Ahuja Valecha & Associates LLP
Chartered Accountants
Pune | Bangalore I Dubai

Western India Regional Council of
The Institute of Chartered Accountants of India

Webinar on - Professional Opportunities – Startup Fund Raise Documentation

Prepared and Presented by CA Lalit Valecha

Attributes of a Startup Founder

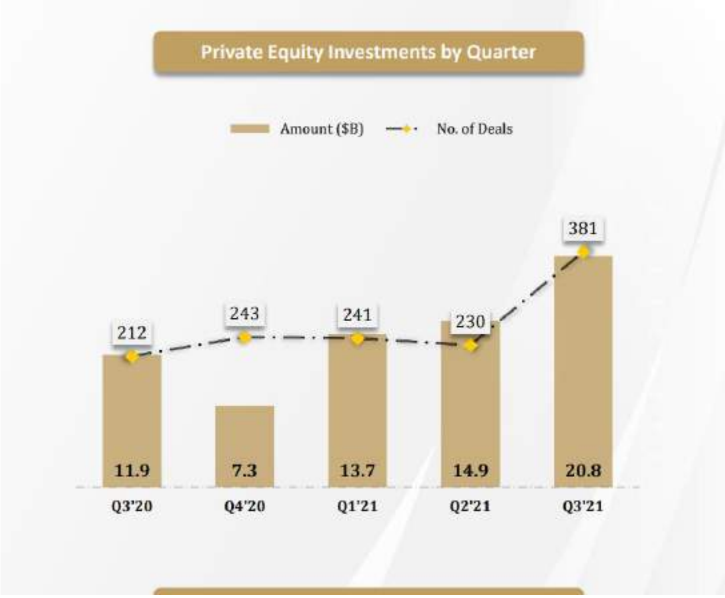
Needs from Advisors / Consultants

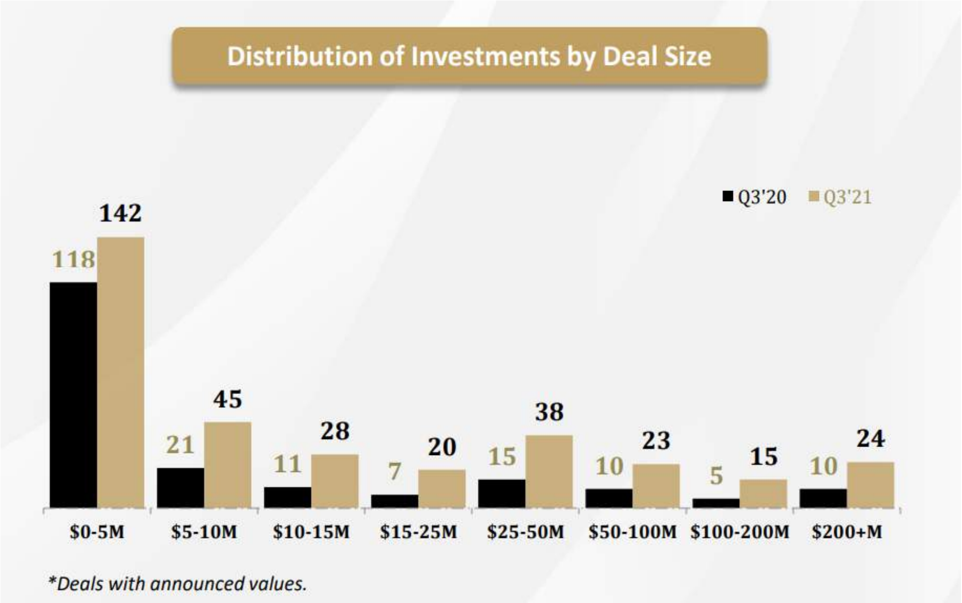
1. Work as a Busines Partner
2. Time effectiveness is utmost important
3. Solution oriented
4. Simple yet sustainable solution
5. Continuous engagement due to ever changing needs and business pivot
6. Holistic Approach
7. Reliable partner for financial, Compliance and Tax related needs
8. Upskill with the evolving business needs along with the stage of the Startup
9. Agility
10. They like Seamless data sharing and single dashboard

PE Investments in India during Jul-Sep 2021

20.8 Bn

381 Deals





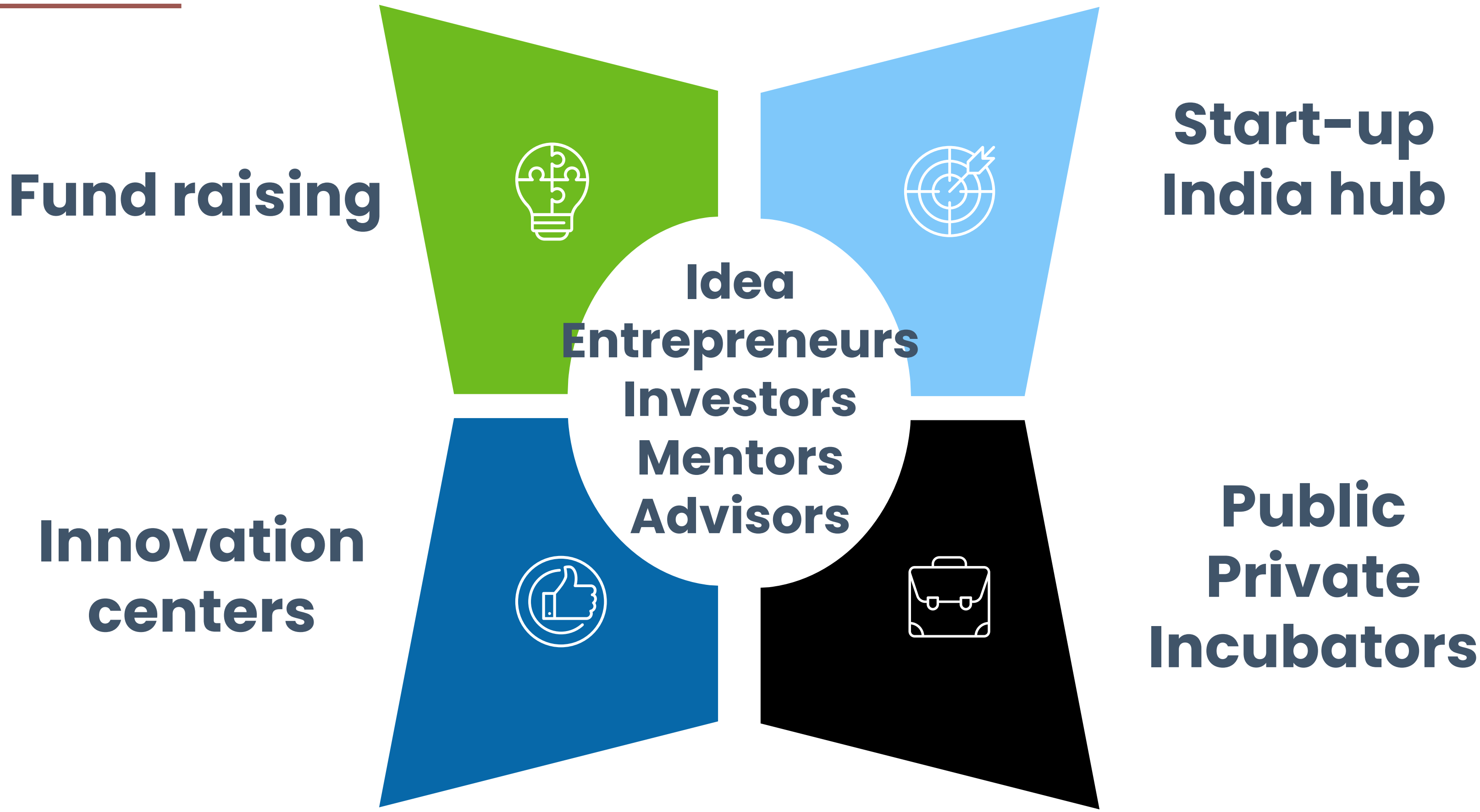
Source: India Private Equity Report by Venture Intelligence

Most Active Unicorn Investor

Above mentioned data excludes Former & Graduated Unicorns

Source: Venture Intelligence Indian Unicorn Highlights on India's $1-Bn+ Valued Start-ups Edition H1'2021

Start-up Eco System



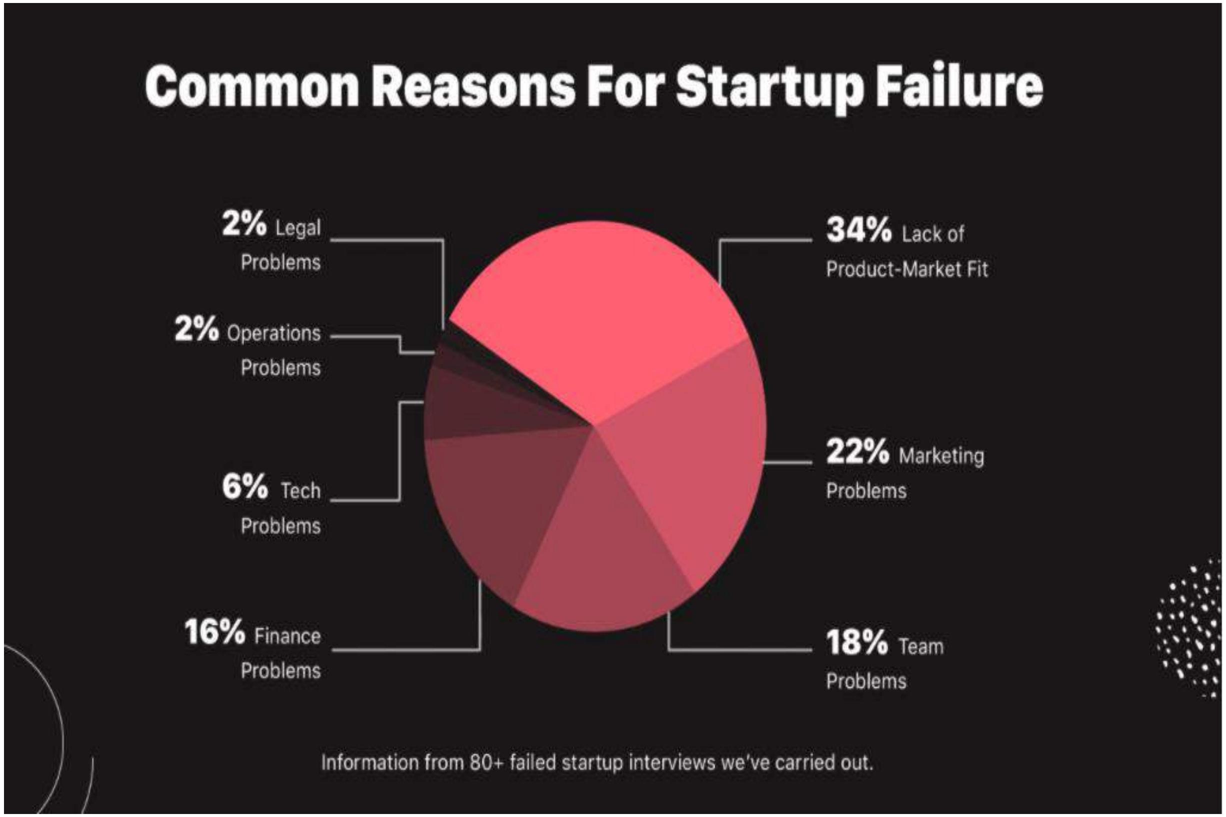
Start up Ecosystem comprises entrepreneurs, different kinds of financial / non-financial support such as debt finance, equity investments, grants and non-financial support including incubation, acceleration support, mentoring and technical experts and Government policies and programmes

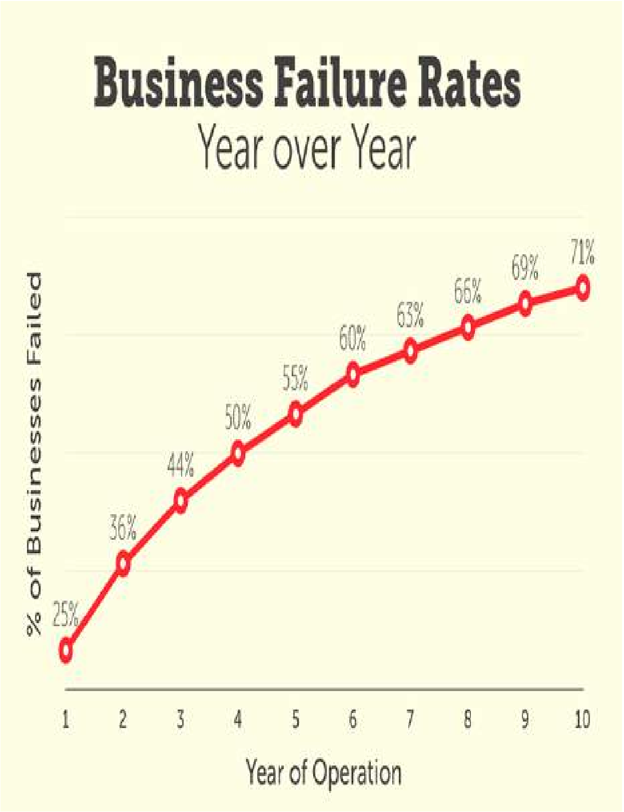
Startup Blueprint

- Live in the future ahead of the time
- Problem Statement – what is missing in world?
- Make a prototype and who it to 100 people
- Iterate prototype and make business plan
- Find a co-founder
- Register a Company

Help required by Founders for Business plan, Structuring Aspects basis regulatory Framework and Company Formation

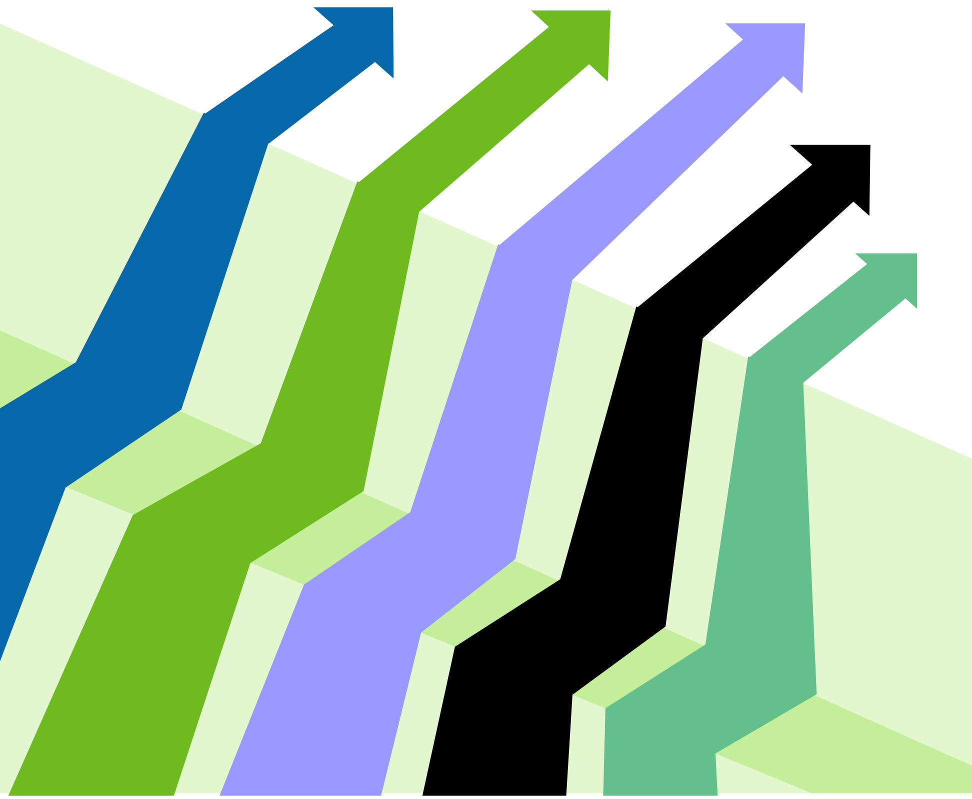
Start-up Failure Reasons





Importance of a Strong Business plan calculating Exact burn, Fund Raise Requirement balancing Founder Dilution in initial Stages. Lesser budget allocation for Engineering/ Product team, Team Allocation and CAC can lead to failures. Also planning for adequate fund raise at right valuation.

Start-up Needs



- LLP Vs. Company and all post incorporation registrations also whether Externalization required
- Founders Agreement
- Make a Pitch Deck and business plan
  (Important to Know your TAM)
- IP protection including drafting of Employment agreement
- Have an ESOP plan in place for employee
- Secure appropriate funding

LLP Vs Company

	LLP	Private Limited
Registration	Mandatory under the Limited Liability Partnership Act, 2008	Mandatory under the Companies Act, 2013 - Registrar of Companies
Compliance	Moderate	Slightly High
Liability / Ownership	Limited liability of the LLP – Partners not personally labile	Limited liability of the company – Shareholders are not personally labile
Legal Status	Considered to have a separate legal entity. Perpetual succession – but to some extent linked to Partners	Considered to have a separate legal entity. Perpetual succession
Mgmt responsibility	Designated Partners	Board of Directors

Where to Incorporate

Scenario 1: Due to Global Customer Needs few start-ups may want Subsidiary Structures Outside India.

In this case Angel tax Exemption may not be available. Which means the startup can look at issuing CCD as opposed to CCPS or Equity to Angel Investors or go through the Syndicate route for AIF investment.

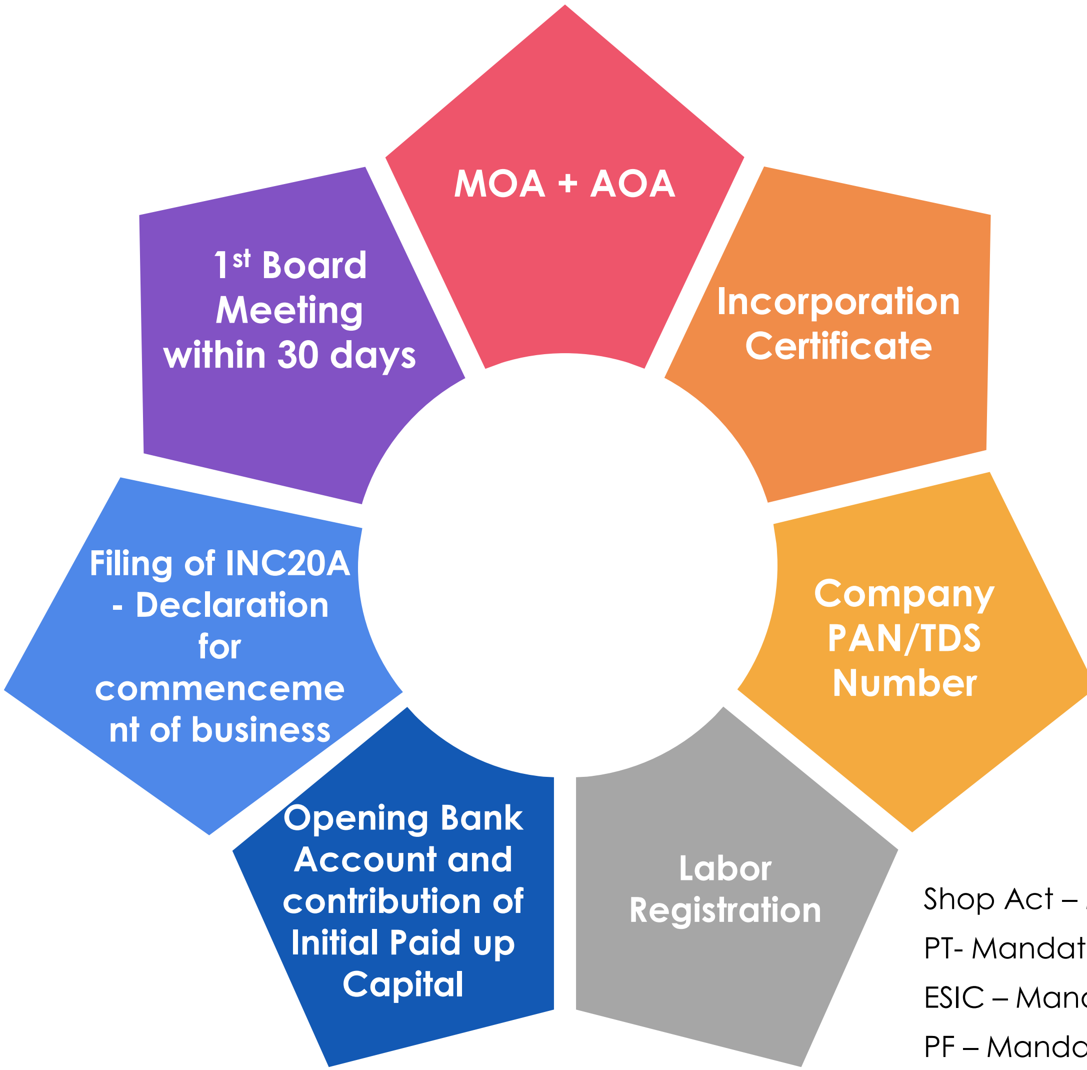
Scenario 2: Quite a Few Indian Start-ups Look at USA and Singapore as their Head-Quarters / Parent Entity for Customer, Investor preferences

Round Tripping- FEMA

POEM / Transfer Pricing

Problems to solve if Founders in India want to create overseas Holdco Structures, prevalent in SaaS business particularly on B2B

Formation Documents



Shop Act – Mandatory Immediately

PT- Mandatory immediately

ESIC – Mandatory once headcount > 10

PF – Mandatory once headcount > 20

POSH – Mandatory once headcount > 10

Ahuja Valecha & Associates LLP
Chartered Accountants

Annual Compliances

Regulatory Compliance

Intimation by Director about disqualification	DIR 8	To be obtained as on 31st March of each Financial Year (FY)
Disclosure of Interest by Director	MBP 1	At the First Board Meeting (BM) in every financial year and at the BM held immediately after the change in interest
Annual Directors KYC	e-Form DIR-3 KYC	On or before 30th June of immediate next financial year
Annual Return of Deposits	e-Form DPT-3	Annually, on or before the 30th June every year
Return to Registrar by SBO	e-Form BEN-2	Within 30 days of date of receipt of declaration by the significant beneficial owner
Filing of Annual Return	e-Form MGT-7	Within 60 days from the date of Annual General Meeting
Annual Return on FLA	Form FLA	To be filed on or before 15th July every year
Audited Financial Statements, Directors Report and Auditors Report	e-Form AOC-4/AOC-4-XBRL	Within 30 days from the date of the Annual General Meeting

Must Haves

#startupindia

MSME
MICRO, SMALL & MEDIUM ENTERPRISES
सत्यमेव जयते

ANGEL TAX EXEMPTION

Goods and Services Tax

Start-up Eligibility Criteria

Must be a Private Limited Company/LLP/Partnership Firm

Within a period of 10 years from the incorporation

Yes

Annual turnover shall not exceed 100 Crores

Yes

Entity shall be working towards innovation, development/improvement of products/ processes/services, or shall be a scalable business model with a high potential for employment generation or wealth creation

Yes

Shall not invest in

- Building/Land that is residential house; held as stock-in-trade
- Loans or Advances other than in the ordinary course
- Capital Contributions; Shares and Securities in other entities
- Modes of Transport that costs more than INR 10 Lakh
- Jewellary or any other asset

Application to DPIIT + Certificate of Incorporation/Registration + Write up of the nature of business + Inter Ministerial Board (IMB)

Employee Stock Option Plan

- Employee Stock Option Plans/Equity Incentive Plans (commonly referred to as ESOPs) are one of the most important tools **to attract**, **encourage** and **retain Employees**. It is the mechanism by which employees are compensated with increasing equity interests over time.

- Employee can exercise his/her options once the vesting condition(s) has been satisfied any time before the expiry of exercise period.

- Employees to be covered under the ESOP shall be identified basis their criticality as well as line of sight to the business performance.

- It is a **right offered by a company** to its employees to take equity shares of company at discounted price.

Grant of options → Vesting of options → Exercise of Vested options → Allotment of Shares

Pitch Deck

Problem Statement

Solution

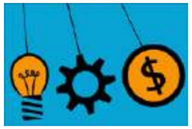
Market

Product

Team

Competition

Financials



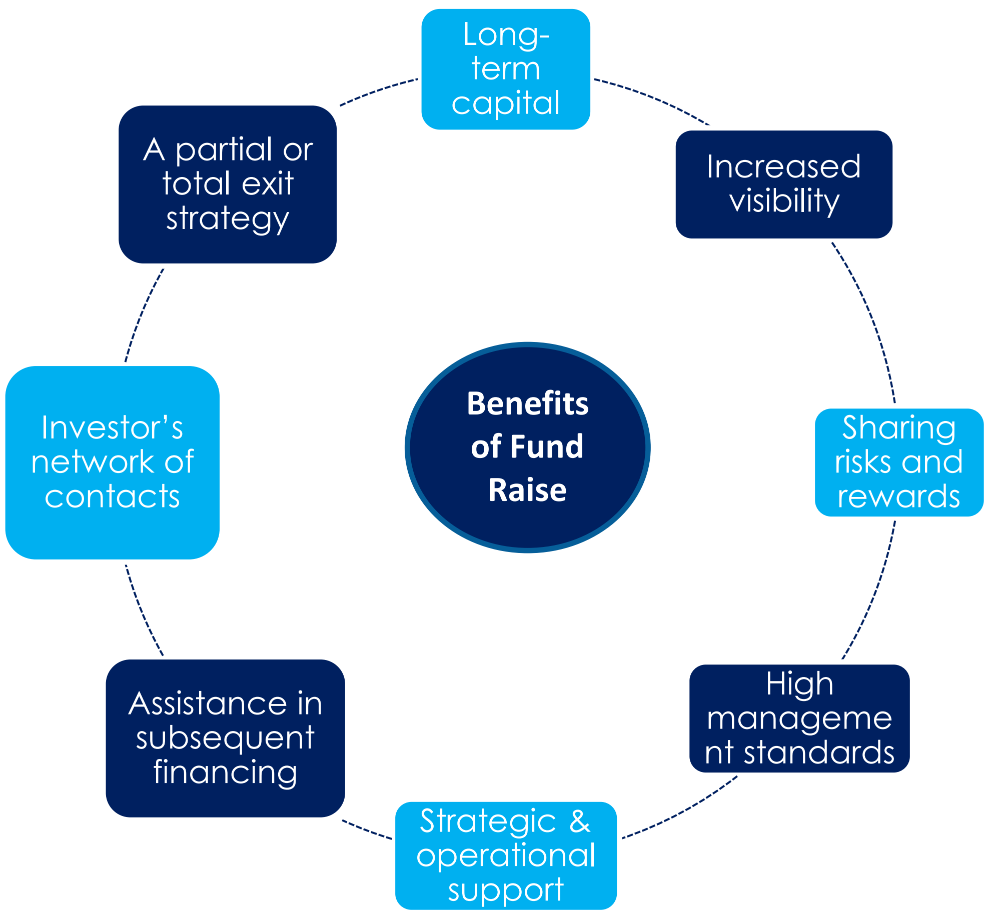
Amount being Raised

Founders Profile

Types of Funding

Bootstrap	An entrepreneur should ascertain how much amount he/she can contribute from his/her own pockets. Assess all of your investments and savings kept in multiple accounts, and approach your friends and family. This stage involves fewer complexities and documentation, and even your friends and family maybe ready to lend at a cheaper rate. Self-funding or **bootstrapping is apt if your startup requires a little investment earlier**
Seed Capital	Seed-capital is an investment made at the **preliminary stage of the startup**. This helps the business in identifying and creating a perfect direction for their startup. Funds raised at this stage are used for knowing the customers' demands, preferences, and tastes, and then formulating a product or service accordingly. Most of the budding entrepreneurs raise this capital from **friends, mentors, and family**, while some take up loans in exchange for common stock
Venture	When the company's **final products or services reach the market, venture capital funding comes into the picture**. Regardless of the products' profitability, every business considers using this stage that further involves multiple rounds of funding
Series A	Series A investment, being the very first round of funding, doesn't ask for external funding. At this stage, startups have formulated a specific plan for their product or service. It is mostly **used for marketing and improving your brand credibility, tapping new markets and helping the business grow**
Series B	When a business relies on Series B investment, it portrays that the product is marketed right, and the customers are actually buying the product or service, as decided earlier. Such funding helps a business in **paying salaries, hiring more staff, improving the infrastructure and establishing it as a global player**
Series C	A startup can receive as many rounds of investment as possible, there is no certain restriction on it. However, during Series C investment, the owners, as well as the investors, are pretty cautious about funding this round. The more the investment rounds, the more release of the business' equity.

Benefits of Fund Raise



Key points of Capital Raise

- Cash flow
- Liquidity
- Product-by-product analysis/Service-by-service analysis
- Expense control
- Industry-specific metrics

Types of Securities

1. Equity
2. Compulsory Convertible Preference Shares CCPS
3. Compulsory Convertible Debt
4. Convertible note

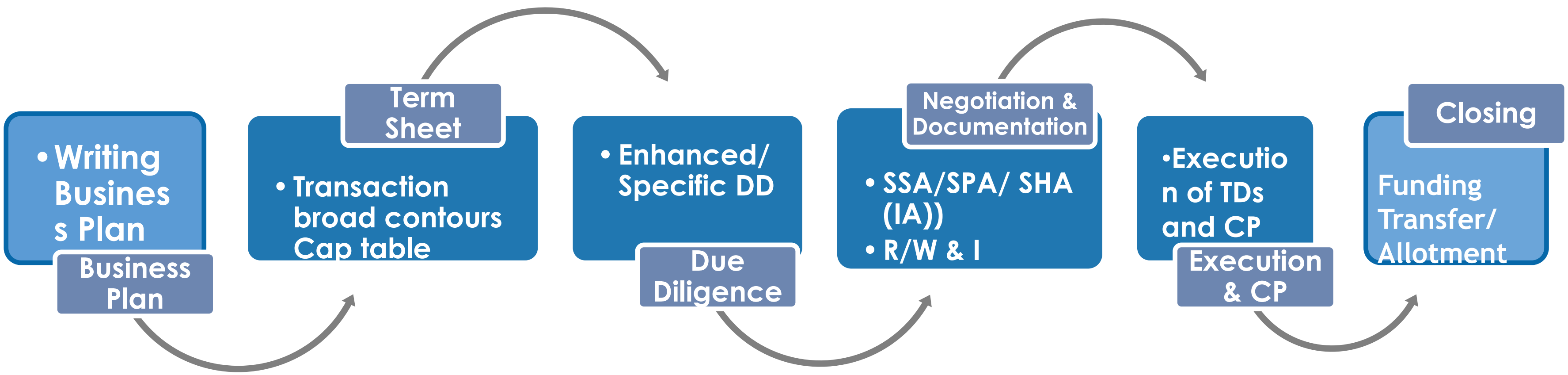
Investment Instruments

❖ Types of Instruments

- Deal documentation and inter se rights between the Investor and Promoters usually depends to a large extent on the choice of instruments used to invest in the company:

PARTICULARS	EQUITY SHARES	COMPULSORILY CONVERTIBLE PREFERENCE SHARES
Type of Investors	Generally used by Investors who wish to have control the decision making of the Company	Generally subscribed to by Institutional Investors and provides them preferential and protection
Nature of Return	Rate of return fluctuates, depending on the distributable profits	Dividends are either given as a fixed amount or an amount calculated at a fixed rate
Right to receive dividends	Residual claimants over the dividends distributed by the Company	Due to first preference, have the right to dividends before equity shareholders
Right to receive surplus capital during liquidation	Entitled to repayment of capital invested after all the financial creditors and preference shareholders, and do not have access to surplus capital on winding up	Entitled to repayment of capital in preference to equity shareholders, it may carry subsequent right to any surplus capital after distribution to equity shareholders, if participatory
Voting Rights	Equity shareholders are entitled to vote on every resolution placed before the Company	Unless otherwise agreed contractually, preference shareholders may only vote on resolutions that directly affect their rights

Steps in Fund Raise



Term Sheet Key Terms – Watch Outs

Exit Rights and Drag Right – IRR if any

Liquidation Preference

Valuation

Founder Vesting and Lock In

ESOP pool- Dilution to Founders

Liquidity Sale during Vesting Period curve out

Documentation Support – CP / CS

Allotment of Shares Closing Documents including FCGPR

Private Placement/ Rights Issue Documentation

Representation, Warranties and Indemnities

Valuation of Shares –
1) Cos Act Registered Valuer
2) FEMA- CA

Cap table modelling for SSA/ SHA

Data Room creation, Negotiation and Finalisation

Checklist – Essential Documents

- The documentation for an investment transaction consists of:

✓ **Business Plan**
✓ **Term Sheet**
✓ **Share Subscription Agreement (SSA)**
✓ **Share Purchase Agreement (SPA)**
✓ **Shareholders' Agreement (SHA)**
✓ **Due Diligence Reports**
✓ **Disclosure Letter**
✓ **Confidentiality Agreements**
✓ **Employment Agreements**
✓ **Deeds of Adherence**

- There may be other documentation agreed on between the parties depending on the structure and other terms of the deal, such as an escrow agreement for safeguarding shares, consideration or assets

- In this session, we will discuss some of the customary terms in the Term Sheets, SSA, SHA and SPA

Mergers and Acquisition Avenues

1. Intellectual Property ('IP') Sale

Transferring IP to country having better IP regulations for founders/investors

2. Merger / Fast Track Merger

Merger or Fast Track merger opportunities with existing companies

3. Share Transfer

Transferring of ownership through share transfer and valuation opportunities

4. Buy Back

Buy back of shares by the Company for better ESP and tax benefits

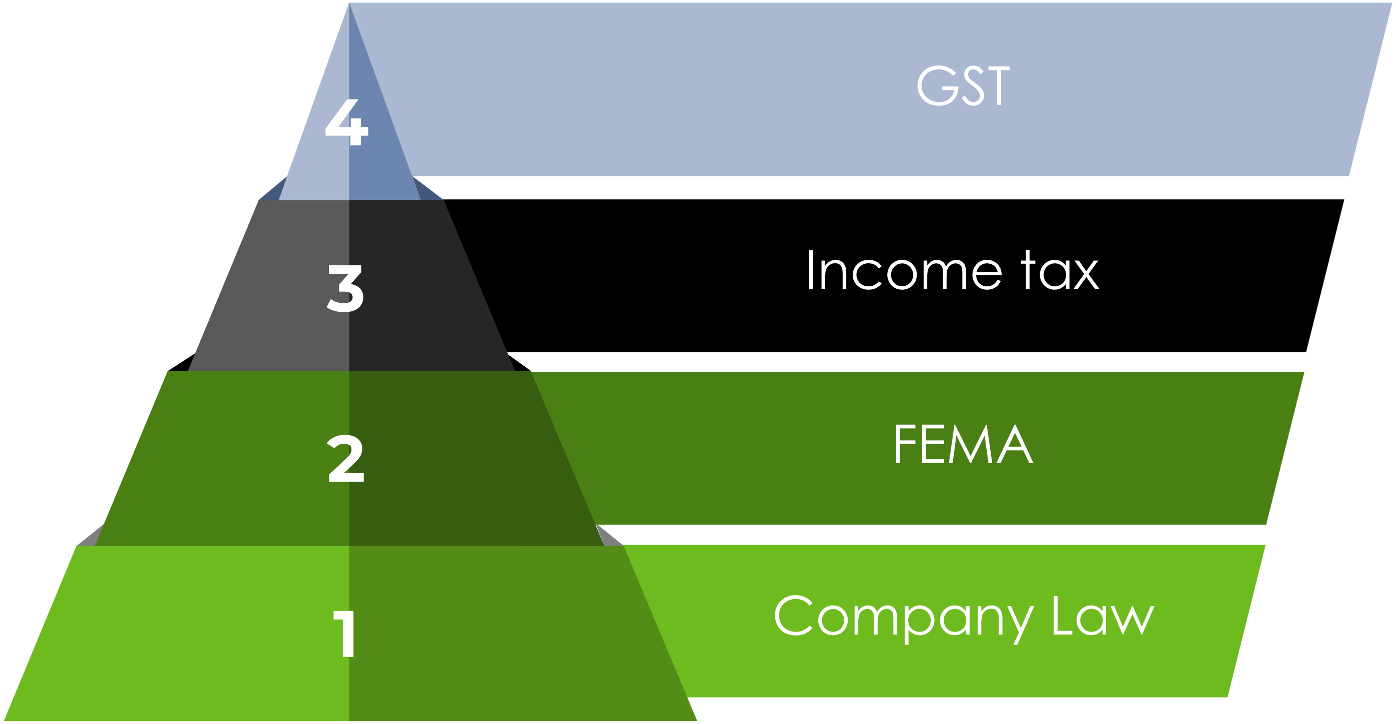
5. Share Swap

Exchange of shares of one company with other for structuring

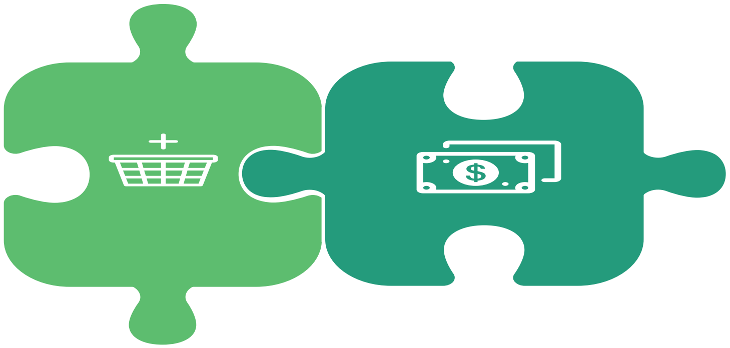
6. Slump Sale

Sale of business as a undertaking for easy and fast transfers

Regulatory Framework and Networking



Networking with Lawyer and CS affiliates for compliances



Networking with CPA and outside India consultants for cross border transactions

Common Mistakes

- Sole Founder
- No Co-founder Agreement
- In-adequate ESOP pool
- IP Not protected – NDA/ Confidentiality / registration
- IP like Domain registration and logo in name of founder – IP assignment required
- Committing stocks to mentors as advisory stock without proper documentation and tax consequences
- Not reading/ Negotiating the term sheet
- Not having well shareholder agreement for Angel/ Friends and family round
- Under valuation in seed / Pre-seed funding which leads to dilution of founder early on
- Not having employment agreement for founders No salary taken by founder
- Not having adequate Insurances – D&O, Cyder Security, and Professional Indemnity insurance
- Not raising enough for market fit product
- Lack of PR
- Focusing more on PPT rather than product
- Start-ups forgetting the revenue is king infact in few SAAS companies its capital
- Not tracking key revenue drivers – MRR/ ARR/ Churn/ CAC etc.

Thank You