactions, communication patterns — is processed and stored under the laws of the jurisdiction where the company is incorporated. India's own data protection framework was still being finalized well into the 2020s, leaving a period of years during which Indian user data was governed primarily by foreign legal frameworks.

What India Actually Loses

The direct financial cost of flipping is hard to measure precisely, but it is real and it is large. Every rupee of value created by an Indian startup that is ultimately captured by a foreign holding company is, in economic terms, a transfer of national wealth. When Flipkart was acquired by Walmart for sixteen billion dollars in 2018, the primary beneficiary was SoftBank, Naspers, Tiger Global, and other foreign funds that held equity through Singapore and Cayman holding structures. The Indian founders and employees received some value, but a large share of the gains left the country.

Beyond the financial dimension, there are three other categories of loss that deserve attention.

The first is tax revenue. When profits are earned in India but booked through holding companies in low-tax jurisdictions, the Indian government loses corporate tax revenue that should rightfully belong to it. This is different from the individual tax avoidance associated with multinational corporations — the amounts involved in startup exits can be enormous.

The second is regulatory learning. When India's most sophisticated businesses operate primarily under foreign legal frameworks, India's domestic regulators miss the opportunity to develop expertise in governing modern technology businesses. The best way to build regulatory competence is through experience with the actual companies being regulated. If those companies are operating under Singapore law, Indian regulators do not get that experience.

The third, and perhaps most important, is the cultural signal that flipping sends to the next generation of founders. If the message that circulates in startup communities is that building in India is painful and that serious founders eventually move their companies abroad, it creates a self-fulfilling prophecy where the most ambitious people plan for an exit from Indian jurisdiction from day one rather than working to improve the domestic ecosystem.

The Reverse Flipping Trend — Coming Home Is More Complicated Than It Looks

Since 2022, several prominent Indian startups have made headlines by "reverse flipping" — moving their holding companies back to India. Razorpay, Zepto, Pine Labs, and others announced plans to redomicile to India, often in preparation for domestic IPOs.

This is genuinely good news. But it is worth being clear about why companies are doing it and what the process actually involves, because the narrative of "homecoming" obscures some important complications.

The primary driver of reverse flipping is the maturation of India's domestic capital markets. The success of domestic tech IPOs created a credible exit pathway that did not require foreign incorporation. For a company planning to list on the NSE or BSE, it is significantly simpler to have an Indian holding company. The regulatory benefits of foreign incorporation become less valuable when the planned exit is a domestic IPO.

But the process of coming back is not simple. When a company redomiciles to India, the share exchange that moves equity from the foreign entity to the Indian entity can trigger capital gains tax obligations. The FEMA implications of inbound mergers are complex. Legal fees for managing the restructuring can run into crores of rupees. Nishith Desai Associates, one of India's leading technology law firms, has noted that the "Repatriation Tax" on success can be substantial — companies are essentially paying a penalty for having been forced to leave in the first place.

The deeper problem is that reverse flipping is being driven by financial incentives rather than by genuine improvements to India's regulatory environment for early-stage companies. The same Angel Tax problem that pushed founders abroad still exists for new companies. The same FEMA complexity still applies to new foreign investments. The same predictability gap in regulatory policy still makes early-stage investors nervous about Indian jurisdiction.

In other words, India is getting its successful companies back, but it has not yet fixed the conditions that caused them to leave. The next wave of ambitious founders is still looking at the same calculus that their predecessors faced.

Policy Recommendations

Based on the analysis in this paper, five specific policy changes would materially reduce the incentive for Indian startups to flip.

First, fast-track regulatory sandboxes for digital businesses. The RBI and SEBI should formalize and expand regulatory sandbox frameworks that give startups a defined period to operate under simplified rules while developing compliance infrastructure. This would reduce the first-mover penalty for building under Indian law.

Second, a single-window compliance system for startup foreign investment. FEMA compliance, DPIIT recognition, income tax valuation certification, and GST registration should be manageable through a single digital interface with standardized processing times. Every week that a founder spends waiting for regulatory clearances is a week of runway consumed.

Third, eliminate or fundamentally restructure the Angel Tax. The current exemption for DPIIT-recognized startups is an improvement, but the underlying provision still creates uncertainty. A clean legislative solution would replace subjective "fair market value" assessments with a simple safe harbor — any investment from a SEBI-registered angel fund or recognized venture capital firm should be exempt from Section 56(2)(viib) without the need for a valuation certificate.

Fourth, develop a domestic secondary market for private company shares. SEBI has taken initial steps toward creating platforms for secondary trading of private securities. Accelerating this development would give early investors a liquidity pathway that does not depend on foreign incorporation.

Fifth, make reverse flipping genuinely attractive through tax policy. If India wants its successful companies back, it should create a formal redomiciliation framework with a clear tax treatment that does not punish companies for returning. A defined restructuring window, possibly timed to planned IPOs, with reduced capital gains treatment for the redomiciliation transaction itself, would accelerate the return of successful companies and signal to future founders that the Indian jurisdiction is worth building in from the start.

Conclusion

The flipping phenomenon is not really about startups preferring Singapore or Delaware. It is about founders making rational decisions in the face of institutional conditions that make building in India more expensive and more uncertain than it needs to be. The good news is that those conditions are mostly policy choices, which means they can be changed. The bad news is that they have not changed fast enough, and the companies that are now coming back through reverse flipping are doing so because India's capital markets have matured, not because the early-stage regulatory environment has improved.

India has every structural advantage it needs to build a world-class innovation economy. The talent is there. The market is there. The entrepreneurial energy is obviously there. What is missing is an institutional environment that matches the ambition of the people building within it. Fix that, and founders will not need to pack their bags.

Acknowledgment

I would like to express my sincere gratitude to everyone who supported and guided me in the successful completion of this project titled “Why Indian Startups Pack Their Bags and Leave: The Flipping Phenomenon, Sovereignty Loss, and the Road Back Home.”

First and foremost, I extend my heartfelt thanks to my project guide/supervisor for their invaluable guidance, constant encouragement, and insightful suggestions throughout the course of this study. Their expertise and support played a vital role in shaping this research work.

I am also thankful to the faculty members and staff of my department/institution for providing the necessary academic resources, facilities, and encouragement required for completing this project successfully.

I would like to express my appreciation to my friends and classmates for their cooperation, motivation, and constructive discussions that helped improve the quality of this work.

Financial support and sponsorship

Nil.

Conflicts of interest

The authors declare that there are no conflicts of interest regarding the publication of this paper

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