LEAN STARTUP MANAGEMENT

MODULE 5 : Legal Aspects

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There are 7 aspects that have to be diligently followed in the legal terms by every startup:

1. Formalizing a business structure and founders agreement

A Private limited company is the best option for startups looking to raise funds as it provides the required flexibility to manage external investments and company stock

A Founder’s Agreement is essentially a document that specifies important details about the founding team and the business, such as, roles, responsibilities, executive compensation, operational details and exit clauses

2. Applying for business licenses

Business licenses are the legal documents that allow a business to operate while business registration is the official process of listing a business (along with relevant information) with the official registrar.

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3. Understanding taxation and accounting laws

There are a broad variety of taxes, such as, central tax, state tax and even local taxes that may be applicable for certain businesses.

Different business and operating sectors attract different taxes. Knowing this beforehand can prove to be useful

4. Adhering to labour laws

Laws with regards to minimum wages, gratuity, PF payment, weekly holidays, maternity benefits, sexual harassment,payment of bonus among others will need to be complied with.

5. Ensuring protection of intellectual property

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1.Copyrights 2.Trademarks 3.Patents 4. Trade Secrets

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6. Ensuring effective contract management

As per the Indian Contract Act, 1872, all agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration with a lawful object, and are not expressly declared to be void.

7. Details about winding down the business

When a startup decides to shut down, all the stakeholders from vendors to employees to customers and investors need to informed in advance and the whole process must be properly planned and executed in order to make the exit easy on everyone.

A startup can be shut down through either of:

– Fast Track Exit Mode
– Court or Tribunal Route
– Voluntary Closure
– According to Insolvency and Bankruptcy Bill, 2015

REGULATORY

5 key regulatory considerations which startups need before doing business in India :

Business structure : In India, a startup business may be set up either as a limited liability partnership or as a private limited company depending on the nature of the business, tax efficiency, corporate flexibility, cost of formation, compliance requirements and so on. Typically, we have seen that startups in India prefer incorporating a private limited company as it is easier to raise funds from investors.

Licenses and registrations : There are a number of licenses and registrations which are required to be obtained in order to carry out business in India depending on the nature of business of the startup and the entity that is incorporated i.e. Permanent Account Number (PAN), Importer Exporter Code (IEC), Tax Deduction and Collection Account Number (TAN), Goods and Service Tax (GST), Shops and Commercial Establishment certificate, employment related registrations depending on the number of employees, certificate from the Inter-Ministerial Board of Certification (IMBC) for tax benefits and so on.

REGULATORY

Intellectual Property (IP) : For most technology-centric startups, IP is very important. IP includes copyright, trademarks, patents, design, software development codes, programs, research findings, algorithms etc. and it is imperative that a startup protects these effectively from the very beginning as IP rights may also be licensed and/or sold and thus have financial implications as well.

Contract management : A startup would need to enter into various written contracts to make them legally binding and enforceable, i.e. service agreements with vendors, distribution agreements with distributors, employment agreements with employees, consultancy agreements with consultants, non-disclosure agreement (NDA) with various third parties for protection of confidential information, leave and license or lease agreements for use of premises, shareholder agreements (including subscription agreements and/or share transfer agreements) with investors, partnership agreement between partners, IP-related agreements for protection or assignment of IP, etc.

REGULATORY

Contract management : As a startup should ideally try to mitigate risks which it may face from any commercial arrangement that it would be entering into, it is essential that these agreements are not one side and are negotiated properly. Also, startups should keep in mind that most agreements need to be stamped and registered (if required) prior to execution.

Compliance requirements : There are a number of reporting requirements that a startup would need to comply with depending on the nature of the entity that is incorporated and the investment that is made. In the event that the entity is a company, various filings/reportings would need to be made with the relevant registrar of companies and the company would have to comply with the Indian Companies Act, 2013. In the event the entity is a limited liability partnership, then various filings/reportings would need to be made with the relevant registrar of companies and the partnership would have to comply with the Limited Liability Partnership Act, 2008. Also, in case of foreign investment, relevant filings/reportings would need to be made to the Reserve Bank of India etc.

CSR

Corporate social responsibility (CSR) is a self-regulating business model that helps a company be socially accountable—to itself, its stakeholders, and the public. By practicing corporate social responsibility, also called corporate citizenship, companies can be conscious of the kind of impact they are having on all aspects of society, including economic, social, and environmental.

To engage in CSR means that, in the ordinary course of business, a company is operating in ways that enhance society and the environment, instead of contributing negatively to them.

As important as CSR is for the community, it is equally valuable for a company. CSR activities can help forge a stronger bond between employees and corporations, boost morale and help both employees and employers feel more connected with the world around them.

CSR

For a company to be socially responsible, it first needs to be accountable to itself and its shareholders. Often, companies that adopt CSR programs have grown their business to the point where they can give back to society. Thus, CSR is primarily a strategy of large corporations. Also, the more visible and successful a corporation is, the more responsibility it has to set standards of ethical behavior for its peers, competition, and industry.

Example of Corporate Social Responsibility

Starbucks has long been known for its keen sense of corporate social responsibility and commitment to sustainability and community welfare. According to the company, Starbucks has achieved many of its CSR milestones since it opened its doors. According to its 2019 Global Social Impact Report, these milestones include reaching 99% of ethically sourced coffee, creating a global network of farmers, pioneering green building throughout its stores, contributing millions of hours of community service, and creating a groundbreaking college program for its partner/employees.
Starbucks' goals for 2020 and beyond include hiring 10,000 refugees, reducing the environmental impact of its cups, and engaging its employees in environmental leadership.

CSR

Why should a company implement CSR?

Many companies view CSR as an integral part of their brand image, believing that customers will be more likely to do business with brands that they perceive to be more ethical. In this sense, CSR activities can be an important component of corporate public relations.

The movement toward CSR has had an impact in several domains:

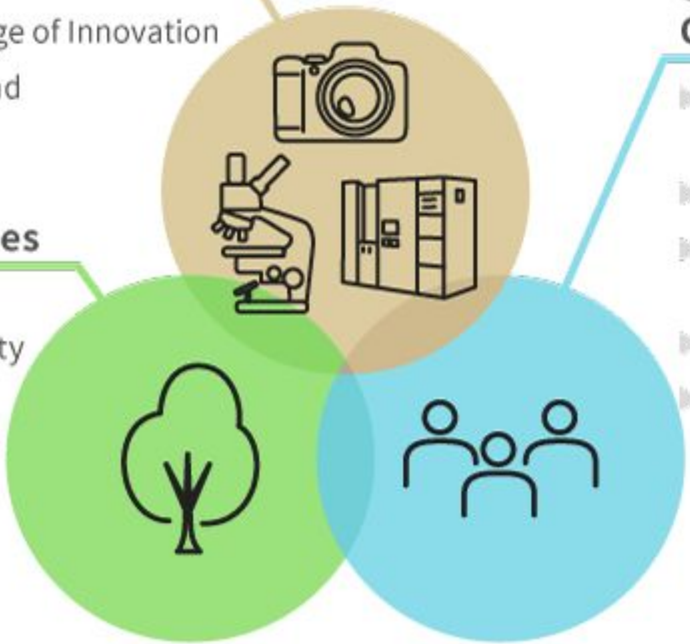
- For example, many companies have taken steps to improve the environmental sustainability of their operations by installing renewable energy sources, promoting volunteerism among company employees, and donating to charity. In managing supply chains, efforts have also been taken to eliminate reliance on unethical labor practices, such as child labor and slavery.
- Although CSR programs have generally been most common among large corporations, small businesses also participate in CSR through smaller-scale programs such as donating to local charities and sponsoring local events.

Contributing to Society through Business Activities

- Solving Social Issues by Using Opto-electronics Technologies
- Taking Up the Challenge of Innovation
- Improving Product and Service Quality

Responding to Environmental Issues

- Promoting a Decarbonized Society
- Promoting Resource Circulation
- Contributing to a Healthy and Environmentally Safe Society



Strengthening CSR Foundations

- Strengthening Supply Chain Management
- Respecting Human Rights
- Promoting the Success of Diverse Employees
- Strengthening Compliance
- Ensuring Effective Governance

STANDARDS

Your standards define how your company acts, which, in turn, builds trust in your brand. They can be guidelines that describe quality, performance, safety, terminology, testing, or management systems, to name a few. They can comply with authoritative agencies or professional organizations and be enforceable by law, such as required medical degrees for doctors or credentials for financial planners. Or they can be voluntary rules you establish to create confidence among your clients that your business operates at a high and consistent quality level, such as a restaurant only using the highest quality, locally-sourced ingredients.

Standards must align with your mission, business objectives, and organizational leadership, and be implemented consistently across your enterprise. Employees need to buy into the value of adhering to standards so everyone is pulling in the same direction and reinforcing your brand.

STANDARDS

Controlling and measuring standards :
Standards are what your business aspires to, but they don't guarantee performance. You need to create processes to control how your standards are implemented, and measure and evaluate how they help your business grow. Written guidelines, technical specifications, product inspection processes, management and financial audits, and even customer surveys can be effective performance indicators and help you determine if you're meeting your standards, or if the standards need to be tweaked in some way.

Voluntary Standards : are typically developed by the National Standards Bodies that are mostly governmental in developing countries and yet standards developed by them are voluntary. In most developed countries, standards bodies are private bodies having strong connect with industry. The Bureau of Indian Standards (BIS) is the national standards body of India with over 20000 standards and any entrepreneur setting up a business is well advised to look at BIS standards available for his product or service as first point of reference, if its not a regulated sector.

STANDARDS

Consider this . . .

Your customers want products and services that are high quality, reliable, consistent, and safe.

Reliance upon standards and conformity assessment activities helps to demonstrate these important characteristics, earning customer loyalty.

But isn't it expensive to participate?

In challenging economic times, some executives decide to downsize or even eliminate their organization's standards development efforts. What they don't realize is that re-starting their internal processes later can be much more expensive and time consuming than maintaining a well-functioning system.

STANDARDS

Case Study:

From 1999 to 2002, approximately 15,300 fires occurred annually where the first item ignited was a mattress and its bedding. These fires resulted in an annual average of 350 deaths, 1,750 injuries, and $295 million in property loss. In an effort to reduce deaths and property damage, the U.S. Consumer Product Safety Commission (CPSC) and the National Institute of Standards and Technology (NIST) joined forces to establish flammability standard 16 CFR Part 1633 .

The mandatory standard is designed to reduce the severity of mattress fires ignited by open flame sources such as candles, matches, lighters, and cigarettes. The CPSC estimates that 16 CFR Part 1633 prevents as many as 270 deaths, 1,330 injuries, and millions of dollars in property damage every year.

TAXES

Prime Minister Narendra Modi proclaimed the **Startup India** campaign in 2016 to boost entrepreneurship in India. The action plan aimed at promoting bank financing for startups, simplifying the incorporation of startup process and grant of various tax exemptions and other benefits to startups.

But all the benefits and exemptions are available to the startups only if they come under the criteria of an ‘Eligible Startup’.

Tax exemptions allowed to Eligible Startups under Startup India Program:

1. 3 year tax holiday in a block of seven years

The Startup incorporated between April 1, 2016, till 31st March 2021 were eligible for this scheme. Budget 2021 has extended the eligibility to 31st March 2022. Such startups will be eligible for getting 100% tax rebate on profit for a period of three years in a block of seven years provided that annual turnover does not exceed Rs 25 crores in any financial year.This will help the startups to meet their working capital requirements during their initial years of operation.

TAXES

2. Exemption from tax on Long-term capital gains:
A new section 54 EE has been inserted in the Income Tax Act for the eligible startups to exempt their tax on a long-term capital gain if such a long-term capital gain or a part thereof is invested in a fund notified by Central Government within a period of six months from the date of transfer of the asset. The maximum amount that can be invested in the long-term specified asset is Rs 50 lakh. Such amount shall be remain invested in the specified fund for a period of 3 years.If withdrawn before 3 years, then exemption will be revoked in the year in which money is withdrawn.

3. Tax exemption on investments above the fair market value:
The government has exempted the tax being levied on investments above the fair market value in eligible startups. Such investments include investments made by resident angel investors, family or funds which are not registered as venture capital funds. Also, the investments made by incubators above fair market value is exempt.

TAXES

4. Tax exemption to Individual/HUF on investment of long-term capital gain in equity shares of Eligible Startups u/s 54GB.

The existing provisions u/s 54GB allows the exemption from tax on long-term capital gains on the sale of a residential property if such gains are invested in the small or medium enterprises as defined under the Micro, Small and Medium Enterprises Act, 2006. But now this section has been amended to include exemption on capital gains invested in eligible start-ups also.

This exemption will boost the investment in eligible startups and will promote their growth and expansion.

5. Set off of carry forward losses and capital gains allowed in case of a change in Shareholding pattern.

The carry forward of losses in respect of eligible start-ups is allowed if all the shareholders of such company who held shares carrying voting power on the last day of the year in which the loss was incurred continue to hold shares on the last day of previous year in which such loss is to be carry forward.The restriction of holding of 51 per cent of voting rights to be remaining unchanged u/s 79 has been relaxed in case of eligible startups.

THANK YOU