

Fund Raising Initiatives in India: It's Start-Up Time!!

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Abstract

The current era in the Indian Corporate sector marks a shift in the attitude of the government of legislative inertia to a notion to build encourage and accelerate global ties through business and technology. – (i.e. “Case of doing business in India”). The growth oriented economy has led to the rise of small business organisations, initiated by a group of persons driven by an entrepreneurial zest to set up their own business, be it products or services in the market, popularly termed as “start-ups”. The period from 2013 till today can be labelled as the period of “start-up boom”, especially in the field of e-commerce targeting sectors such as retail, hospitality and housing to name a few. However, after the initial success visibility and profitability depends on the regularity of its operations in order to meet their capital requirements, wherein a handful of them have been fortunate to receive multiple rounds of funding by venture capitalists, private equity firms, and investors etc. Furthermore, the Securities & Exchange Board of India, in order to encourage start-up companies has taken baby steps by realising a consultative paper on the issue of alternate capital raising in start-ups along with certain regulatory amendments. It is pertinent to note that the need of the hour is to have a defined regulatory mechanism that would facilitate start-up companies to secure additional funding in order to hold forth in the market. Keeping in view the recent trends in this subject, this paper aims to focus on recent trends in this subject, this paper aims to focus on recent initiatives for building a platform for alternate capital raising in India and highlights the adequacy for a legal framework in light of initiatives taken by different countries.

KEYWORDS- E-Commerce, Start-ups, SEBI, Equity.

Introduction

“Whether India cannot dream that India becomes number one in the world of start-up. Today we are not at that position. Brothers and Sisters, I have to provide strength to start-up and, therefore, I resolve that in the coming days "Start-up India" and "Stand-up India" will be there or the future of the country.”¹

India has entered a highly ambitious and globalised age of existence, wherein energies of all citizens and governments alike are channelized only towards achievement of a higher and modernised level of living directed towards an enlightened and progressive economy. The advent of a new government in a country brings with it an array of new thoughts and ideologies which in turn influence all policy decisions made by the executive towards the betterment of the country and its people. The nation has seen the entry of a new peoples’ government in 2014 charged with ideals and ambitions to take its citizens to the highest paradigm of growth, development and prosperity of

¹Prime Minister Narendra Modi’s address at the 69th Independence Day function, Red Fort, New Delhi. Available at <http://www.narendramodi.in/text-of-prime-minister-shri-narendra-modi-s-address-in-hindi-to-the-nation-from-the-ramparts-of-the-red-fort-on-the-69th-independence-day> (last visited August 27, 2015).

each one and all. The caption quoted above are the words of our very own Prime Minister who is the face of the government's vision in a globalised village in which India is a butterfly rearing to fly its coloured wings. The present vision of the government as stated hereinabove² reflects a temperament of the executive, which is now turning into a liberal and flexible approach encouraging the development of all sectors of the economy, primary and others alike. The corporate and industrial sectors have heavily benefited from the expansion of foreign investment caps in various sectors such as defence, pharma, insurance etc. the advent of 2015³ has seen a change in the vision of the government to that of encouraging micro, small and medium organisations in order to mould their functioning in such a manner as to bring them to the mainstream economy ensuring a greater concentration of production and manufacturing within the country itself. This vision of the government has assumed into a movement christened "*Make in India*" which has been propelled and gained tremendous popularity in the industry. Another key initiative launched and already set in motion by the central government is the promotion and encouragement of start-up companies in India, an idea promoted in furtherance of the future envisioned by the Prime Minister.⁴

Human needs have diversified to such an extent that man prefers to choose from the vast options made available to him. The growing needs cause man to proceed towards inventing diverse choices and thus striving for the betterment of society, therefore giving birth to new ideas and conceptions, a start-up company being one of them. The period from 2013 till present date can be labelled as the period of "start-up boom", especially in the field of e-commerce targeting sectors such as retail, hospitality and housing to name a few. Inspired by the zeal to make it on their own, there is a large percentage of young executives in various well known organisations in the market who, driven by entrepreneurial zest to set up their own business, be it product or services market, venture out on their own by building their own companies popularly termed as "start-ups". We may now choose to define a start-up as a novel business venture set up by entrepreneurs, in its evolution stage of business activity. India has witnessed a revolutionary expansion of various businesses through the establishment of start-up companies and their innovative business models. A start-up company, to put it in concise words, nurtures the unique and dynamic formula used by a skilled entrepreneur to market his product at a grass root level. However, after the initial success that may bring glory and recognition to a start-up company, its continuous visibility and profitability depends on the regularity of its operations. Most start-up companies in India face the issue of additional funding to meet their capital requirements, wherein a handful of them have been fortunate to receive multiple rounds of funding by venture capitalists, private equity firms, angel investors etc.

The object of this paper is to *firstly*, highlight the need and the importance of a regulatory mechanism in the form of a well-defined law to regulate start-up funding in India, *secondly*, study the steps undertaken by the Securities and Exchange Board of

²Ibid.

³For more details see Consolidated FDI Policy, Department of Policy and Promotion, Ministry of Commerce and Industry available at http://dipp.nic.in/English/Policies/FDI_Circular_2015.pdf (last visited August 27, 2015).

⁴Supra. note. 1.

India (“SEBI”) towards encouraging start-up companies to raise additional capital and *lastly*, carry out a comparative analysis of the initiatives taken by SEBI in relation to other economies, for instance the USA.

Need for regulatory mechanism governing alternate capital raising

A prominent question that may arise in the minds of thinkers is whether there is an actual necessity to devise a law setting up a distinct platform for fund raising by start-up companies in India. The answer is a prominent yes, as a legal framework to enable start-up organisations to raise considerable amount of funds from different categories of investors ensures that expansion of such organisations is not jeopardised for want of adequate capital. The grounds for having a watchdog to oversee alternate capital raising can be summed up under the following heads:

(i) Continuity of business:

As mentioned in the introductory chapter⁵, the launch of a start-up company gives it initial popularity and thus makes it a household name in the area of the product or service offered by them to the consumers. However, an on-going and uninterrupted presence of a start-up in the market is only possible through additional funding after utilisation of its start-up capital. Thus, a well-defined legal framework in the form of regulations would clearly enhance the chances of various start-ups to strive for a continuous presence in the market and achieve a higher position amongst allied competitors.

(ii) Higher investment within a defined framework:

It has been observed that the existence of a high-quality legal system backed by defined statutory provisions and rules pertaining to alternate capital raising in a country is in all respects likely to encourage greater number of investors to pump in capital in the start-up company, as a well-defined law shall ensure adequate protection to all investors even the minorities alike.⁶ However, in case of organisations incorporated in countries with a poor quality legal system, there are high chances of investors (essentially private equity investors) to obtain majority shareholding in the particular company so as to maintain majority control over the affairs of the start-up company.⁷

(iii) Constitutional duty of the state:

The idea of promoting start-up culture in India is inherently imbibed in the constitutional principles that govern our democracy. Part IV of the Constitution of India imposes a set of duties upon the government that are to be observed as the cardinal principles followed by the legislature at the time of framing policy

⁵Supra, p. 2.

⁶La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R., *Law and Finance*, Journal of Political Economy, 106(6), 1113-115, (1998) cited in Qianqian Du and Ilan Vertinsky, *International patterns of ownership structure choices of start-ups: does the quality of law matter?*, 37 (2), Small Business Economics, Sept 2011, at 236.

⁷Lerner, J., & Schoar, A., *Does legal enforcement affect financial transactions? The contractual channel in private equity*, 20(1), The Quarterly Journal of Economics, (2005), 223, 224 cited in Ibid. 239.

and the executive at the time of enforcing policy in society. Article 38 of the Constitution impose a duty upon the state to promote the welfare of the people by securing and protecting a social order in which social, economic and political can be attained.⁸ Furthermore, clause 2 therein states that, “*the State shall, in particular, strive to minimize the inequalities in income, and endeavour to eliminate inequalities in status, facilities and opportunities, not only amongst individuals but also amongst groups of people residing in different areas or engaged in different vocations.*” The principle is a reaffirmation of the principles declared in the Preamble to our Constitution *inter alia* being the realisation of social, economic and political justice.⁹ To define the general principle of economic justice as embodied in Article 38 of the Constitution in a greater depth, Part IV places greater responsibility on the State through Article 39 (b) and (c) of the Constitution. Article 39 (b) requires the State to frame its policy in such a manner that, “*the ownership and control of material resources of the community are so distributed as best to sub serve the common good.*” The enactment of the aforesaid provision embarks on a social mission, aiming at the distribution of natural resources which, in turn would promote the achievement of distributive justice by embracing all material resources in society.¹⁰ Furthermore, the term ‘*material resources of the community*’ stated in clause (b)¹¹, has not been restricted just to natural resources or public possessions but has been broadly interpreted as including all private and public sources of meeting material needs.¹² Article 39 (c) under Part IV of the Constitution states that, “*the State shall, in particular, direct its policy towards securing that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.*” The object of the clause is to permit the State to regulate the economic system in such a manner that its functioning does not lead to concentration of wealth and means of production to the common detriment.¹³ Upon a bare reading of the aforesaid directives of the Constitution, it may be inferred that the promotion of alternate capital raising is a step progressing towards the accomplishment of the twin goals of just distribution of material resources as well as minimising of concentration of wealth in the hands of a few as propagated in clauses (b) and (c) of Article 39 of the Constitution.

(iv) Freedom of trade and profession

Another contributing factor to the need for having an alternate capital raising platform in India lies under the right to practice any trade, profession or the carrying on of any occupation, trade or business, a fundamental right *inter alia* guaranteed to Indian citizens under Part III of the Constitution.¹⁴ The provision is wide enough to include the terms trade, profession, occupation or business,

⁸INDIA CONST., Art. 38, cl. (1).

⁹M.P. JAIN, INDIAN CONSTITUTIONAL LAW, 1373, (5th ed.), Wadhwa Nagpur, (2006).

¹⁰Air India Statutory Corporation v United Labour Union, (1997) 9 S.C.C. 377 (India).

¹¹Supra ft. nt. 8.

¹²State of Karnataka v Ranganatha Reddy, A.I.R. 1978 S.C. 215, 250 (India).

¹³KesavanandaBharati v Union of India, A.I.R. 1973 S.C. 1461 (India)

¹⁴INDIA CONST. art. 19, § 1, cl. (g).

the object whereof can be envisaged to make the aforesaid guarantee as comprehensive as possible to include all avenues and modes through which a man may earn his livelihood.¹⁵ The Constitution has made available the exercise of this freedom by citizens subject to certain restrictions which include firstly, restriction in the interests of the general public; secondly, carrying on any trade, business, industry or service by the State or a corporation owned and controlled by the State to the exclusion, whether complete or partial of the citizens; and thirdly, the prescribing by the State of any technical or professional qualifications necessary for practising any profession, trade, occupation or business.¹⁶

A conjoint reading of the duties prescribed under Part IV and the right conferred under Part III of the Constitution of India paves the way for building an alternate capital raising platform in the country. The document, being the supreme law of the land imbibes within it the objective of realising economic justice for all its citizens and the promotion of fund raising initiatives for start-up ventures shall surely boost the achievement of the goal so clearly envisioned for the country by the draftsmen of the Constitution.

Regulatory framework for promotion of start-up funding

SEBI has undertaken certain initiatives to enable start-up companies to secure additional capital requirements through the following mechanisms:

(i) SEBI (Listing of Specified Securities on Institutional Trading Platform) Regulations, 2013 (“ITP Regulations”)

The ITP Regulations were enacted by the SEBI vide a notification¹⁷ with the objective to further amend certain other regulations governing the securities market viz. the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (“**ICDR Regulations**”), the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 and the SEBI (Delisting of Equity Shares) Regulations, 2009.¹⁸ Some of the features of the ITP Regulations that have been enacted as the principle amendments to the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 are discussed hereinbelow:

(a) Insertion of “Chapter XC”

The ITP Regulations have incorporated a new chapter in order to govern “*the listing and issue of capital by small and medium enterprises on institutional trading platform without Initial Public Offering*”¹⁹, which are applicable to small and medium enterprises not listed in any recognised stock exchange but intending to list specified securities exclusively on the

¹⁵Sodan Singh v New Delhi Municipal Committee (1989) 4 S.C.C. 155 (India).

¹⁶INDIA CONST. art. 19, cl. 6.

¹⁷SEBI (Listing of Specified Securities on Institutional Trading Platform) Regulations, 2013, LAD-NRO/GN/2013-14/27/6720 published in the Extraordinary Gazette of India Part III-Section 4, October 8, 2013.

¹⁸Preamble, I.T.P. Regulations, 2013.

¹⁹Chapter XC, Ibid.

institutional trading platform.²⁰ An institutional trading platform means, “*The trading platform in a SME exchange for listing and trading of specified securities of small and medium enterprises for informed investors.*”²¹ Similarly, regulation 106X (1) (b) of the ITP Regulations also defined small and medium enterprises which are broad enough to include a start-up company.

(b) Eligibility requirements for listing

The ITP Regulations prescribe that small and medium enterprises shall be eligible for listing of its securities on the institutional trading platform subject to certain eligibility requirements viz. that the company, its promoters, its group company or director should not:

- appear in the Reserve Bank of India’s (“**RBI**”) list of wilful defaulters;
- have any winding up proceedings instituted in any court;
- be referred to the Board of Industrial and Financial Reconstruction within a period of five years prior to the listing application date;
- have any regulatory action taken by the SEBI, RBI, the Insurance Regulatory Development Authority and the Ministry of Corporate Affairs within a period of five years prior to the listing application date;
- have completed more than ten years after incorporation and its revenues should not have exceeded one hundred crore rupees in any of the previous financial years;
- have its paid-up capital exceed twenty five crore rupees in any of the previous financial years;
- should submit at least one year’s audited financial statements for the immediate preceding financial year at the time of making the listing application; and
- the company shall have received funding from any of the following investors: alternative investment fund, venture capital fund, other category of investors/lenders approved by SEBI, or an angel investor from an association/group of angel investors, or project finance or working capital finance from a scheduled bank, or registered merchant banker, or qualified institutional buyer, or specialised international multilateral agency or domestic agency or public financial institution.²²

(c) Conditions for issue of securities and raising of capital

Companies applying for trading of their securities on the ITP platform are required to comply with additional requirements such as filing of an

²⁰106W, Ibid.

²¹106X (1) (a), Ibid.

²²106 Y, Ibid.

information document after submission of the listing application.²³ The minimum trading lot on the ITP is prescribed to ten lakh rupees.²⁴ Furthermore, the companies so listed on the ITP platform are permitted to raise capital through issue of securities on a private placement basis or a rights issue.²⁵

(d) Promoter shareholding and lock-in period

The ITP Regulations compel promoters to hold not less than twenty percent of post holding capital (“**Promoters’ Holding**”) at the time of listing of specified securities. Furthermore, the post listing capital is mandatorily required to be lock-in for a period of three years from the date of listing.²⁶

(e) Exit option

Small and medium enterprises listed on the ITP have been provided with the option to exit from the same under certain circumstances. However, the ITP regulations also prescribe situations wherein it shall be mandatory for companies to exit from the platform.²⁷

(ii) **SEBI Discussion Paper on Alternate Capital Raising Platform and Review of other regulatory requirements**

The regulation of start-up funding through ITP Regulations, though initiated from 2013 did not facilitate a successful launch of substantial capital raising in the start-up world. In order to curb the inadequacies faced by companies due to the stringent regime under the ITP Regulations, SEBI has, in April 2015, released a discussion paper on ‘*Alternate Capital Raising Platform and Review of other regulatory requirements*’ (“**Discussion Paper**”), wherein SEBI had also invited public comments for a specific time period. There arose an inherent requirement for SEBI to bring out the Discussion Paper as the ITP Regulations posed a number of technical difficulties for start-up companies. *Firstly*, the ITP Regulations permit listing of securities on the ITP however, the issue of such securities to the public is expressly prohibited.²⁸ *Secondly*, in an interaction of the Indian Software Product Industry Round Table with SEBI, the growing number of start-up companies in the software market and need for creating regulatory awareness in the industry has been conveyed to SEBI. *Lastly*, there has arisen a greater need to provide easier exit options to private equity investors from small and medium enterprises.²⁹ The proposals outlined in the Discussion Paper are explained herein below:

(a) Proposal to set up an alternate capital raising platform

²³106Z, Ibid.

²⁴106ZC, Ibid.

²⁵106ZA, Ibid.

²⁶106ZB, Ibid.

²⁷106ZD, Ibid.

²⁸Supra, ft. nt. 25, Discussion Paper para 1.2

²⁹Discussion Paper, para 1.3, 1.4.

The idea of the Discussion Paper primarily focuses on building a platform for new age companies that are having innovative business models and belong to the knowledge-based technology sector, to raise money from institutions and high net worth individuals. The Discussion Paper seeks to provide a start-up friendly environment due to the contribution of start-up companies to nation building, employment generation and promotion of innovation.³⁰

(b) Eligibility

The alternate capital raising platform shall be thrown open initially for companies specialising in the area of software product development, e-commerce, new age companies having innovative business models which either facilitate the creation of new opportunities or serve important efficiency enhancement in existing business activities. The eligible players shall comprise of those companies wherein there is no person either individually or through a person acting in concert that holds twenty five percent or more of the pre-issued share capital and shall access capital through the Institutional Trading Platform (“ITP”).³¹

(c) Modification of ITP

The Discussion Paper brings about a variation in the existing structure of the ITP by bringing out the following changes:

- the proposed alternative trading platform divides investors into two categories viz. Qualified Institutional Buyers (inclusive of family trusts) (“QIBs”) and Non-Institutional Investors wherein QIBs shall not be allotted more than five percent of the issue size;
- minimum application size of the issue on such platform shall not exceed ten lakh rupees and the minimum number of allottees to the issue shall not exceed five hundred. However, the minimum trading lot on the platform has been fixed to five lakh rupees; and
- the companies listing on the ITP shall stay so for a period of at least one year. After completion of a year, the company is given the option to migrate to the main board after compliance of eligibility requirements of stock exchanges.³²

(d) Generalised object of issue

The current framework under the ICDR Regulations³³ requires the start-up companies to disclose the objects of any issue made by them which included large number of grounds. However, the discussion paper proposes to generalise the object of issue in the case of every company listed on the ITP, the object now being stated as ‘general corporate purpose’.

³⁰Para 2.10, 2.8, Ibid.

³¹Ibid, para 3.1.3, 3.3.1.

³²Ibid. para 3.2.2-3.2.8.

³³I.C.D.R. Regulations, Chapter VIII-Part A (VII.), 44.

(e) Reduced lock-in period of shares

According to Regulation 36(a) of the ICDR Regulations, the Promoters' Holding must be locked in for a period of three years from the date of commencement of the commercial production or date of allotment of public issue whichever being earlier. Furthermore, Regulation 37 of the ICDR Regulations provide a one year lock-in period in respect of the pre-issue capital held by persons other than the promoters. However, the Discussion Paper has proposed a reduced and uniform lock-in period of six months for all shareholders in a start-up company.

(f) Disclosure of basis of issue price

The Discussion Paper stipulates the disclosure of the basis of issue price as deemed fit by the issuers accessing the ITP.

(g) Modification of the definition of QIBs

QIBs according to the Discussion Paper, is a term which is widened to include systematically important NBFCs as well as family offices/trusts registered under the Alternate Investment Funds Regulations, 2012.

(h) Additional Disclosures

The Discussion Paper places a restriction to the definition of group companies as only limited to those under AS-18 of the accounting standards enacted by the Institute of Company Secretaries of India and tightens the nature of disclosures pertaining to the litigations against the issuer company. Furthermore, the Discussion Paper requires the display of the complete list of creditors of the issuer company on its web page.

(iii) SEBI Board Meeting dated June 23, 2015 (“Board Meeting”)

Pursuant to the floating of the discussion paper, SEBI has convened a meeting on June 23, 2015 at Mumbai, wherein certain key decisions were taken by the board members regarding certain policy modifications *inter alia* consisting of a simplified framework for capital raising by technological start-ups and other companies on ITP. Many of the proposals as suggested in the Board Meeting are in harmony with the amendments proposed to the ITP Regulations in the Discussion Paper. The minutes of the Board Meeting suggest the following amendments to the ITP Regulations:

(a) Accessibility of ITP

It has been decided in the Board Meeting that there shall be an institutional trading platform wherein capital raising shall be a cardinal objective. The platform shall be made available *firstly*, to companies which are intensive in their use of technology, information technology, intellectual property, data analytics, bio-technology to provide products, services or businesses platforms with substantial value addition and in which at least twenty five percent of the start-up capital is held by QIBs or any other company in which at least fifty percent pre-issue capital is held

by QIBs.³⁴

(b) Categories of investors

The proposed rules discussed at the Board Meeting permit only two kinds of investors to access the institutional trading platform viz. institutional investors or QIBs also including family trusts, systematically important NBFCs registered with RBI and intermediaries registered with SEBI, all of them having a net worth of more than five hundred crores or more, and non-institutional investors excluding retail investors.³⁵

(c) Post-issue capital limit

The new proposals do not permit any person, even though they are persons acting in concert, to hold more than twenty five percent of the post-issue share capital in the company.³⁶

(d) Disclosure norms and issue caps

It has been decided in the Board Meeting that the companies seeking to list on the institutional trading platform shall only disclose the broad objects of the issue made by such a company. There is also no cap placed when the issue is made by companies towards raising amounts for general corporate purposes.³⁷ However, it is pertinent to note that the term '*general corporate purposes*' has not been defined anywhere in the Board Meeting minutes.

(e) Minimum application size and allottees

The Board Meeting has placed a minimum application size for each company to ten lakh rupees and directed the minimum trading lot to be of the same amount. The total number of persons to which such allotment shall be made has been fixed to two hundred or more in the event the issue is a public offer.

(f) Migration to main board

The minutes of the Board Meeting propose that the companies listed on the institutional trading platform shall have the option to move to the main board after a completion of three years subject to the compliance requirements of other stock exchanges.³⁸

Fund raising by start-up companies in USA

In order to encourage the economic growth for improving capital market access for emerging growth companies as well increasing the job market³⁹, the Congress has

³⁴Para 2, Board Meeting.

³⁵Para 2 (vii), Ibid.

³⁶Para 2 (iii), Ibid.

³⁷Para 2 (iv), Ibid.

³⁸Para 2 (xii), Ibid.

³⁹Preamble, Jumpstart Our Business Startups Act, H.R. 3606-18.

enacted the Jumpstart our Businesses Start-ups Act (“**JOBS Act**”), which was given presidential assent on April 5, 2012 primarily to amend the provisions of the Securities Act, 1933 to incorporate capital issue by small companies. In order to further this objective, Title IV of the JOBS Act provides the policy framework for capital formation by a small company. Section 401 of the JOBS Act provides an exemption to small and medium enterprises from mandatory registration with the Securities and Exchange Commission (“**SEC**”) subject to compliance of certain conditions which *inter alia* involve the aggregate of specific securities amounting to fifty million dollars to be offered and sold within a period of twelve months. Moreover, the provision gives an option to the companies to make a public offer of the aforesaid securities subject to filing of offer document with the SEC along with other allied documents.⁴⁰

By virtue of a notification dated March 25, 2015, the SEC has brought forth changes to rules pertaining to exemptions granted to small and medium enterprises by amending Regulation A, to be made effective from June 19, 2015 (“**Final Rules**”).⁴¹ Salient features of the Final Rules are summarised hereinbelow:

(i) Creation of a two-tier capital raising system

The Final Rules have proposed the setting up of a two stage system to enable fund-raising by small and medium enterprises on the listing platform consisting of Tier 1 and Tier 2. Tier 1 is a phase wherein enterprises are permitted to raise 20 million dollars through offer of securities whereas in Tier 2, companies may raise up to 50 million dollars through offer of securities. In the event securities are sold by existing shareholders in the total amount so offered shall not exceed six million dollars under Tier 1 and in case of Tier 2, this total amount shall not exceed fifteen million dollars.

(ii) Limit on purchase of securities

The Final Rules prescribe that if an investor is not an accredited investor as defined under the Regulation D, the investment limit for such persons is limited to not more than ten percent of the greater annual income or net worth in case of natural persons and ten percent of the greater of annual revenue or net assets in the end of a fiscal year if the investor is an artificial person.

(iii) Solicitation of capital

Issuers both under Tier 1 as well as Tier 2 have been permitted to solicit interest in the offering to be made by them before or after filing of the offer statement with the SEC. The Final Rules stipulate compliance with certain conditions such as issue of a preliminary offer circular in the event the solicitation is carried out after filing of offer statement.

(iv) Stringent filing for Tier-2 funding

Companies that seek capital funding under Tier-2 are mandated to file financial statements in their offering circulars in accordance with their American public

⁴⁰Jumpstart Our Business Startups Act, § 401, H.R. 3606-18.

⁴¹Amendments for Small and Additional Issues Exemptions under the Securities Act (Regulation A), [Release Nos. 33-9741; 34-74578; 39-2501; File No. S7-11-13].

accounting standards.

(v) Review of eligible issuers

Till the promulgation of the Final Rules, Regulation A limited the applicability of the rules of exemption to issuers with a principal place of business in the USA or in Canada. However, the Final Rules also provide that the exemption shall not apply to issuers that are or have been subject to any order made by the SEC under Section 12(j) of the Securities Act, 1933, secondly, those issuer companies which have not filed reports with the SEC which are required to be filed during the last two financial years before filing of the offer document.

(vi) Pre-emption of state laws

According to the Final Rules, exemption from registration under state security laws at the time of issuing securities to qualified purchasers which is defined to mean, “*any person to whom securities are offered or sold in a Tier 2 offering*”.

Concluding comments

India is now an active participant in the world start-up race, soon catching up pace to become a frontrunner on the track to becoming “start-up India” as rightly remarked by the Prime Minister in his speech.⁴² However, the future of Indian start-up funding is still in a very nascent stage, with the government only taking baby steps towards initiating the setting up of an alternate trading platform. With the regulatory framework still in the embryonic stage, there lies ample scope to examine and determine options that may be best suited to enact a law governing capital raising by start-up companies in the country so as to be amenable to the need faced by growing economy at the current hour. As highlighted in the Discussion Paper, due to the lack of a flexible regime to regulate capital raising by start-ups in the country, many of these companies are advised by institutional investors to consider listing the same in jurisdictions other than India leading to a gradual exit of these entities outside the boundaries.⁴³ In light of the circumstances existing in the industry, the following measures are recommended to ease up start-up funding:

(i) Adoption of the US Model

A regulatory mechanism involving the establishment of a tier system as in the Final Rules to raise capital through public issues by start-up companies is a method which may serve beneficial to a smooth sailing capital raising economy. A perusal of the recent statistics pertaining to start-up funding in India leads to an observation that most start-up companies seek funding amounts anywhere between a lakh which is likely to go up to funding in crores in various rounds.⁴⁴ Due to diverse numbers of funding amounts, it would be advisable to fix investment tiers with fixed trading lots in different tiers. For instance, the Discussion Paper stipulates a minimum trading lot of one lakh rupees⁴⁵,

⁴²Supra, 1.

⁴³Discussion Paper, para 2.6-2.7.

⁴⁴Indian Startup Funding & Investment Chart [2015] <http://trak.in/india-startup-funding-investment-2015/> (last visited September 5, 2015)

⁴⁵Supra, ft. nt. 32.

similarly, it is suggested that the proposed alternate trading platform pursuant to the release of regulations, may consist of two tiers wherein the maximum limit of funding shall be fixed with a minimum trading lot of a pre-decided amount by SEBI.

(ii) Broader scope of start-up companies

The Discussion Paper has fixed a description of start-up companies to those only belonging to the knowledge based technology sector.⁴⁶ It is pertinent to note that the economy is flourishing to such an extent that start-ups are mushrooming not only in the IT sector but also in various other fields such as hospitality, transport, retail and even personal wellness to name a few. It is thus, submitted that restricting the scope of the proposed regulations only to technology sector shall render no assistance to other sector specific emerging start-ups in India.

(iii) Definition of ‘general corporate purposes’

The Discussion Paper as well as the Board Meeting has outlined the raising of funds on the ITP for general corporate purposes. However, the term by itself is very broad and can at times lead to vague conclusions. Thus, it is submitted that the term be defined in the regulations in order bring clarity to the purposes for which funds shall be raised and place a scope to the concept.

(iv) Involvement of several bodies

It is submitted that, although the SEBI is the only regulator of the securities market in India, start-up companies are so much in demand and affect India Incorporated as a whole, the framing of regulations building an alternate capital platform must involve representatives from different fields such as management, finance, accounting and the like.

An overview of the capital formation initiatives in India reveal that there is still a long way to go towards attaining a well-defined framework to regulate capital raising by start-up companies in India. It is hereby suggested that the following pointers also be borne in mind at the time of bringing forth the final legislation so as to achieve the twin goals of ease of doing business in India as we all start-up India. It is important to bear in mind that the creation of an alternate capital platform is a need of the present hour. The current year is almost coming to an end with no response from SEBI on the proposed regulatory mechanism. The longer time taken by the government to set up the platform, the greater are the chances of exhausting the light burning into the entrepreneurial visions of many Indian minds.

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⁴⁶Supra, ft. nt. 31.

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