9 CHAPTER

Start-ups and its Registration

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9.1 Start-ups	
Start-up Meaning	◆ Start-up company (start-up) is an entrepreneurial venture which is typically an emerging, fast- growing business that aims to solve an unmet need by developing a viable business model around an innovative product, service and processor a platform. ◆ Start-ups may have high rates of failure, but the minority of successes includes companies that have become large and influential.
Eligibility for becoming a Start-up Company	◆ The Government of India has announced **'Start-up India'** initiative for creating a conducive environment for start-ups in India. The various Ministries of Government of India have initiated a number of activities for the purpose. ◆ An entity shall be considered as a Start-up: ■ Turnover of the entity for any of the financial years since incorporation/ registration has not exceeded one hundred crore rupees. The words "Turnover" is as defined under the Companies Act, 2013. ■ Entity is working towards innovation, development or improvement of products or processes or services or if it is a scalable business model with a high potential of employment generation or wealth creation. ■ Up to a period of ten years from the date of incorporation/ registration if it is incorporated as a private limited company (as defined in the Companies Act, 2013)/ registered as a partnership firm (registered under section 59 of the Partnership Act, 1932)/ a limited liability partnership (under the Limited Liability Partnership Act, 2008) in India. However, an entity formed by splitting up or reconstruction of an existing business shall not be considered a 'Start-up'. ◆ An entity shall cease to be a Start-up on completion of ten years from the date of its incorporation/ registration or if its turnover for any previous year exceeds one hundred crore rupees.

Recognition as Start-ups	**The process of recognition of an eligible entity as start-up shall be as under:** ◆ Start-up shall make an online application over the mobile app or portal set up by the DPIIT. ◆ The application shall be accompanied by: ■ Copy of Certificate of Incorporation or Registration, as the case may be. ■ Write-up about the nature of business highlighting how it is working towards innovation, development or improvement of products or processes or services, or its scalability in terms of employment generation or wealth creation. ◆ DPIIT may after calling for such documents or information and making such enquires, as it may deem fit: ■ recognise the eligible entity as Start-up ■ reject the application by providing reasons.
Eligibility Criteria for applying to Income Tax exemption (80-IAC)	**The entity should be a recognized Start-up:** ◆ Only Private limited or a Limited Liability Partnership is eligible for Tax exemption under section 80-IAC. ◆ Start-up should have been incorporated after 1st April, 2016.
***Note:** Under section 80-IAC, the Startup incorporated after April 1, 2016 but before the 1st day of April, 2022 is eligible for getting 100% tax rebate on profit for a period of three years. The start-ups recognized under the Start-up India policy can now claim tax benefits in three out of the first ten years under section 80-IAC of the Income-tax Act, 1961. Also, the annual turnover must not exceed Rs. 100 crores in the previous year relevant to the assessment year for which deduction is claimed.*	
Tax Exemption u/s 56 of IT Act (Angel Tax)	**Post getting recognition a Start-up may apply for Angel Tax Exemption. Eligibility Criteria for Tax Exemption under section 56 of the Income-tax Act:** ◆ Entity should be a DPIIT recognized Start-up. ◆ Aggregate amount of paid up share capital and share premium of the Start-up after the proposed issue of share (if any) does not exceed INR 25 Crore.
Benefits/Exemptions For Start-ups	◆ **Simple process:** Government of India has launched a mobile app and a website for easy registration for start-ups. Anyone interested in setting up a start-up can fill up a simple form on the website and upload certain documents. The entire process is completely online. ◆ **Reduction in cost:** The government also provides lists of facilitators of patents and trademarks. They will provide high quality Intellectual Property Right Services including fast examination of patents at lower fees. The government will bear all facilitator fees and the start-up will bear only the statutory fees. They will enjoy 80% reduction in cost of filing patents. ◆ **Easy access to Funds:** The government is also giving guarantee to the lenders to encourage banks and other financial institutions for providing venture capital. ◆ **Tax holiday for 3 Years:** Start-ups will be exempted from income tax for 3 years provided they get a certification from Inter-Ministerial Board (IMB) ◆ **Apply for tenders:** Start-ups can apply for government tenders. They are exempted from the **"prior experience/turnover"** criteria applicable for normal companies answering to government tenders. ◆ **R&D facilities:** Seven new Research Parks will be set up to provide facilities to start-ups in the R&D sector. ◆ **No time-consuming compliances:** Various compliances have been simplified for start-ups to save time and money. Start-ups shall be allowed to self-certify compliance (through the Start-up mobile app) with 9 labour and 3 environment laws.

	◆ **Tax saving for investors:** People investing their capital gains in the venture funds setup by government will get exemption from capital gains. This will help start-ups to attract more investors. ◆ **Choose your investor:** The start-ups will have an option to choose between the VCs, giving them the liberty to choose their investors. ◆ **Easy exit:** In case of exit, a start up can close its business within 90 days from the date of application of winding up. ◆ **Meet other entrepreneurs:** Government has proposed to hold two start-up fests annually both nationally and internationally to enable the various stakeholders of a start-up to meet. This will provide huge networking opportunities.
Benefits / Exemptions to Start-ups under the Companies Act, 2013	◆ **Section 2(40)- Definition of financial statement:** The financial statement in relation to a private company (if such private company is a start-up) may not include the cash flow statement *[Exemption notification dated 13th June, 2017]*. ◆ **Section 54- Issue of sweat equity shares:** A start- up company may issue sweat equity shares not exceeding 50% of its paid up capital upto ten years from the date of its incorporation or registration *[Section 54 read the Rule 8(4) of The Companies (Share Capital and Debenture) Rules, 2014]* ◆ **Section 62 – Further issue of share capital:** For the purposes of section 62(1)(*b*), an "Employee" does not include- *i.* employee who is a promoter or a person belonging to the promoter group; or *ii.* a director who either himself or through his relative or through anybody corporate, directly or indirectly, holds more than ten per cent of the outstanding equity shares of the company. The aforementioned conditions shall not apply to a start-up upto ten years from the date of its incorporation or registration *[Section 62 read with Explanation to rule 12(1) of The Companies (Share Capital and Debentures) Rules, 2014]* ◆ **Section 73- Prohibition on acceptance of deposit from public:** "Deposit" does not include an amount of twenty five lakh rupees or more received by a start-up company, by way of a convertible note (convertible into equity shares or repayable within a period not exceeding ten years from the date of issue) in a single tranche, from a person *[Section 2(31) read with Rule2(c)(xvii) of the Companies (Acceptance of Deposits) Rules, 2014]* ◆ **Section 73- Prohibition on acceptance of deposit from public r/w Rule 3 of the Companies (Acceptance of Deposits) Rules, 2014:** The maximum limit in respect of deposits to be accepted from members shall not apply to a private company which is a start-up, for ten years from the date of its incorporation *[Second proviso to Rule 3(3) of the Companies (Acceptance of Deposits) Rules, 2014]* ◆ **Section 73- Prohibition on acceptance of deposit from public:** Clauses (*a*) to, (*e*) of sub-section (2) of section 73 shall not apply to a private company which is a start-up, for five years from the date of its incorporation *[Exemption notification dated 13th June, 2017]* ◆ **Section 92- Annual Return:** In relation to a private company, which is a start-up, the annual return shall be signed by the company secretary, or where there is no company secretary, by the director of the company *[Exemption notification dated 13th June, 2017]*, ◆ **Sections 173 – Meetings of Board:** A private company, which is a start-up, shall be deemed to have compiled with the provisions of section 173, if at least one meeting of the Board of Directors has been conducted in each half of a calendar year and the gap between the two meeting is not less than ninety days *[Exemption notification dated 13th June, 2017]*

	◆ **Section 446B- Lesser penalties for One Person Companies or Small Companies :** If a start-up company fails to comply with any of the provisions of the Companies Act, 2013, where penalty is payable. Such company, its officer in default or any other person, as the case may be, shall be liable to a penalty which shall not be more than one half of the penalty specified in such provisions subject to a maximum of **Rs. 2 lakh** in case of a company and **Rs. 1 lakh** in a case of an officer who is in default or any other person, as the case may be .
Life Cycle of Start-up	The start-up lifecycle is segregated into 4 stages: **Stage 1:** Ideation And Development: The first stage of the start-up lifecycle is ideation. It is categorised by the importance of testing feasibility of the products/service offered. It is at this stage that garnering a variety of opinions to further assess a business model takes precedence. Testing the potential viability of an entrepreneurs' business can help answer larger questions about government aid, regulations and other aiding factors as the business inches to the next stage. Some overarching considerations of the ideation and development stage are: ◆ Target Market. ◆ Business Models ◆ Team Skill Sets. **Stage 2:** Validation: Once on entrepreneur has evaluated feasibility of the idea and has highlighted broad scale business strategies, it is important to validate the product or services offered. The process involves defining goals, developing a value proposition and validating the same through customer feedback. This stage of a start-up exudes high relevance as it drives the understanding of potential outcomes. Moreover, it highlights the features as considered in the ideation stage by giving the entrepreneur viability proof through testing. Some overarching considerations of the validation stage are: ◆ Validating and Testing of Prototypes. ◆ Modifications. **Stage 3:** Early Traction: It is at the Early Traction stage that a set of target customers may test efficacy of the product/ service offered validation of a product can portray definitive results to the outside world, a stage that may present its own set of challenges and visibly express revenue and cash flow. It may be helpful to iterate that a market for this product is created and developed at this stage. The customer retention rate confirms the early traction of the company and its product. Start-up acquires more customers by actively seeking funds from crowd funding agencies, angel investors or networks, incubators and seed grants from Government. **Stage 4:** Growth/Exit: In the fourth stage of the start-up lifecycle, the company has attained true economic health, has sufficient size and product-market penetration to ensure economic success, and earns average or above-average profits. The company can stay at this stage indefinitely, provided environmental changes do not hinder its market niche or ineffective management reduce its competitive abilities. At this stage, the company may choose to scale up or expand its market through mergers and acquisitions or preparing for an Initial Public Offering (IPO). Depending upon the strategy followed, some of the companies are successfully able to sustain the growth stage, rapidly scaling up their business to achieve valuation of more than $1 billion and become unicorns. These businesses offer ideal business for other strat-up across sectors and encourage them to scale up.

Unicorns Start-ups	A unicorn is a term used to indicate a privately held start-up company with a valuation of over $1 billion. For a unicorn, the journey starts from the growth stage, they are disruptors which start out in an incredibly unique way to solve an everybody problem. The reasons these start-up become so successful is because all of their solutions fill a specific need in a new and different way. The Indian start-up ecosystem has developed dynamically in recent times. Two decades back, there were only few active investors and limited number of support organisations, such as incubators and accelerators. However, in the past decade. There has been a significant increase in both investment activity and infrastructure facilities to provide the much-needed impetus to the expansion of the unicorn tribe.
Pivoting	Pivoting in start-up usually occur when a company shifts its business strategy to accommodate changes in its industry, customer preferences, or any other factor that impacts its bottom line. It is essentially the process of a start-up translating direct or indirect feedback into a change in its business model. Most successful companies go through several pivots to find product-market fit. What makes the experiment work is usually not one major pivot, but a series of experiments across customers, problem, product, technology and growth channels. **Major Areas of** focus during pivoting include the following: ◆ Turning one feature of a product into the product itself, resulting in a simpler, more streamlined offering. ◆ Focusing on a different set of customers by positioning a company into a new market or vertical. ◆ A product is turned into a feature of a larger suite of feature as part of another product. ◆ Changing a platform for example from an app to software or *vice versa*. ◆ Employing a new revenue model to increase monetisation. *Example: A company might find that an ad-based revenue model may be more profitable.* ◆ Using innovation technology solutions to build a product, thereby reducing the cost of manufacturing and creating a more reliable product.

Registration Steps

Step 1: Formation of a Company in India: The law of companies in India is governed by the Companies Act, 2013 which is a comprehensive legislation and provides for provisions relating to all phases of a company's life, *i.e.* incorporation, management, mergers, winding up, etc. A Registrar of Companies ('ROC') is appointed under the Act for designated regions, who is the nodal authority for affairs related to companies in that particular region.

Step 2: Types of Companies in India: Any person can choose to incorporate either a company with unlimited liability or one with liability limited either by shares or guarantee. An incorporated company may take one of the following three forms:

- Private Company
- Public Company
- One Person Company.

Step 3: Charter documents of a Company:

- **Memorandum of Association:** The MoA sets out the objects for which the company is proposed to be incorporated in the manner provided hereunder:

  (*a*) The first and foremost clause in MoA shall be the name of the proposed company suffixed with the words limited or private limited, as the case may be;

  (*b*) The state where the registered office of the company shall be situated.

(c) The third clause contains the main objects for which the company is going to be formed/ incorporated. The MoA binds the area of operation of the company in respect to the objects mentioned therein and any decision or actions taken in contravention of the MoA shall be void. A company cannot run any business contrary to the main objects mentioned in their MoA.

The MoA and AoA of a company can be modified post incorporation in accordance with the applicable provisions of the Companies Act.

- **Articles of Association:** The articles of a company contain regulations for the management of the company. This document is confined to the applicability of the provisions of the Companies Act, on private or public limited company, as the case may be.

Step 4: Legal formalities for incorporation of a company:

- **Pre-incorporation formalities:** The below mentioned compliances are required to be carried out with regard to setting up of company in India:
  - Digital Signature Certificates ('DSC') for the proposed directors of the company by preparing and filing of Incorporation documents as required under the provisions of the Companies Act, 2013.
  - Any person (not having DIN) proposed to become a first director in a new company shall have to make an application for DIN (Maximum 3) through web form SPICe+. The applicant is required to attach the proof of Identity and address along with the application. DIN would be allocated to User only after approval of the form.
  - The next step is filing of online application through Simplified Proforma for Incorporating Company electronically (SPICe+ -INC-32), with eMoA (INC-33), eAOA (INC-34) and AGILE-PRO-S.
  - The final step of the incorporation process and obtaining a certificate of incorporation of the company.
- **Post incorporation formalities:** Once the certificate of incorporation has been issued by ROC, the company becomes a separate legal entity in the eyes of laws in India, and requires certain basic registrations to initiate the business which includes filing of application for obtaining a permanent account number, tax deduction account number in the name of the company and any other business specific registrations from the relevant government authorities *i.e.* Import– Export Code Number in case of company carrying out the business of import and/or export.

PAST EXAMINATION QUESTIONS

Ques 1: Amar is young entrepreneur willing to establish an incubator setup in the space of IT, software development, cloud computing or hardware/software maintenance. Advice Amar regarding benefits available to entrepreneurs in establishing Start-ups.

Hint: Refer Topic Benefits/Exemption For Start-ups.

Ques 2: 'Startup India' initative has been started by the government of India for creating conducive environment for startup in India. Explain the pre-conditions for determining an entity as a startup venture.

Or

Pawan incorporated a Private Ltd. Company in the year 2016 for carrying on the business of supplying freshly chopped vegetables to various food chains in and around New Delhi NCR. He wants his entity to be recognised as a start-up. Advise the process to be followed by him for recognition of his company as a start-up.

Hint: Refer Eligibility for becoming a Start-up Company.

Questions For Practice

Ques 1: Discuss Life Cycle Of Start-Up?

Hint: Refer Topic Life Cycle Of Start-Up.

Ques 2: Discuss benefits to Start-ups under the Companies Act, 2013?

Hint: Refer Topic Benefits / Exemptions to Start-ups under the Companies Act, 2013.

9.2 Financing Options Available For Start-up Companies

Characteristics of Investment	Equity Financing	Debt Financing	Grants
Nature	No component of repayment of the invested funds.	Invested Funds to be repaid within a stipulated time frame with interest.	No component of repayment of the invested funds.
Risk	Risk factor for the investor is higher as he has no guarantee against his investment.	Risk Factor for the investor is lower as he generally has collateral against his investment.	No risk factor for the start-up as no collateral is involved.
Pressure for Repayment	Less pressure for start-ups to adhere to a repayment timeline but added pressure from investors to achieve growth targets.	More pressure for start-ups to adhere to repayment timeline and as a result more pressure to generate cash flows to meet interest repayments.	No pressure for repayment as grants are a form of monetary support provided for a specific purpose.
Return to Investor	Capital growth for investors.	Interest payments.	No Return.
Involvement in Decisions	Equity Fund Investors usually prefer to involve themselves in decision making process.	Debt Fund have very less involvement in decision making.	No direct involvement in decision making.
Sources	Angel Investors, Self-financing, Family and Friends, Venture Capitalists, Crowd Funding, Incubators/Accelerators.	Banks, Non-Banking Financial Institutions, Government Loan Schemes (CGTMSE, Mudra Loan, Stand-up India).	Central Government, State Governments, Corporate Challenges, Grant Programs of Private Entities.

Question For Practice

Ques 1: Discuss Financing Options Available For Start-up Companies?

Hint: Refer Topic 9.2 FINANCING OPTIONS AVAILABLE FOR STARTUP COMPANIES.

9.3 Seed Capital

- The funding done at the nascent stage is called seed funding and the capital is known as a seed capital.
- Seed capital is the initial capital used at the time of starting the business.
- This capital can come from the founders, families or friends required for the market research, product development and other initial stage operations.
- Seed funding permits exploration of the business idea and converting it into a viable product or service that further attracts venture capitalists.
- Seed funding is a risky investment option, as most funding agencies would like to adopt a wait and watch approach to see whether the idea has a business potential.
- The paperwork involved in seed funding is relatively less and straightforward as compared to advanced rounds of funding.

Question For Practice

Ques 1: Write Short Note On : Seed Capital.

Hint: Refer Topic 9.3 Seed Capital

9.4 Crowd Funding

- The entrepreneur can get money for his venture by showcasing his idea before a large group of people and trying to convince people of its utility and success.
- The entrepreneur needs to put up on a portal his profile and presentation which should include the business idea, its impact and the rewards and returns for investors. It should be supported by suitable images and videos of the project.

- This is recent phenomena being practiced for getting seed funding through small amounts collected from a large number of people (crowd) usually through the Internet. The company's existing in India which are specializing in "Crowd Funding".
- The Consultation Paper defined Crowd funding as solicitation of funds (small amount) from multiple investors through a web-based platform/ social networking site for a specific project, business venture or social cause.

Question For Practice

Ques 1: Write Short Note On: Crowd Funding.

Hint: Refer Topic 9.4 Crowd Funding.

9.5 Mudra Banks

- Micro Units Development and Refinance Agency Bank (or MUDRA Bank) is a public sector financial institution in India. It provides loans at low rates to micro-finance institutions and non-banking financial institutions which then provide credit to MSMEs. It was launched by Prime Minister Narendra Modi on 8 April 2015.
- The bank will classify its clients into three categories and the maximum allowed loan sums will be based on the category: Shishu: Allowed loans up to Rs. 50,000 (US$780) Kishore: Allowed loans up to Rs.5 lakh (US$7,800) Tarun: Allowed loans up to Rs.10 lakh (US$16,000).
- **Eligible Borrower from MUDRA Bank:** Those eligible to borrow from MUDRA bank are:
  - Small manufacturing unit.
  - Shopkeepers.
  - Fruit and vegetable vendors.
  - Artisans
- The basic criteria of age should be 18 years old. Loan under the scheme of the Pradhan Mantri Mudra Bank Loan will be available if and only if it is for commercial and business purposes and not for personal purposes. At the most, borrower can buy vehicle from mudra loan, given that it is used for commercial purposes. Lastly, this loan is for new business and is only applicable for small business owners.

Processing of Loan:

Once the beneficiary identifies an idea and comes up with a business plan, he is supposed to select the business category under which he wishes to avail the loan (Shishu, Kishor or Tarun). The beneficiary can contact the nearest Public/ Private sector bank where he/ she can apply for business under PMMY. The list of institutions partnering in the MUDRA initiative is available on the MUDRA portal.

Documents required for submission for approval of Mudra Loan:

- Proof of Identity (Self attested Voter ID/Driving License/PAN Card/ Aadhaar Card/Passport/any other Photo ID issued by Government).
- Proof of Residence (Recent Telephone Bill/Electricity Bill/Property Tax Receipt (not older than 2 months)/ Voter ID Card/Aadhaar Card/Passport/Domicile Certificate/Certificate Issued by a local authority).
- Applicant's recent photograph (not older than 6 months).
- Quotation of Machinery/other items to be purchases.
- Name of the Supplier/Details of Machinery/Price of Machinery.
- Proof of Identity/Address of the Business Enterprise (relevant licenses & certificates).
- Proof of Category(SC/ST/OBC/Minority etc.).

Purpose for which Mudra Loan Extended:

- Business loan for Vendors, Traders, Shopkeepers and other Service Sector activities.
- Working capital loan through MUDRA Cards.

- Equipment Finance for Micro Units.
- Transport Vehicle loans – for commercial use only.
- Loans for agri-allied non-farm income generating activities, *e.g.* bee keeping, poultry farming, etc.
- Tractors, tillers as well as two wheelers used for commercial purposes only.

Illustrative List of activities that can be covered under MUDRA Loans:

- **Transport Vehicle:** Purchase of transport vehicles for transportation of goods and passengers such as auto rickshaws, small goods transport vehicles, 3 wheelers, e-rickshaws, taxis, etc. Tractors/Tractor Trolleys/Power Tillers used only for commercial purposes are also eligible for assistance under PMMY. Two Wheelers used for commercial purposes are also eligible for coverage under PMMY.
- **Community, Social & Personal Service Activities:** Salons, beauty parlours, gymnasium, boutiques, tailoring shops, dry cleaning, cycle and motorcycle repair shops, DTP and Photocopying Facilities, Medicine Shops, Courier Agents, etc.
- **Food Products Sector:** Activities such as papad making, achaar making, jam/jelly making, agricultural produce preservation at rural level, sweet shops, small service food stalls and day to day catering / canteen services, cold chain vehicles, cold storages, ice making units, ice cream making units, biscuit, bread and bun making, etc.
- **Textile Products Sector / Activity:** Handloom, powerloom, khadi activity, chikan work, zari and zardozi work, traditional embroidery and hand work, traditional dyeing and printing, apparel design, knitting, cotton ginning, computerized embroidery, stitching and other textile non-garment products such as bags, vehicle accessories, furnishing accessories, etc.
- **Business loans for Traders and Shopkeepers:** Financial support for on lending to individuals for running their shops / trading & business activities / service enterprises and non-farm income generating activities with beneficiary loan size of up to 10 lakh per enterprise/borrower.
- **Equipment Finance Scheme for Micro Units:** Setting up micro enterprises by purchasing necessary machinery/equipments with per beneficiary loan size of up to 10 lakh.

Mudra Card:

- MUDRA Card is a debit card issued against the MUDRA loan account for working capital portion of the loan.
- MUDRA Card also helps in digitalization of MUDRA transactions and creating credit history for the borrower.
- MUDRA Card can be operated across the country for withdrawal of cash from any ATM/micro ATM and also make payment through any **'Point of Sale'** machines.
- The borrower can make use of MUDRA Card in multiple drawls and credits so as to manage the working capital limit in cost-efficient manner and keep the interest burden minimum.

Questions For Practice

Ques 1: Write Short Note On: "Mudra Card".

Hint: Refer Topic Mudra Card.

Ques 2: Discuss eligible borrower from MUDRA Bank?

Hint: Refer Topic Eligible Borrower from MUDRA Bank.

Ques 3: Discuss Illustrative List of activities that can be covered under MUDRA Loans?

Hint: Refer Topic illustrative List of activities that can be covered under MUDRA Loans.