

# Creating An Amiable Startup Ecosystem

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**T**he initiatives taken by the Government under the Startup India Action Plan are commendable. The startup industry must be curious and they would be having many questions in their mind regarding the startup India Action Plan. Presently, India is witnessing a very exciting and never seen before phase of the startup ecosystem. The Government has already made many announcements to promote and facilitate startups and many more are to come. Generally, the barriers of entrepreneurs relate to cash strapping, finding the right investor, mentoring, scaling the model, business evaluation, dealing with investors, and compliances, and these areas require to be revisited.

However, in order to create a robust startup ecosystem, with the aim of making the startup India Action Plan more effective, the Union Government needs to incorporate a few suggestive measures.

## Provision of seed funding

Most of the times, it is a costly affair for the young entrepreneurs to set up the company for doing the business. Having very little money at their disposal from personal sources, they are not in a position to form a company unless they get some seed funding. At the same time, investors expect that entrepreneurs should come to them after having company and initial statutory registration. The entrepreneurs are scared, if the investor does not invest then they have to maintain company at their cost. Further, at the time of investment, first startup has to

increase its authorized capital for issuing shares to the investors, which again involve cost to the entrepreneur. It will be a very good step if the deferred payment of (Ministry of Corporate Affairs) MCA fee for (a) incorporation of the company and (b) increase in authorized capital, and be allowed up to 6 months so that after investment, the startup can pay the fee to ROC without any difficulty.

## Rendering a proper timeframe

As per the Startup India Action Plan, the entity shall fall under definition of a startup, if it has not completed 5 years from the date of incorporation/ registration, and shall cease to be a startup if its turnover for the previous financial years has exceeded INR 25 Crores. A few startups may have already passed a few years or completed 5 years from the date of their incorporation. This may be a roadblock for many entrepreneurs. To facilitate the startups, the Inter- Ministerial Board should calculate the five year period from the date of the grant of a certificate as startups, and not from the date of Incorporation of the company.

## Simplified norms for issue of shares

Further, issues of shares for the investment made in the startup by an investor by way of private placement, is time consuming and a costly affair for both the investors as well as the startups, and thus it restricts several startups to get the investments in time. Simplification



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of issue of further shares should be provided and measures should be introduced to bring forth a system where issue of shares by the startup is less time consuming and cost effective.

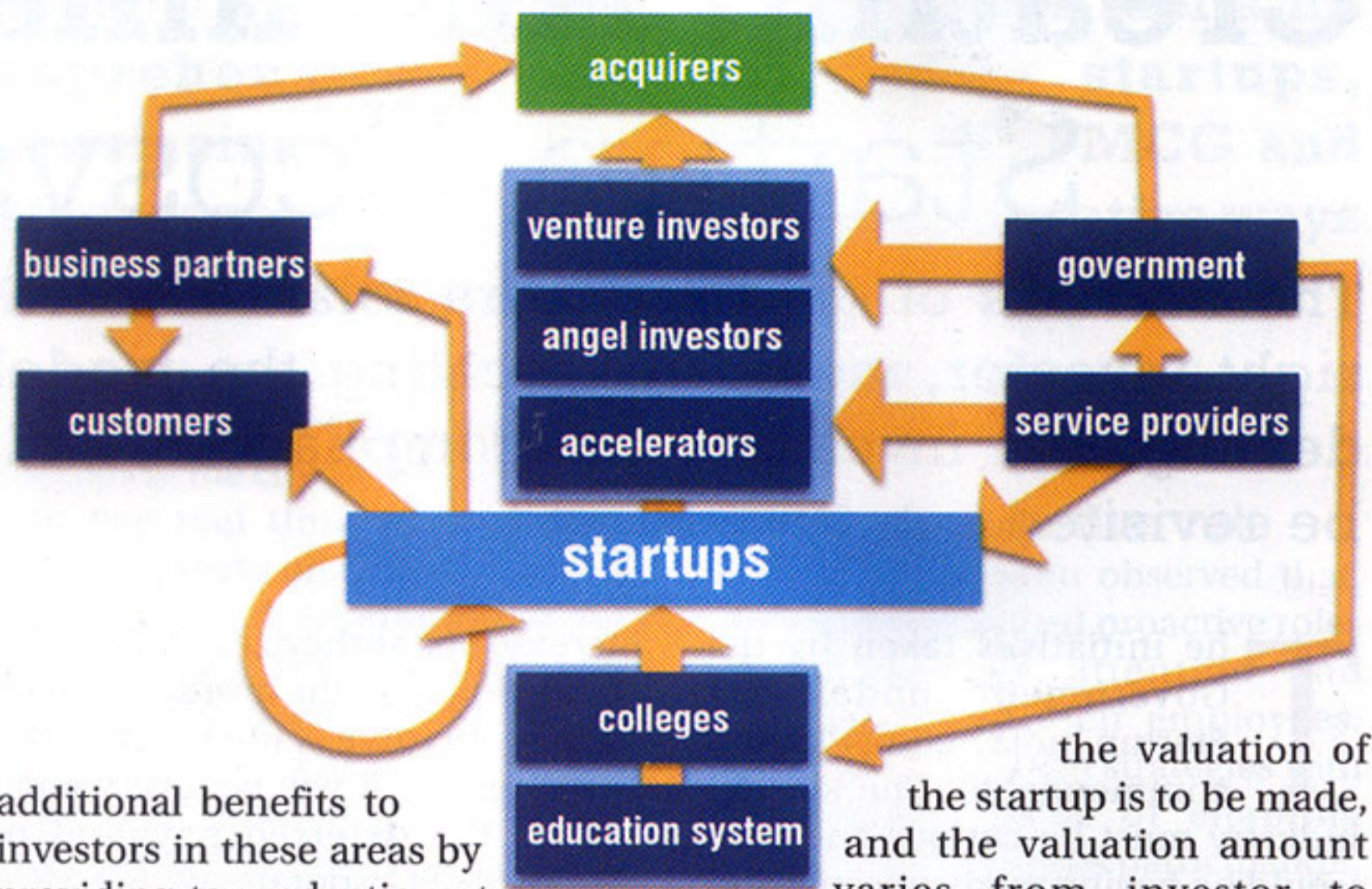
A smoothed investment process During the course of providing capital to a startup, individual investors generally come together and invest in an individual capacity. Due to high evaluation, the number of shares

issued to investors is less, and many times the face value of shares issued is less than Rs.20,000/-, sometimes create hindrances in the process of investment and therefore delays the whole process. This provision may be relaxed for startups for a smooth process of Investment. Presently, while making an investment in startups, Shareholder Agreement and Share Subscription Agreement are entered into between the investor and the startup. Articles of Association of the startups are altered according to such agreements. For startups, subject to Companies Act 2013, the Shareholder Agreement and the Share Subscription Agreement entered between the parties will be deemed superior to the Article of Association.

**Easier share buy back**

As per Companies Act 2013, the buy-back of the shares shall only be from: (a) Its free reserves; (b) The security premium account, or (c) Proceeds of the issue of any shares or other specified security, which reduces the exit opportunities for the investors. Buy back of securities must be made simpler and more options shall be introduced so that investor has wide options for exit. For example, from

**The Startup Ecosystem**



additional benefits to investors in these areas by providing tax reduction at various levels. Entrepreneurs and startups are not aware of how much dilution of equity is to be given to the investors. If the equity stakes of the promoter substantially go down in the initial round of funding, subsequent investors avoid funding such companies. For a period of 5 years, as it enjoys the status of a startup, the promoter's equity shall not dilute below 65% or so, by way of fresh issuance of shares.

the valuation of the startup is to be made, and the valuation amount varies from investor to investor. Promoters of the startup themselves are unaware as to how to value their startup. The provisions of valuation and requirements under company law and tax law should be relaxed for startups, and help save them time as well as money.

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the loan by promoters etc., this would attract more angel investors to invest in startups.

**Promoting investment in all sectors**

Presently in India, capital flows are easily available to those startups that are operating in IT and Technology spaces, while the remaining areas that comprise of manufacturing, traditional businesses and rural areas find it hard to find investors. The Government should provide

**Simplifying share transfer to a non-resident**

Process of sale of shares from a resident to a non-resident or vice versa should be simplified. The procedures of FEMA should be relaxed during the initial 5 years of the Startup. FC-TRS form under FEMA should be waived off since financial records are already being uploaded on ROC and MCA.

**Parameters of valuation**

There is no set parameter as to how

**Tax exemption to Angel Investors**

As per Section 56 (2) (vii(b)) of The Income Tax Act, 1961, where a startup receives any consideration for issues of shares which exceeds the FMV of such shares, such excess consideration is taxable at the hands of startups. Currently, investment by Venture Capital Funds (VCF) in startups is exempt from the purview of this provision. As per the startup India Action Plan, the same should be extended to investment made by incubators in the startups, but not individual angel investors. In addition to VCF and Incubators, the exemption should be extended to individual angel investors who have been investing in startups by way of direct allotment of shares by the startups. The qualification of such an angel investor may be kept as follows- (a) total investments made in startups is not less than 5 Lakhs; (b) minimum investment in one startup is not less than Rs.50,000/- .

**Investing capital gains**

As per the startup action plan, exemptions will be provided to

persons who have capital gains during the years, if they have invested such capital gains in the Fund of Funds recognized by the Government. Investment of capital gains only in the Fund of Funds demotivates the startups. In addition to investing the entire capital gain in the Fund of Funds, it is suggested that 50% of the capital gain should be invested in the direct investment of startups to encourage the startups.

### Tax holiday to service startups

As per the Union budget, new manufacturing companies, incorporated on or after 1st March, 2016 are given a benefit to be taxed at 25% + surcharge + cess provided they do not claim any profit linked deductions, investment allowance or accelerated depreciation, but it does not include service companies. In addition to the tax holiday of 3 years provided to startups, the policy should provide the above tax benefits to startups also including service companies, after the completion of their tax holiday of 3 years. The startups must be allowed to pay tax at 25%.

### Creation of an online depository

A startup requires many agreements with employees, vendors, policies such as terms of User Terms, Privacy Policy, etc., which are very essential and thus the Startups have to spend a lot of money to get such documents drafted. Government

may develop a free online depository of contracts and such documents with the pro bono help of law firms, which can be freely downloaded by the startups.

### Safeguarding startup patent and trade secrets

Under the Startup India Action Plan, one of the eligibility to be a startup is that a patent has been granted in India. Presently it takes a lot of time for a patent to be granted, by which the very purpose of the startup may get defeated. Eligibility of patent should include patent applied and/or patent granted in India and abroad. In case of patent applied, there should be some mechanism at

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the Indian Patent Office, which can give its report within 15 days whether such patent application is frivolous or not, so that Government benefits cannot be exploited. Presently there is no mechanism for protection of trade secrets. The Government should develop and provided for a trade secret protection mechanism.

### Simplifying M & A procedures

In the Startup ecosystem, only 1% or less startup may succeed. If they

are closed, then it is a loss to the entrepreneur, loss of resources and country. The Government should make M&A process simpler and tax efficient till the time both the entities are under the category of startup by way of establishing one window services, set off of loss and relaxation of taxes.

### Providing an online list of investors

Startups are confused and have no knowledge, which investor to approach for funding. Due to lack of information, many startups are unable to reach the correct set of investors. Government should develop an online freely accessible

portal where all Angel Investors, Funds, Incubators, etc. are listed after KYC check. The portal should provide the contact details along with their addresses, investment areas and ranges, application process etc; this can provide genuine and easy access of investors to startups.

### Staying away from the capital market

It is not the appropriate time for E-Commerce & startups companies to approach the capital market in India. Capital Market in India is not very optimistic and ready to accommodate the high valuation of such companies. E-Commerce & Startups should wait until the capital market and the public has confidence on the valuation and stability of such companies.

### Prospective areas for startups

The Key for success of startups is Technology, Innovation, Scalability, and constant review & modification in business model. Startups in Artificial Intelligence, Fintech, Health & Pharma, and Education space carry better prospects. **HC**

