THE VENTURE CAPITAL LAW REVIEW

Editor
Hajime Tanahashi

THE LAWREVIEWS

The Venture Capital Law Review

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PREFACE

I am very pleased to present this first edition of *The Venture Capital Law Review*, for which it has been my honour to serve as editor.

A country's economic outlook can often be gauged by the environment for start-up companies within its borders. Start-ups are key drivers of the new technologies and industries that enable economies and society to flourish. The entire start-up ecosystem is important but the financing environment is key, which is where venture capital plays a pivotal role.

Despite all the hardships of the ongoing covid-19 pandemic, the venture capital sector has remained relatively resilient. While many countries saw some slowdown in venture capital investments in 2020, many also saw generally healthy growth in new fund formation and fundraising. Many governments are also fostering the start-up ecosystem in their countries through ongoing regulatory reforms, in addition to special measures enacted to ease the economic impact of the pandemic.

This publication provides a legal and regulatory overview of VC funds, including both fund formation and management. We look at the various types of legal entities and regulatory frameworks that are available in forming a fund, as well as the key terms of the agreements that are entered into between funds and their investors. We also highlight the regulatory environment for fund managers.

Of course, we also take a look at the raising of capital from the start-up perspective. Start-ups still primarily rely on VC funds to finance the various stages of their growth. However, we are seeing a variety of new fundraising options for start-ups – including crowdfunding – although these often encounter a different set of regulatory issues and restrictions.

Ultimately, the exit from a VC investment is important both to the VC fund and also to the start-up. We take a look at various exit options, which typically entail either an initial public offering or a negotiated acquisition of the start-up. The use of a SPAC (special purpose acquisition company) has been attracting interest as a potential exit mechanism, although the degree of availability of this structure varies widely across jurisdictions.

I hope that you will find this first edition of *The Venture Capital Law Review* to be an interesting and informative overview of the venture capital and start-up environment in many important jurisdictions around the world. I would like to thank the many leading practitioners who have generously contributed their time and expertise to make this publication possible.

Hajime Tanahashi
Mori Hamada & Matsumoto
Tokyo
August 2021

Chapter 6

INDIA

Anand Kumar[1]

I OVERVIEW

The Indian start-up ecosystem has evolved exponentially over the years. Initially, one could count the number of start-ups and most of them would fall into one category only. The word 'unicorn' was not commonly associated with Indian start-ups. From computer games, consumer media tech, healthtech, fintech services (including mobile wallets and digital payment solutions), bots, AI powered automation platforms and SaaS companies, the ecosystem has significantly changed in the last decade and now almost every sector has been occupied by these new start-ups. The effective government policies and trust of venture capitalists have largely contributed to this paradigm shift. A report by Bain & Company[2] states that between 2012 and 2020, the number of start-ups in India increased by 17 per cent each year, while funded start-ups increased at a similar rate of 16 per cent CAGR. Currently, of around 110,000 start-ups in India, about 9 per cent are funded, implying significant room for further investments. While Delhi, Bangalore and Mumbai continue to be the start-up capitals of India, other cities such as Hyderabad, Pune and Chennai have emerged as hubs witnessing a lot of recent start-up activity as well.

Despite the pandemic, the start-up ecosystem in India remains strong – among the top five globally, with 12 additional companies achieving 'unicorn' status in 2020, taking India's unicorn tribe to a total of 37 (behind only the US and China globally). Continued growth in the start-up ecosystem in India has led to the creation of more than three million direct and indirect jobs over the last eight years. At US$8.76 billion, the amount of capital infused into the start-up ecosystem is almost 81 per cent of the total US$9.94 billion recorded for the full year of 2020, according to available research data.[3]

The number of start-up deals was up slightly by 4 per cent to 441 in January–May 2021 from 424 deals in Q1 2020. By comparison, the total number of deals in the whole of last year was 881. The increase in start-up funding activity has been driven largely by a surge in late-stage deals and a flurry of new unicorn additions of a record 14 new start-ups valued at over US$1 billion in just the first five months of 2021. Of the total newly minted unicorns, a good 11, or around 80 per cent, of them were added in the months of April and May alone, racking up the quantum of late-stage start-up investments.

1 Anand Kumar is managing partner at Pier Counsel.
2 IVCA & Bain & Company, 'India Venture Capital Report 2021' (March 2021).
3 Ibid.

II YEAR IN REVIEW

In order to combat the hardship caused by the pandemic, the Small Industrial Development Bank of India[4] has launched a Covid-19 Startup Assistance Scheme. Under this, eligible start-ups can avail of loans up to 20 million Indian rupees for a maximum period of 36 months. In addition to this, in March 2020 the government amended the Insolvency and Bankruptcy Code, 2016 to increase the threshold of default from 100,000 Indian rupees to 10 million Indian rupees to provide some degree of relief to the aggrieved companies.[5]

III LEGAL FRAMEWORK FOR FUND FORMATION

i Structures and legal entities used in the formation of venture capital funds

In the Indian jurisdiction, a venture capital fund can be structured or incorporated in the form of a trust, a company, a limited liability partnership or a body corporate, which:

a is a privately pooled investment vehicle that collects funds from investors using a defined investment policy; and

b is not covered under the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996; the Securities and Exchange Board of India (Collective Investment Schemes) Regulations, 1999 or any other regulations of the Board to regulate fund management activities.

Each way of incorporation of venture capital funds has its own set of pros and cons. Some of them are enumerated below for each of the categories.

Venture capital fund as a trust

Trusts offer wide operational flexibility in comparison to limited liability partnerships or body corporates. In addition, it has limited disclosures that are required to be made and the compliance requirement is low as well. A trust is not under any separate supervisory authority, which is not the case with LLPs and companies. A person who establishes a trust and put assets into it is called a settlor. A trust is therefore set up by a settlor for the benefit of one or more individuals (beneficiaries) legally owned by trustees who are legally obliged to act in the best interest of the beneficiaries. Furthermore, the Trust Act permits trusts to receive contributions from individuals other than settlors. Lastly, the liquidation procedure for a trust is governed by the trust deed and no further compliances are required, which, again, is not the case with LLPs or companies.

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4 Covid-19 Startup Assistance Scheme, available at: https://sidbi.in/files/announcements/SIDBI_CSAS-Scheme_Details.pdf (last accessed on 17 July 2021).

5 Ministry of Corporate Affairs, available at: https://www.mca.gov.in/Ministry/pdf/Notification_28032020.pdf (last accessed on 17 July 2021).

Venture capital fund as a limited liability partnership

Limited liability partnerships offer the protection of the members' assets from any impending liability as LLPs are a separate legal entity, which is not the case with trusts. The major disadvantage of the LLP is that public disclosure needs to be made, which again is not the case with trusts. The winding-up of an LLP needs to comply with the LLP Act, 2008. These factors suggest that the compliance cost for LLPs is higher than that for trusts.

Venture capital fund as a company

Out of the three, a company has the highest degree of compliance requirement as under the Companies Act, a company must comply with a number of requirements periodically, thereby increasing the cost of operation. Effectiveness is diluted as well because the meeting of the minds of shareholders is of essence to operate.

In India, the majority of the venture capital funds are established as trusts because of the benefits mentioned above and the limitations of LLPs and companies.

ii Structures for fund managers

The investment manager is involved with all operations of a fund including its investment and divestment related choices. The investment committee (IC) scrutinises all prospective transactions (acquisition as well as exit). Typically, members, directors, nominees of the sponsor, an AIF manager with strong market knowledge and domain experts comprise the IC. The IC's job includes maintaining price discipline, ensuring that all transactions conform to the fund's strategy and evaluating the risk-return profile of the agreements.

There is also the advisory board whose job is to provide informed counsel to the fund manager and IC of the fund based on the information and reports given to it by the fund manager. The advisory board typically provides recommendations to the investment manager and IC concerning managing 'conflicts of interest' situations, threshold levels advice pursuant to the fund documents, investment risk management and corporate governance and compliance-related aspects.

The fund managers further appoint a management company. The management company is the entity that embodies the firm itself: the management company employs the investment professionals, typically owns the firm's branded assets and receives management fees from each of the firm's investment funds. As a consequence, the management company structure is essential in creating governance and remuneration, which in turn create a firm's distinctive culture.

iii Key considerations in structuring venture capital funds in India

The government of India from time to time has introduced various regulations such as mutual funds and other collective investment schemes for investment purposes. Multiple considerations had to be undertaken before structuring a venture capital fund. Primarily, one needed to decide what category of investment funds one wanted. Amid this confusion, the venture capital fund (VCF) vehicle came to be used by many other investment funds such as private equity (PE) funds for investment into public equity, real estate and other segments. This made it difficult for the government of India to promote innovation, entrepreneurship, emerging companies and the start-up ecosystem. It was against this backdrop that in 2012 it was deemed necessary to bring in regulation to cater to the start-up segment pursuant to which the Securities and Exchange Board of India (SEBI) introduced the SEBI (Alternative

Investment Funds) Regulations, 2012 (the AIF Regulations) and recognised AIFs, such as PEs and VCFs, as a distinct asset class separate from promoter holdings, creditors and public investors. Regulation 3(4) of the AIF Regulations has categorised the types of AIF under which an entity can register and obtain a certificate of registration.

Category I AIF is for investment in start-up, early-stage ventures, social ventures, SMEs and other infrastructure. It mandates that:

a A maximum of 25 per cent of the investible funds can be invested in a single company.
b Category I AIFs of a given subcategory can invest in units of a category I AIF belonging to the same subcategory.
c Borrowing is not permitted except to meet temporary funding requirements and only for a period of 30 days. Borrowing is allowed for a total of four times in a single year. Borrowing shall not exceed 10 per cent of the investible funds.

Category II AIF includes private equity funds and debt funds and is not covered under Category I or Category III AIF. It has the following mandates:

a A maximum of 25 per cent of the investible funds can be invested in a single company.
b The entity must invest in unlisted investee companies or units of other alternative investment funds.
c Borrowing is not permitted except to meet temporary funding requirements and only for a period of 30 days. Borrowing is allowed for a total of four times in a single year. Borrowing shall not exceed 10 per cent of the investible funds.
d The entity may engage itself in hedge funds subject to SEBI guidelines.
e The entity may agree with a merchant banker to subscribe to the unsubscribed portion of the issue or to receive or deliver securities in the process of market making under Chapter XB of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.
f The entity is exempted from the SEBI (Prohibition of Insider Trading) Regulations, 1932 if it invests in companies listed on the SME Exchange or the SME segment of exchange provided it discloses to the stock exchange in which relevant investee company it has listed any acquisition or dealing in securities within two days and the investment shall be locked in for one year from the date of investment.

Category III AIF employs diverse or complex trading strategies and may employ leverage including investment in listed or unlisted derivatives. It mandates that:

a A maximum of 10 per cent of the investible funds can be invested in a single company.
b The entity can invest in securities of listed or unlisted investee companies or derivatives or complex or structured products.
c The entity can deal in goods received in delivery against physical settlement of commodity derivatives.
d The entity cannot invest in units of fund of funds.
e The entity can engage in leverage or borrow subject to investor approval and subject to the maximum limit as specified by SEBI.

Furthermore, Regulation 13(2) requires that tenure of closed-ended AIFs shall be set at a minimum of three years for Category I and Category II AIFs.

iv Tax considerations

Pass-through status has been accorded to venture capital funds registered under the AIF Regulations via Section 10(23FB) of the Income Tax Act, 1961. Any income generated by Category I or Category II AIFs that is not in the nature of 'profits and gains of the business profession' is to be taxed in the hands of the investor. Income under 'profits and gains of the business profession' is taxed at the fund level and it does not pass through the unit holders.

In addition, Section 194LBB of the Income Tax Act, 1961 provides that income payable to an investor of an AIF shall be taxed at 10 per cent. Furthermore, Section 115UB of the Income Tax Act, 1961 allows losses incurred by the AIF to be passed through the investors except for business losses. To avail of this, an investor is required to be invested in the fund for a minimum period of 12 months.

v Regulations that govern the formation of venture capital funds in India

Pursuant to the AIF Regulations, a venture capital fund is defined as an alternative investment fund that invests primarily in unlisted securities of start-ups and early-stage venture capital undertakings. Angel funds come under the purview of venture capital funds.

Regulation 3 of the AIF Regulations mandates that registration is mandatory for alternate investment funds to operate in India. An AIF needs to register in either the Category I Alternative Investment Fund, the Category II Alternative Investment Fund or the Category III Alternative Investment Fund.

Exemptions for funds

The exemptions, as provided under the AIF Regulations are as follows:

a funds can apply to the board for exemptions from strict compliance with the AIF Regulations and the board upon examination may grant the entity an exemption or issue instructions as may be deemed appropriate; and

b funds that are registered under the Securities Exchange Board of India (Venture Capital Funds) Regulations, 1996 are required to be registered until the existing fund or scheme managed by the fund is wound up.

Marketing a fund

At present there are no specific regulations regarding marketing funds. Under the AIF Regulations, AIFs can be marketed only through private placement by the issuance of an information memorandum.

vi Disclosure requirements to potential investors

According to the Securities and Exchange Board of India (Disclosure & Investor Protection) Act, the following disclosures must be made to potential investors:

a the contents of the prospectus, including the issuer company's financial statements;

b the prospectus shall contain all material information that is true and adequate to enable the investor to invest. The issuing company shall file a prospectus or letter of offer with SEBI and the Registrar of Companies, through a merchant banker; and

c the prospectus must be accompanied by the agreement with the domestic depository, which certifies that all of the disclosures provided in the prospectus are accurate and correct.

IV FUND AGREEMENTS

A private placement memorandum (PPM) is a securities disclosure document used in a private offering of securities by a private placement issuer or an investment fund (collectively, 'the issuer'). From an investor's point of view, the purpose of the PPM is to obtain needed information about the issuer and its securities, to make an informed decision about whether to purchase the security. The investor wants to know the parameters of investing in the issuer and the potential rights, risks and rewards of its investment. For the issuer, the purpose of the PPM is to provide the necessary disclosures about the risks, strategies, management team, investment criteria and other information about its securities to protect itself and its managers against claims of misstatements or omissions.

i Summary of offering terms

The summary of the terms of the offering is just as its name suggests – a condensed description of the offered terms, including the offering structure, the description of the securities, price, minimum subscription amount, investor qualification standards, disclosure of applicable management fees, withdrawals, placement agent commissions and discussion of the terms from the issuer's governing documents (limited partnership agreements, operating agreements, etc.).

ii Risk factors

Risk factors are disclosures of the potential risks investors should consider that could lead to a loss of their investment. Risk factors must be drafted with specificity, tailored for each industry type, offering structure, and investment strategy or business plan. The risk factors section is included early in the PPM so that it will be one of the first sections a potential investor will read.

iii Estimated use of proceeds and expenses disclosures

A vital component of the PPM is the disclosure of how the proceeds of the offering are expected to be used. A private placement issuer includes a use of proceeds section that contains language describing how the offering proceeds will be deployed (item by item) and how much is anticipated to be allocated to each category. The 'estimated' use of proceeds is a best-case forecast of how the proceeds will be used.

Different from an offering for a private placement issuer, an investment fund does not include specific estimated use of proceeds but instead includes a discussion of which expenses that investment fund will cover.

One point of caution, however, is that the one item that should not be estimated, but firmly stated, is the amount of compensation that any related party will take from the transaction, or directly from the proceeds of the offering, whether in the form of salary, fees, consultant payment, purchase or sale of an asset to the issuer, such as intellectual property, or any other direct or indirect compensation paid to a founder or related party from the proceeds.

iv Description of the securities

One of the sections of the PPM requiring the greatest need for a skilled private placement attorney is the description of the securities. In this section, the issuer discloses the attributes of the debt or equity offering. These attributes are prepared in the governing documents of the issuer (an operating agreement, limited partnership agreement, shareholders' agreement, etc.), or a promissory note (with a debt offering). The description of the securities section describes key terms of the governing document (or promissory note). Thus, it is vital to begin with the operating agreement before preparing the PPM.

v Business and management sections

The business section describes the business of the issuing company. The management section contains biographical and background information about the managers, founders, directors key officers, etc. The most important factor in preparing the business and management sections is to present information that is free from misleading statements and does not overstate accomplishments or opportunities.

vi Other offering documents

The PPM itself does not constitute the 'offering'. The PPM is nothing more than a disclosure document describing the offering, including its structure, strategies or business plan, risks, and management. The offering documents include several supporting documents that should be prepared in conjunction with the PPM. Other documents include the subscription agreement, the investor suitability questionnaire, and most importantly, the issuer's organisational documents (an operating agreement, limited partnership agreement, shareholders agreement, etc.), a promissory note (with a debt offering) and others.

V FUND MANAGEMENT

The purpose of the fund needs to be specified in the memorandum of association in the case of a company, the trust deed in the case of a trust, or the partnership deed in the case of a limited liability partnership. Regulation 9 of the AIF Regulations states that investment funds need to mention investment strategy, investment purpose and investment methodology in their placement memorandum to the investors. It further provides that any change shall only be made with the consent of at least two-thirds of unit holders by value of their investment in the fund.

From the above, it can be stated that investment by the fund in ancillary business can be done if the investment information is provided in the placement memorandum or if at least two-thirds of the unit holders provide their consent for the investment.

VI RAISING CAPITAL BY START-UPS

Often bootstrapping and bank financing may not be a viable alternative for many entrepreneurs because initial capital requirements prior to profitability are beyond the founders' financial capacity. Therefore, most start-ups opt for investment through venture capital entities as it significantly eases the financial burden on the start-ups and allows them to focus on their actual work. At the outset, a start-up generally relies upon the funds of the founders as well as investors who provide funds at the very early stage of the start-up, which is referred to as seed funding. The AIF Regulations in India establish the concept of angel investors. Angel investors can be an individual or a body corporate or a registered AIF. As the start-up grows, it raises funds through a series of investments based on its market position and needs, categorised as Seed or Pre-Series A, Series A, Series B and Series C investments. Obtaining venture capital offers numerous opportunities to an entrepreneur. It improves a start-up's creditworthiness as it adds to its net worth.

Angel funding as a source of financing is attractive and a simple and quick source of seed capital. Angels typically do not seek an active role in the business, board representation or any other special shareholder right.

Series A funding is used by start-ups in optimising product offerings and user base by creating business models that generate long-term profit. The important factor focused on this stage is the scale of operations and users. Usually, early-stage venture capital firms with a high risk appetite are seen investing in this round of funding. At this stage, the idea has moved from a proof-of-concept and has hit the market and shown some levels of traction.

Series B funding is the second round wherein the focus is on taking the business to the next level in terms of scaling and expansion. Private equity investors and venture capitalists contribute to the capital of a business when certain predetermined milestones are achieved. The cost of funding at this stage is higher compared to Series A funding.

Series C funding is the third injection of capital, which is usually available to successful businesses so that investors can see higher returns by continuing to scale fast and wide. This round represents stabilising lines of credit obtained from the investors who believe the start-up's growth story.

i Types of securities issued

Investors, generally, opt for compulsorily convertible preference shares as they provide the requisite protection to investors in terms of liquidity. They give the flexibility to the investor to convert the current preference shares into equity after a company has achieved a predetermined goal. For example, if a company is liquidated, any assets remaining after meeting debt obligations have to be distributed to preference shareholders and then to equity shareholders. Investors holding preference shares will require a liquidation preference in an amount at least equivalent to their original amount plus all accrued and unpaid dividends.

ii The legality of crowdfunding in India

Equity crowdfunding is illegal as per Section 42 of the Indian Companies Act, which mandates that offer of securities can only be made to a maximum of 50 individuals and if it is made to more than that it shall be considered as a public offer and provisions related to public offers will become applicable to it. SEBI has stated that digital equity crowdfunding is unauthorised, unregulated and illegal. Donation or reward-based crowdfunding can be used by start-ups as it does not involve the issuance of securities.

iii Investment agreements

An investment agreement or business investment agreement is a contract to formalise a transaction between an investor and a company whereby the investor acquires an ownership interest in a company in exchange for an investment of some kind.

There are different types of investment agreements available both to venture capital funds and start-ups. The most common investor agreements are:

a share purchase agreement;
b share option agreement;
c convertible debt agreement;
d restricted share agreement; and
e deferred compensation.

In India, parties generally sign a share subscription and shareholders' agreement.

The key terms in investment agreements used for investment funds or start-up companies, or both, are as follows:

Investors

As the investment agreement deals with the subscription for shares by the investors in return for the investment monies, the investment agreement should bind all investors participating, including any separate funds that are investing.

Future shareholders

It is usual to have a provision requiring any transferee or new allottee of shares to enter into a deed of adherence which has the effect of treating the new shareholder as if he were an original party to the investment agreement and therefore bound by the provisions of the agreement.

Tranche payments

It is common for companies that are still in the phase of technology developments, like life sciences, to have milestone-based payouts. Each such tranche can be measured against the achievement of agreed milestones. It is also common for investors to be able to waive milestones or other completion conditions if these are not achieved.

Completion conditions – initial tranche

The investors will stipulate that certain conditions must be satisfied before the initial tranche of the investment can proceed to completion. The investment agreement will stipulate that the proceeds of the investment (whether on the initial or subsequent tranches) must be used for achieving the agreed milestones and the realisation of the agreed business plan or budget.

Subsequent tranche completion mechanics

These are the actions that need to be taken on the completion of the subsequent tranches of investment such as the issuance of shares.

Warranties

Warranties are representations made by the warrantors, who are usually the founders and the company, that certain statements relating to the company are true and accurate at the completion date. Although the investors will have carried out due diligence on the company and under common law would have a right to sue the founders for misrepresentation if the information provided was inaccurate, the investors will prefer such statements to be expressly included in the contract. In India, representation and warranties insurance (R&W insurance) is available, which can be put to use to cover financial implications arising from the breach of representation and warranties. R&W insurance policies are obligated to make payments only when a specified amount is borne by the parties (i.e., if the specified amount is 1 million for insurance coverage of 10 million, then the policy will release the amount of 10 million when loss of 1 million has been incurred by the parties to the transaction). With respect to founders, before making any warranty, they should be aware of the customary and business-related warranty prevalent in their respective industry. In addition to this, one needs to ascertain if the warranties should be joint or several.

Investor consent regime

Investors will want a contractual right to prevent shareholders from taking key decisions without their consent. This applies to management decisions as well as shareholder decisions, such as:

a varying the rights attaching to the shares;
b the issuing or granting of options over the company's securities;
c adopting new articles of association;
d removing or appointing a director;
e making a material change like the business of the company;
f acquiring any shares or other securities;
g making any changes in the service agreements;
h entering into unbudgeted capital expenditure exceeding a certain amount;
i entering into any litigation;
j incorporating a new subsidiary; and
k disposing of any assets (in particular IP) of the company other than in the ordinary course of business.

Financial information

It is often a requirement that, when they bring an institutional investor on board, management have to produce management accounts, audited accounts and financial models and budgets for the upcoming financial years, which they have to deliver to investors before certain dates. This can be burdensome for management to produce. In addition, investors are likely to require that they can access on request the accounts of the company for inspection.

Board representation

In most cases, investors are likely to require that they can have an entrenched right to appoint a director and that a majority, if not all, of the directors appointed by the investors, need to be present for there to be a quorum of any meeting of the board to allow the business to proceed. Founders may also have an entrenched right to appoint a director. In some cases, investors may look for 'observer rights' so that they have the right to send non-directors to sit in and observe board meetings and to receive board papers, but not to vote. While board representation is to be expected, it can prove unwieldy if a company has gone through several rounds of investment with new institutions collecting new board members at each round.

Restrictive covenants

The purpose of restrictive covenants or non-competes is to prevent the founders from competing with the business of the company while, and when they cease to be, involved with the company. Typically, restrictive covenants will be found in the service agreement as well as the investment agreement. However, restrictive covenants in the investment agreement are generally more enforceable than those in the service agreement, as the founders are giving the covenants as shareholders (not employees) in part consideration for the investment.

Exit

There may be a provision in the investment agreement which states the parties' intention to work towards an exit. Additionally, share transfer restrictions play an important role in structuring exits and controlling the capital structure of a company. While a private limited company may impose any kind of transfer restrictions on its shares, the shares of a public limited company are statutorily freely transferable. However, in the spirit of giving primacy to contractual covenants among parties, Section 58(2) of the Companies Act, 2013 provides that any contract between parties (shareholders) in respect of transfer of securities shall be enforceable as a contract. This may be borne in mind while choosing the right vehicle for a start-up.

Confidentiality

There will be a provision in the agreement to ensure that its parties will keep all confidential information confidential. Normally, an investor is expressly allowed to disclose information to its employees, members, participants, etc.

Costs

The company usually pays for investors' reasonable legal and due diligence fees or a proportion of such fees as well as its costs and sometimes those of the founders.

VII EXIT

Public offering is the typical exit mechanism used by venture capital funds in India. Access to the IPO market is considerably smooth due to the proactive approach of SEBI. It has also been observed that smaller start-ups are being acquired by larger companies. In recent times, activities in the M&A market have been on a continuous rise. The stellar debut of Zomato on Dalal Street (an online food-delivery company), an IPO which opened up to public market investors on 14 July 2021 in India, could be a test case for a host of emerging tech companies in their late stage of PE driven growth wanting to go public. It is likely that start-ups will continue to outperform broader markets over the next several years.

The current regulatory framework of India is not supportive of the special purpose acquisition company (SPAC) structure. For instance, the Companies Act, 2013 authorises the Registrar of Companies to strike off the names of companies that do not commence operation within one year of incorporation. SPACs typically take two years to identify a target and perform due diligence. If SPACs are to be made functional in India, enabling provisions will have to be inserted in the Companies Act.

Further, SPACs do not find acceptance even under the Securities and Exchange Board of India Act. The eligibility criteria for a public listing requires a company to have net tangible assets of at least 30 million Indian rupees in the preceding three years, minimum average consolidated pre-tax operating profits of 150 million Indian rupees during any three of the last five years and net worth of at least 10 million Indian rupees in each of the last three years. The absence of operational profits and net tangible assets would prevent SPACs from making an IPO in India.

VIII OUTLOOK

Overall, we see continued improvement on the policy and regulatory front, with the Indian government having introduced several programmes to boost the start-up ecosystem. Flagship initiatives such as Atma Nirbhar Bharat, Startup India, Digital India, and the Alternative Investment Policy Advisory Committee (AIPAC) continue to improve the environment for investors and start-ups.

Focus on creating a favourable and nurturing environment for start-ups through a wide array of government schemes and initiatives has led to significant improvement in the World Bank's Ease of Doing Business rankings for India over the last four years as well – a jump of 68 places from 131 in 2016 to 63 in 2020.

In the wake of the pandemic, several initiatives and policies from the government aimed at improving the health of businesses post lockdowns such as Atma Nirbhar Bharat and Startup India have ensured availability of funding and easier compliance requirements for start-ups in India.

While multiple new policy initiatives were introduced to bolster start-ups across industries, some sector-specific decisions helped turbocharge high-priority segments:

a the new National Education Policy (NEP) 2020 reimagines education in India with a core focus on bridging the digital divide, providing a sizeable thrust to edutech; and

b regulations for telemedicine and the National Digital Health Mission (NDHM) will likely play an essential part in bolstering healthtech in India.

In addition to the AIF Regulations, which have made venture financing smoother, the government of India has identified various legal challenges inherent in the start-up ecosystem and has introduced several new policy initiatives to make it easier for ordinary people to create and improve the ease of operating business and achieve core business objectives. It has arguably never been a better time for Indian entrepreneurs to navigate challenges and pitfalls with the right advice.

Appendix 1

ABOUT THE AUTHORS

ANAND KUMAR

Pier Counsel

Anand Kumar, as the managing partner of Pier Counsel, has a holistic approach towards innovative and client-centric solutions. He is a widely recognised lawyer with expertise in private equity, venture capital, mergers and acquisitions, fund formation, cross-border transactions, intellectual property and general corporate laws. With over 20 years of experience, he is the go-to person for all legal solutions. In addition to this, he is recognised in the field of academia as well. He is invited by numerous business and law schools of India and enjoys the interaction. Furthermore, his love for innovative start-ups and budding innovators in IT, social media, gaming, internet bots, AI, AR/VR, e-commerce, financial technologies, digital technologies, mobile application and services is evident as he has mentored the founders in various aspects of strategy and growth. He has assisted various clients to strengthen their strategy, from launching a new start-up to selling business.

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