

Guidance for Handholding Startups

A startup may start in a small way with big aspirations, but the actual sustainability of the business lies primarily on the nature of innovation in the product or service the startup desires to provide, its ability to create a place for itself in the emerging market, having regard to current and future needs of its prospective customers, and being able to do the same in compliance with the law.



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INTRODUCTION

No doubt, in order to be considered as a “startup”, at the least, there must be some innovation and use of technology to scale up. The startups should have a clear road map covering at least the major aspects like ideation, valuation, proof of concept, business entity formation, initial capital infusion, intellectual property rights, etc.

Obstacles and debacles are usual in every business. In today’s highly competitive world, inventions, innovations and technological advancements could impact the business model seriously and sometimes suddenly. The question is whether a founder/promoter of a startup would have sufficient time and people to understand, appreciate, and detect the factors responsible for the same and if necessary, redefine the business model that helps them to overcome obstacles and avoid debacles.

The founders /promoters of startups may not always be in a position to make reasonable estimates of costs and revenue and therefore there would be limitations to their financial plans. Making aggressive representations about business prospects will certainly result in over-valuations. It is also necessary to ensure that the possible gap between the revenue projections they estimate and the actuals at the end of a period should not be very wide and erratic. In short, it is not necessary to be too conservative; however, it is necessary to apply sufficient thought and be sensitive to the possibility of failing to factor certain factors which may play a spoilsport. It would always be prudent to bear in mind that the funds in hand at a particular stage may burn out faster than what was estimated. Therefore,

projections must be realistic and from time to time, the founders /promoters, officers, investors, and experts must meet and do a structured review to do course corrections if needed. Only when the progress is reviewed at frequent intervals, preferably at least once in every quarter, the startups will be able to analyse where do they stand and how could things be made better.

Raising capital may not be a difficult issue. But choosing the right form of raising funds is more important. Although it is commendable to get by without raising capital and have a bootstrapped business, it may not always be possible nor would it be the right strategy in every case. Therefore, whether to raise funds from external sources and whether it must be equity or debt or both is a matter to be decided after proper deliberations.

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Any present-day investor looks for a clear vision, innovation, talent resources, and the ability of the existing business to maintain and develop stakeholders’ relationships, going one step ahead with environmental, social, and governance (ESG) aspects.

In today’s vigilant and educated environment, investors, customers, and other stakeholders prefer eco-friendly products and services and sustainable business models to be associated with them. This has especially made founders/promoters look beyond capitalization and factor in sustainability aspects too as part of the revenue model of the business.

By leveraging the expertise and experience of seasoned professionals, founders/promoters can significantly increase their chances of success and build a robust foundation for their startup. Professional guidance of Company Secretaries, who practice in the field of incorporating entities, ensuring governance and compliance, etc can provide startups with the knowledge, skill, and resources required to navigate the complexities of starting and growing a business and thereby act as a guiding star and hand hold the entrepreneurs to ensure they move in the right direction. There are several major areas where qualified professionals like Company Secretaries could play an important role.

Stages And Pillars

Broadly there are just three stages – ideation and initiation, gaining momentum and course correction, scaling geographically, horizontally, vertically, or otherwise, by introducing new products/services or introducing new uses for the same product or services. It is pertinent to bear in mind that analysis of the third stage at the first stage itself is very important, subject to sufficient infusion of resources, both financial and non-financial.

There are four pillars for the growth of any startup, namely; People, Products & Services, Property and Performance Review. The first pillar, “People” involves defining the requirement of recruiting human capital, their profile and level, and hiring individuals with the right talent and skills. The second pillar, “Products & Services” involves understanding the market needs, emerging trends, technological advancements, cost & time for delivering, availability of capital, scalability, setting the boundaries, etc. The third pillar, “Property” includes both tangible and intangible property. Often, startups do not apply sufficient thought on property secured through intellectual property rights. The last pillar, “Performance Review” is the most important pillar of the four, as it basically means to review periodically the aforementioned three pillars.

Focus Points

Startups need to spend considerable time understanding the needs of the business and the promoters/founders to create a reliable support system in the following five major areas:

1. Choosing the right type of business entity formation;
2. Appropriate processes for ensuring compliance with provisions of various applicable laws and installing a good governance framework;
3. Contracts and Arrangements for protecting and promoting the interests of the Startup, including protecting its intellectual property rights;
4. Timely fundraising from external sources;
5. Proper dispute resolution mechanism.

BUSINESS ENTITY FORMATION

Starting a business is no different than planting and nurturing a tree. From sowing the seeds to bearing the fruit, the journey is not a short one. Similarly, businesses too need time, environment, care, and support to grow and thrive. When starting a business, one of the first things the founders/promoters must do is to select a suitable type of business entity. This decision to identify the right form of business entity emerges from the ability of the promoter to foresee his/ her business objectives or scale of operations.

Professionals advising founders/promoters of startups have to spend considerable time understanding the needs of businesses and advising them on a suitable form of

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business entity. It involves a thorough consideration of subjects such as the products and services proposed to be created/designed and offered, capital to be infused, milestones and timelines, people and geography, and size and scale. It is the responsibility of the professionals to completely understand the requirements of the founders / promoters of startups before suggesting the most suitable form of business entity.

Generally, it is suggested that the founders/promoters opt for the entity type that does not require much legal compliance so that they can concentrate on building the business. Later, it could be converted into a bigger entity such as a company that has considerable compliance requirements. Company Secretaries not only guide in choosing the best form of business entity, but also help in obtaining various licenses, registrations, etc. and further aid the founders/promoters in understanding various exemptions/ grants given by the government for each business.

It is undeniable that determining the right business entity structure and framework will allow the business to run efficiently and achieve the objectives for which it was primarily formed.

COMPLIANCES AND GOVERNANCE

Good governance can help the startup boost its reputation, retain its employees, reduce legal risks, and drive its growth. Moreover, every startup should strive to enhance its governance and adopt practices, principles, and processes that foster an ethical, effective, transparent, and legitimate business structure. Startups with good governance structures attract better investments as risks arising from non-compliances will not be significant. Additionally, complying with the law and maintaining proper books of accounts can facilitate smooth and timely third-party due diligence in case of any fund raising.

Selecting Board room tasks (See Note 1) plays an important role. Board room tasks are chosen on the basis of (a) the fundamental understanding of the founders / promoters; (b) the Applicable law; and (c) memorandum



and articles of association or partnership agreements or other charter documents.

Note 1: Board Room Tasks

While in the beginning everything may be decided at the Board level, it would be useful to keep certain things at the Board Level only.

The following are some of the important subjects that could be considered as Board Room Tasks: -

- Capital infusion
- Decision about the Debt or Equity or a mix
- Hiring KMPs/SMPs
- Policies
- Joint Ventures / Partnerships
- Relevant market determination
- Committees and charters
- Contracts and Arrangements,
- Product life cycle assessment
- Review of performance of People, Products and Properties
- Review of Policies
- Products/ Services to be added /discontinued / modified
- Financial Statements
- Contraventions and remedies
- Disputes resolutions
- Closure/winding up
- Sale of business /units /undertakings

Compliance is not only essential, but also a matter of organizational culture. It helps in building a reputation around the entity. The cost of non-compliance is always very high and the procedure for resolution is often time-consuming. Persistent non-compliance could lead to fines and penalties besides leading to inquiries, inspections, and investigations. Ultimately, serious non-compliance may lead to an order for the winding up of the entity itself. There is a saying that if compliance is costly; try non-compliance. Proper, timely and complete compliance could be considered as Level 1 (minimum requirement) in order to be entitled to do business in any country and it involves identifying Applicable Laws.

FUND RAISING

It is very important to optimize the potential opportunities and startups need access to capital in order to achieve the same. Raising capital is typically one of the first issues a startup will need to address, and the ability to attract investors will play an important role in its ultimate success. Raising capital will enable the startup to scale up more quickly, enhance its valuation, gain credibility, attract talent, and enjoy relatively generous funding terms.

Each financing option has its own advantages and disadvantages. It is important for startups to carefully consider the options before choosing the best path forward. Not every founder/promoter would be aware of all the pros and cons of various funding options and the professionals play a very important role here in apprising the founder/promoter regarding the same. Professionals guide the founders/promoters through various stages and series of funding. They suggest the feasible debt-equity ratio, financing sources, and some would also be able to help the founders/promoters connect to the accelerators and incubators.



PROTECTING THE INTELLECTUAL PROPERTY RIGHTS

Intellectual Property Rights (IPR) are the intangible legal rights resulting from intellectual activity in industrial, scientific, literary & artistic fields. These rights safeguard the creators and other producers of intellectual goods & services by granting them exclusive rights for a specific period.

Innovation being a main criterion to be eligible to be registered as a startup, it is essential for the startup to work towards innovation or provide improvement to the existing products, services and processes and to have the potential to generate employment and create wealth. When a startup patents its inventions, the startup's value and fund raising possibilities increase significantly.

The four major categories of Intellectual property which predominantly affect startups are Patents, Trademarks, Copyrights, and Industrial Designs. As the technology, brand name, design, and creativity behind the concept etc., are worth protecting and the IPR paves the way for protecting it, the startups cannot miss out on this big area.

Investors will like to invest in a business that has a sound intellectual property strategy that safeguards their investment. Without adequate legal and contractual protection for IPR created or acquired or used by a startup, there would be a threat to the ability of the startup as it would be more vulnerable to infringement and could quickly lose its ground to its competitors.

By securing exclusive rights to their intellectual property, startups can prevent others from using, selling, or profiting from their ideas or creations without permission.

DISPUTE RESOLUTION

In the course of business, disputes may arise due to various reasons. Disputes arise even when the going is good. Disputes may arise on account of breach of covenants or obligations, undertaken by a person in terms of any contract to which he is a party. India has a time-tested law on contracts. Parties may choose remedies against breach of contract under the law relating to contracts.

Increasingly parties are resorting to Alternative Dispute Resolution methods, instead of going to court and commencing litigation against one another. With the establishment of Commercial Courts, we see a significant reduction in resolution time with regards to Commercial Disputes. At the same time, the Arbitration and Conciliation Act, 1996 has also witnessed substantial changes by introducing efficient methods for a speedy resolution of disputes.

In any case, it is desirable to sort out disputes and nip them in the bud so that the disputes do not grow into serious proportions. Mediation may also be resorted to by engaging seasoned and trained mediators so that the relationship does not grow from bad to worse and resolution happens in a cost-effective and time-efficient manner without leaving further scope for prolonged

litigation of several rounds, reaching up to the top court of the country.

Disputes may also arise due to differences of opinion amongst partners /shareholders/investors on account of delay in achieving the estimated numbers. Patience runs out as time runs out. It is always necessary to form and choose a business entity in which there is support from the applicable law for dispute resolution. For example, disputes amongst shareholders are resolved under company law by intervention of the National Company Law Tribunal (NCLT) which has benches across the country.

Disputes occur about ownership and control over assets, intellectual property rights, other properties, contracts, rights, and benefits. Apart from the above, there are number of reasons why disputes arise. Therefore, one must be careful and cautious in all his dealings and keep a clear divorce between personal transactions and business affairs.

In addition to this, disputes emerge in relation to financial obligations undertaken by a startup towards its creditors. Creditors may be financial creditors or operational creditors. Any default in repayment of any debt on the due date can be resolved by the creditor by initiating the corporate insolvency resolution process before the NCLT. If such situations are not handled seriously, the entity may change hands.

Resolution of disputes sometimes gets delayed on account of attachment of the founders/promoters to the business founded or grown by them. However, withdrawing from growing the dispute is an art learnt through experience. An unresolved dispute can remain as a thorn in the flesh unless it is resolved/ remedied at the earliest opportunity itself.

Company Secretaries could play a very crucial role in dispute resolution. They are entitled to represent the startup or any of its stakeholders before NCLT / NCLAT, and to act as Arbitrators / Mediators and bring about a resolution to the disputes.

SUBJECTS REQUIRING CONTINUOUS APPLICATION OF MIND

1. Determination of the organogram and command structure for driving the management of the affairs of the startup;
2. Defining the qualifications, skills, and experience of people to be hired and hiring the right talents and training the resources;
3. Defining the products and services and if there is a market, introduce new products and services;
4. Determining the relevant market (See Note 2) and looking out for opportunities for expanding the relevant market;
5. Use of technology (See Note 3) for offering products and services and deploying analytical tools for real

time delivery, cost reduction and monitoring the performance improvement and profit maximisation;

6. Exploring partnerships and associations for growth;
7. Review of qualitative and quantitative performance of people, products, partnerships and properties.

Note 2: Relevant Market

Identifying the relevant market for the products and services proposed to be offered by the startup is a major Board Room task. The relevant market for a startup refers to the specific segment of the overall market where the startup's products or services are targeted. It encompasses the geographic area and the customer base that the startup can effectively reach and serve, considering competition, demand, and market dynamics. Identification of relevant market aids in the following -

- Determining size of financial and non-financial resources;
- Timelines for spreading out;
- Regulatory and compliance needs;
- IPR Protection.

The identification or determination does not mean, right from the initiation, the products and services are going to be offered across the entire relevant market. Once the relevant market is identified, the startup should decide what extent of the relevant market the startup sees possibility for immediate presence and what is the timeline for growing the area of operation ultimately spreading out across the entire relevant market.

Note 3: Technology

Technological tools are necessary for achieving several crucial things:

- Technology itself is the driver;
- Technology as an enabler for;
 - a) Scaling up,
 - b) Quality and timely delivery,
 - c) Cost reduction and profit maximisation,
 - d) Market needs,
 - e) Regulatory needs.

CONCLUSION – THE MANTRAS FOR A STRONG FOUNDATION

Startups are advised to adopt the following five Mantras to lay a strong foundation:

1. Focus on the fundamentals and be wedded to core competencies.
2. Build a strong balance sheet.
3. Reduce the gap between actuals and projections.
4. Establish a strong compliance and governance culture.
5. Review yesterday's solutions, which may be the cause for today's problems, to quote Thomas Sowell. 