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India Crowd-funding

Procedural Requirements for Indian Startups to raise funds from Foreign Investors

PREFACE

India currently does not have a legal framework for Crowd-funding. A concept paper on Crowd-funding issued by the Securities & Exchange Board of India proposed several alluring amendments to the existing framework; however, the chaos caused due to warnings issued by SEBI in September 2016 insisted many Crowd-funding Platforms in the country keep their operations on hold.

In another context, SEBI would come into the picture whenever there is public issue of the securities by a company. Under such circumstances, the issuer company has to follow the provisions of SEBI Act, 1992, Securities Contracts (Regulation) Act, 1956, Depositories Act, 1996 in addition to the applicable provisions of the Companies Act, 2013. However, if the company is going for **Private Placement**, the above provisions would not apply and the only compliance required would be under the Companies Act, 2013 and the rules framed thereunder.

Following the **Private Placement** regulations, Indian Startup Companies can raise funds from Foreign Investors and there is no bar on any amounts except as specified in FDI / ECB Guidelines. Funds can either be raised as Foreign Direct Investment or as External Commercial Borrowings. Depending upon the type of the product, the nature of the investment i.e. FDI / ECB would change and accordingly, procedural requirements would change.

Considering Indian Startup Companies raising funds through issue of Equity Shares or Compulsorily Convertible Equity Shares, the same would amount to Foreign Direct Investment in India. Accordingly FDI rules would become applicable.

PRIVATE PLACEMENT UNDER THE COMPANIES ACT

As per Chapter III - The Companies (Prospectus and Allotment of Securities) Rules, 2014, in case of a private placement of securities, private placement offer or invitation cannot be made to more than 200 persons in the aggregate in a financial year.

Such offer can be made only to such persons whose names are recorded by the company prior to the invitation to subscribe, and that such persons shall receive the offer by name, and that a complete record of such offers shall be kept by the company and complete information about such offer shall be filed with the Registrar within a period of thirty days of circulation of relevant private placement offer letter.

All monies payable towards subscription of securities through private placement shall be paid through cheque or demand draft or other banking channels but not by cash. Further, rules require that the payment to be made for subscription to securities shall be made from the bank account of the person subscribing to such securities and the company shall keep a record of all such bank accounts. Shares are to be allotted within 60 days.

Company offering securities through private placement **shall not release any Public Advertisements or utilize any media, marketing or distribution channels or agents to inform the public at large about such an offer**.

Issuing companies need to follow Companies (Prospectus and Allotment of Securities) Rules, 2014. The company has to send Private Placement Letters and Application Forms pre-numbered to the Investors to whom the offer is being made. Investment per investors shall not be less than INR 20,000.

Return of allotment of securities shall be filed with Registrar of Companies within 30 days of allotment along with a complete list of all security holders containing the full name, address, Permanent Account Number and E-mail ID of such security holder.

STEPS TO BE FOLLOWED

Following steps are to be followed for Indian Startups raising funds from Foreign Investors:

Step – 1
Investors should give following details along with his KYC Documents to his bank:

1. Remitter's name
2. Remitter's Bank Account Details
3. Amount of Remittance
4. Purpose of Remittance – (Investment in Shares in Indian Company)
5. Particulars of Beneficiary (Recipient) and Beneficiary's Bank Account Details
6. KYC Documents to be forwarded to Beneficiary's Indian Bank by Remitter's Bank (Passport / National Identity Proof etc.)

Step – 2
Indian Startup Company has to receive FIRC from the Bank. FIRC stands for Foreign Inward Remittance Certificate.

Step – 3
Within 30 days, Indian Company needs to file following documents to the Reserve Bank of India:

1. FIRC
2. Advance Reporting Form
3. KYC Documents (MOA, AOA, Incorporation Certificate, PAN, Address Proof etc.)

RBI will issue a Unique Identification Number (UIN) to the Company which shall be used for all the future correspondences with the Reserve Bank of India.

Step – 4
Within 180 days from the date of receipt of the remittance amount, the company has to issue the shares / securities to the applicants. For the purpose of the issue of shares, following documents are to be filed with the Reserve Bank of India:

1. Form FC-GPR
2. Compliance Certificate from Company Secretary
3. Valuation Certificate from Chartered Accountant

IMPORTANT POINTS TO BE NOTED

1. As the issue of equity shares will be in the Form of 'Private Placement' as per the Indian Companies Act, the number of allottees should not exceed 50 in one round of issue and 200 in totality.
2. A private company can have maximum of 200 shareholder members. As such, this number should not be exceeded when the company goes for multiple rounds of funding.
3. Being Private Placement under the Companies Act, 2013, all the required compliances as per the information given above are to be taken care of by the Issuing Company.
4. In the case of Multiple Receipts and Single Issue of shares in just one go, the above mentioned compliances in Step – 4 would be a one-time activity for one round of funding.
5. For the issue of Compulsorily Convertible Preference Shares, any special scheme need not be drafted. A simple SHA (Shareholders' Agreement) as per Indian Laws would suffice.
6. For Valuation of CCPS, Internationally Accepted Pricing Method should be used. Currently, Discounted Free Cash Flow Method is widely used for valuation and pricing. However, Preference Shares cannot be directly valued. First, Equity shares are to be valued and then using the proposed conversion ratio, pricing of CCPS should be determined.

TIMELINE AND COSTS INVOLVED

1. Timeline differs from case to case. However, if everything goes smooth, receipt of money and issue of equity shares along with all the compliances can be completed in as less as 45-50 days.
2. Costs include the following:
   a. Mandatory Government Filing Fees
   b. Valuation Fees (CA)
   c. Certification Fees (CS)
   d. Professional Charges for handling the Private Placement issue
   e. Bank Charges and Foreign Exchange Fluctuation Charges

   Professionals take care of all the compliance activities and items (a) to (d) above would normally cost INR 50,000 to INR 75,000 from case to case. This range is merely an indicative one and may differ from professional to professional.

CHALLENGES AHEAD

1. RBI allowed Convertible Notes vide its notification dated 10 January 2017. However, necessary changes have not been made to the FDI Policy till date. So procedural compliances with respect to Convertible Notes are still not clear.
2. Procedural Compliances often face practical problems from Bank's side. Countering these problems taken considerable time.
3. Issue of Securities must be completed within 180 days from the date of receipt of the amounts as per FDI Guidelines. However, as per Private Placement Rules, shares are to be issued within 60 days from the date of receipt of moneys. As such, lower of these time limits is to be followed. Thus, shares should be issued within 60 days only.
4. Multiple compliances would require filing of forms with RBI, ROC and RD Bank. Co-ordination in these filings is a critical task.

SUMMARY IN A NUTSHELL

1. Indian Startups can avail help for consulting firms to identify Foreign Investors. Indian Startup Companies can then make offer for Private Placement to these Investors. Emphasis is given on **Private Placement** model and not on Crowd-funding.
2. One must take care that Fundraising Campaigns by the Indian Startup Companies do not amount to Public Offer / Public Solicitation of their Issue. There are no definitions of these terminologies. As such, one needs to apply his / her own professional judgement.
3. A strong back-end support mechanism for Indian Startup Companies needs to be established which will take care of all the compliances under FEMA / RBI / Companies Act. Indian Startup Companies can take help of consultants who have tie-ups with scheduled banks registered as AD Bank for better correspondence with RBI. Consultants can also take care of all the legal and secretarial compliances.

CREDITS

1. SEBI Concept Paper on Crowdfunding in India
2. News Publications like Mint and Economic Times for the news from September 2016

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