

## **NEW CAPITAL RAISING PLATFORM FOR STARTUPS**

### **Background**

Considering the role of startups in nation building, employment generation, fostering innovation and enterprise, it was imperative that the fund raising process for such startups, particularly for those active in the e-commerce/digital space was due to be rationalized.

A lot of Indian companies, in the recent past have been more favorable towards listing overseas, particularly in the United States of America and Singapore for a higher valuations and such markets recognize the potential of a business proposition along with immediate profitability parameters, which is typically beneficial for companies in the digital/e-commerce space.

The Indian Government under the leadership of Mr. Narendra Modi, is consistently taking a pro-investor stand and remains committed to introducing regulatory reforms. At this juncture, opening up the discussion table to firm up the fund raising regulatory landscape at a domestic level for startups seems to be a timely move from SEBI.

Whilst SEBI promulgated Securities and Exchange Board of India (Listing Of Specified Securities On Institutional Trading Platform) Regulations, 2013 on October 8, 2013 introducing the institutional trading platform (“ITP”) for facilitating capital raising by small scale businesses and exit of institutional investors like private equity funds, it was considered that the existing avenues may be made further amenable for accommodating a larger number of growing startup companies. In the aforesaid background, SEBI has released a discussion paper on Alternate Capital Raising Platform proposing a new platform for raising capital (“**Proposal**”) for companies in the area of software product development, e-commerce and new-age companies having innovative business models.

### ***Salient features of the Proposal***

1. ***Categories of Investors:*** The proposed platform will have 2 categories of investors i.e. Qualified Institutional Buyers (“**QIBs**”) and Non-Institutional Investors (“**NIIs**”).
  - Allotment to QIBs will be on a discretionary basis and NIIs on a proportionate basis.
  - Allocation ratio between QIBs and NIIs will be 3:1 respectively.
  - Any under subscription in NII category shall be available to QIB category.
  - No QIB shall be allotted more than 5% of the issue size.
2. ***Migration to Main Board:*** The listing of startups on the ITP shall be for a minimum period of 1 year after which the startup shall have the option to migrate to the main board subject to compliance with eligibility requirements of the stock exchanges.

***Criteria for classification as “Professionally Managed Company”:*** The startups would be required to ensure that no person (individually or collectively with persons acting in concert) shall hold 25% or more of the pre-issue share capital for accessing capital through ITP. In case of breach of the said threshold, the alternative would be to access the main board.

3. ***Application Size:*** A minimum application size of Rs. 10 Lakhs.

4. Trading Lot: A minimum trading lot of Rs. 5 Lakhs, however there is a suggestion that this limit may be lowered for sale of shares by the employees who have been granted stock options.
5. Number of allottees: A minimum number of 500 allottees.
6. Investment by Alternative Investment Funds: Investment by Category I and II Alternative Investment Funds (“AIFs”) in the shares of the startups listed on ITP shall be treated as investment in ‘unlisted securities’ for the purposes of calculation of the minimum investment limits of AIFs in unlisted securities as per SEBI (Alternative Investment Funds) Regulations, 2012. Indicative issue process for an issue through ITP: Whilst specific timelines for the issue process would be clear on notification of final regulations by SEBI in this regard, a broad and indicative issue process that would be required to be adhered to by startups seeking listing is as under:
  - Approval of Board and Shareholders under the Companies Act, 2013
  - Preparation and finalization of draft red herring prospectus (“DRHP”) providing, *inter alia*, disclosures with respect to business, financial information, capital structure, risk factors, promoter information, legal proceedings etc.
  - Submission of listing application to stock exchanges for grant of in-principle approval
  - Filing of DRHP with SEBI for observations
  - Grant of Approval from the stock exchange
  - Completion of allotment of securities

The startups would be required to ensure compliance with SEBI ICDR Regulations, subject to the following carve-outs:

- Main object of issue to be for general corporate purposes and disclosures to be restricted to only broad objects in line with major international jurisdictions.
- Lock-in of entire pre-issued capital for a period of six months uniformly for all shareholders.
- Basis of issue price to include disclosures, other than projections, as deemed fit by issuers.

### ARA LAW View

The Proposal puts in place a potential regulatory framework for enabling the startups to access the domestic capital market and providing a ready exit window to private equity and venture capital investors. From a taxation perspective, considering that the PE/VC players stand invested in the start-up for more than 3 years, there shall be no levy of long term capital gains tax on transactions executed on the floor of the stock exchange. However, what emerges as a concern is that the private equity/venture capital investors with more than 25% shareholding in startups would require dilution for being eligible to take benefit under the Proposal. We expect that the same will surely attract some push back from the industry which awaits the final blue print from SEBI.