THE ECONOMIC TIMES

# How to wind up your startup without any hassle

By Mugdha Variyar, ET Bureau | Jul 26, 2016, 03.41 AM IST

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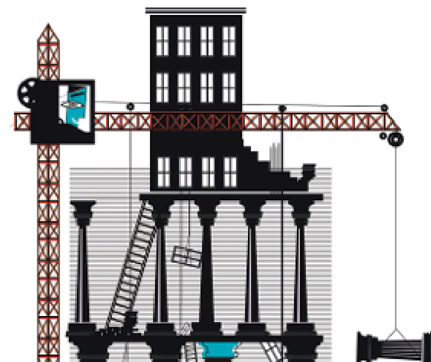
*In the run-up to the jury meeting to choose the winners of The Economic Times Startup Awards 2016, we will run a series of special articles on the theme of entrepreneurship. Here is the final article of a five-part series of tips and tricks to survive and thrive in an environment where money is not plentiful but ideas are.*



*Winding up a company is not only about laying off employees and closing operations. It involves several other procedures to take the company off official records.*

BENGALURU: "Shutting down a company is hundred times more difficult than starting a company," said an entrepreneur who recently shuttered his startup, requesting anonymity as liquidations proceedings were still ongoing.

Several entrepreneurs echo this sentiment. Winding up a company is not only about laying off employees and closing operations. It involves several other procedures to take the company off official records. One way to shut a company is to show a year's record of no operations (revenue) and zero assets and liabilities, after which it will be struck off the register of the Registrar of Companies (RoC), said corporate lawyer Vaibhav Parikh, a partner at Nishith Desai Associates.

The other is to take the court route, which is a longer and costlier process that involves meetings with creditors and several court dates. This could take two to five years based on the complications involved.

The government recently brought in schemes to help with the closing of a company — the Bankruptcy law and the notification of the National Company Law Tribunal, which is likely to replace the traditional courts for company insolvency and disputes.

These schemes are timely, given that an increasing number of startups beset primarily by an unexpected capital crunch are winding down this year. According to startup-focused research firm Xeler8, nearly a thousand startups in India have wound up since June 2014.

## Three Ways to Shut Down

**ABHILEKH VERMA**, partner at Khaitan and Co, explains the pros and cons of the available options:

**1. STRIKE OFF FROM ROC**

The process to close a defunct company is still governed by the Companies Act, 1956 (Old Act) as the relevant provisions set out under the Companies Act, 2013 are not in force yet. But a defunct company can apply to strike off its name from the register of the Registrar of Companies under a so-called 'Fast Track Exit Mode'.

**PROS:** Relatively shorter time and lower cost

**CONS:** The challenge is for a company to fall within the definition of 'defunct company' – nil assets and liabilities and zero business activity. Furthermore, the RoC is vested with unfettered discretion.

**2. TRIBUNAL ROUTE**

The National Company Law Tribunal has the power to order the winding up of a company on certain prescribed grounds.

**PROS:** An option in situations where the creditors do not support the winding up but the shareholders do.

**CONS:** The tribunal route is usually long drawn

**3. VOLUNTARY CLOSURE**

A company can wind up by itself under two categories: (i) members voluntary winding up; (ii) creditors voluntary winding up.

**PROS:** Simple process if the shareholders are on the same page and the company has no debt

**CONS:** It may get dragged on by incidental involvement of an official liquidator and the tribunal.

According to Parikh, startups may not need to use the Bankruptcy law option as many of them do not have debt. "However, they may be

able to take benefit of voluntary winding up. The objective is to limit the process to a shorter time frame of up to 90-180 days, but its effectiveness remains to be seen," Parikh said.

Nasscom president R Chandrashekhar, too, said the Bankruptcy law may not be suitable for most startups. "The new Bankruptcy code, perhaps, is a little more oriented towards traditional business that have huge assets and huge institutional lending and designed from the perspective of lending institutions and to curb crony capitalism," he said in a recent interaction with ET.

"These are desirable objectives but not necessarily focused on the quick three-month closure we would like in cases where there is no debt."

Voluntary winding up, which can be done by either members or creditors, is done without court supervision. When the winding up is complete, relevant documents are filed before the court for obtaining an order of dissolution. But while the process may seem straightforward, the reality is often very different.

The entrepreneur quoted above said he was "forced" to adopt the liquidation process.

"It is forced because you don't have enough money to pay what you owe to your creditors as well as employee salaries and statutory payments. In this route, the creditors file cases against directors (of the company) and you need to personally handle multiple creditors, which could lead to unethical issues such as threats and harassment," he said.

**NEW CLOSURE TOOLS**

**INSOLVENCY AND BANKRUPTCY BILL, 2015**

Startups with simple debt structures may be closed within 90 days of applying for winding up on a fast-track basis. An insolvency professional is appointed for liquidating a startup's assets, as per the Startup India Action Plan. However, since many startups do not have a debt structure they may not be able to avail of this.

**National Company Law Tribunal**

The objective of the National Company Law Tribunal, constituted with effect from June 1, is to limit the winding-up process to a time frame of 90-180 days.

**ALTERNATIVE OPTIONS**

**LIMITED LIABILITY PARTNERSHIP**

Rather than incorporate as a private limited company, startups can explore the option of conducting business as a limited liability partnership (LLP) as the level of compliance is relatively.

**DORMANT COMPANY**

**The New Act allows for a startup to be declared a 'dormant company'. This allows a business to stay afloat with lower levels of compliances. The RoC can strike off a startup's name from its register if the company has been dormant for five years.**

"It is also a very lonely and stressful process if the investors resign from the board and cofounders who are not on the board leave abruptly, as it happened in our case."

The bureaucracy and costs involved in closure is a main reason why several companies remain dormant without legally shutting operations. Parikh said nearly 90 per cent of the startups that fail continue to exist on paper despite closing operations. Of the remaining, a majority choose to strike off the company's name from the RoC's records.

"If a company remains dormant, it still has to bear costs for maintenance and compliance with annual filings, failing which it could be fined by the registrar," he said, adding that in case startups don't want the hassle, they can register as a limited liability partnership (LLP).

Pardeep Goyal, who shuttered his startup SchoolGennie in 2014, advises that bootstrapped companies should avoid the costly procedure of incorporating a private limited company if they can do business as a proprietary or partnership firm.

"I feel there is no need to incorporate private limited unless you have to raise capital from investors or have many stakeholders in the company. We incorporated a private limited company that involved the cost of incorporation and (chartered accountant's) expenses. It's costly to incorporate, maintain and wind up a private limited firm," he said.

"We had not earned much revenue but spent Rs 30,000 on incorporation, Rs 15,000 for annual maintenance to CA and another Rs 10,000 in closure. It was painful to see the balance sheet in loss and still having to pay additional money for closure procedures," Goyal said, adding he had to wait six months to get the closure status of the company.

*(With inputs from Aditi Shrivastava)*

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