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Eased Companies Act to help startups take private company route

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As a minimum share capital is no longer required at the time of incorporation, entrepreneurs are increasingly looking at setting up a private company, rather than opting for other legal forms of entities - such as limited liability partnerships. The notification issued by the MCA in early June has been placed before both houses of Parliament for approval.

Since December 2000, the minimum paid-up share capital for a private company was Rs 1 lakh; now, there is no such requirement. In fact, this particular amendment was notified earlier on May 26. "Requirement of a minimum share capital was demoralizing for startups. Now, even the stamp duty burden attached at the inception stage has been done away with. INC-7, which is the e-application form for company incorporation, no longer requires mention of the quantum of share capital," explains Gopika Shah, partner at Pramod S Shah & Associates, practising company secretaries. "Many young entrepreneurs are showing keen interest in incorporating private companies. We will soon see many companies, largely in the services sector, being incorporated with minuscule capital," adds Shah.

According to MCA's notification dated June 5, private companies are exempt from the provisions of section 43 (relating to types of share capital that can be issued) and section 47 (restriction on voting rights) of the Companies Act, 2013. "Thus, startups incorporated as private companies will have full flexibility in structuring their share capital which is often required to facilitate and accommodate the terms of a Venture Capital investment," says Vishwas Panjiar, Director, Walker Chandiok & Co.

"Exemption from these sections gives freedom to a startup company, to issue any type of instruments, whether it is common shares, preference shares, multi-class shares with special rights and even provide for differential voting and dividend rights to their shareholders. This gives good flexibility for raising funds," adds Vaibhav Parikh, partner, Nishith Desai Associates, international legal counsellors.

According to the notification, a private company can now also obtain deposits from its members to the extent of 100% of its paid-up capital and free reserves. There is no requirement for such a company to issue an offer circular or create a deposit repayment reserve.

"This will be very useful for startup companies. In the absence of a collateral, banks are averse to finance startups. There are a couple of funds that give venture debt (i.e. debt without personal guarantee and hard collaterals) but most of the startups are deprived of debt finance. This relaxation will enable shareholders to lend monies to startups. Permitting debt beyond the stipulated limit would have been more beneficial. However, this is a good start and it also balances risks of highly leveraged companies," says Parikh.

Section 67, which places restrictions on companies for advancing loans for purchase of its own shares, no longer applies to private companies which meet certain criteria - they do not have a corporate shareholder; do not have borrowings from banks, financial institutions or corporates of not more than twice of their paid-up share capital or Rs 50 crore, whichever is lower, and are not in default in repayment of borrowings at the time the loan is being granted. According to experts, these restrictive provisions may hinder startup companies from reaping its full benefits. For instance, most VCs, which invest in startup companies, would be body corporates.

As the startup corporate entity begins to grow, it will now be easier for it to issue right shares. MCA's notification provides that a private company can make a rights issue as soon as 90% of shareholders provide their consent. Issue of ESOPs now requires a simple resolution, as against a special resolution (requiring approval from at least 75% of shareholders).

Operational ease has also been introduced. The board is not required to obtain consent of the shareholders with regard to transactions such as sale of the undertaking, investments or borrowings. Private companies also do not have to file with the Registrar of Companies, the board resolutions, which will reduce compliance cost. "Young entrepreneurs were keen to register a company, but worried about compliance hassles and did not even have enough budgets for meeting the compliance requirements. With operational relaxations and relaxations relating to raising of funds via share capital or debt, private companies may be the preferred mode for entrepreneurship in India," sums up Shah.

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