Legal Framework for Startups in Pakistan

Introduction and Background

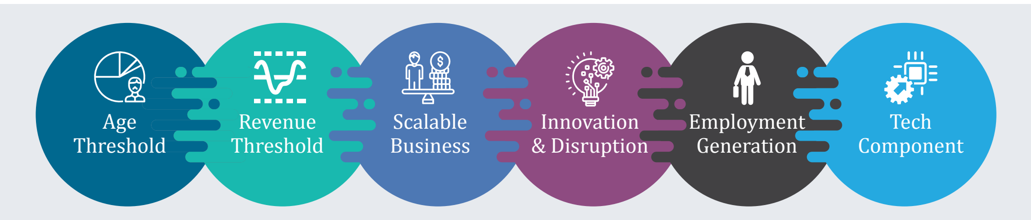
Startups play a very important role in the modern economy and are vital to its social and economic progress. As of 2019, their contribution to the global GDP is estimated at approximately $3 trillion[1]. In addition to the creation of wealth and impact on GDP, startups also have a positive impact on employment. Data from the United States of America (US) show that startups that cross the 5-year threshold have a positive impact on employment despite the evidence that 75% startups fail in their early years[2]. In 2016, it was estimated that startups account for over 21% of total employment in the OECD countries[3].

An important feature of startups is their contribution to innovation and competition in the economy through advanced and innovative technological processes and products and services. Such innovation is spurred by investments which high preforming startups attract from all over the world benefiting their parent countries through increased capital inflows. In 2019, there were approximately $300 billion worth of investments in startups by Venture Capitalists as a result of 32,800 deals. For the decade, the estimate is as high as $ 1.5 trillion[4].

While they exist in all sectors of the economy, startups are often synonymous with nascent businesses that have a technology component either in their production processes or service delivery. This understanding is derived from the manner in which countries around the world define, classify and categorize startups to confer certain benefits through legal frameworks and policies. Aside from policy makers, stakeholders in the ecosystem such as incubators, accelerators and trans-country networks like the Global Entrepreneurship Network (GEN) conceptualize startups as businesses with a strong technological component that is essential to scalability of its operations. This is reflected in the type of businesses that are nurtured and incubated, and the manner in which data are collected and analyzed.

There are similarities in the way countries classify businesses as Startups. The most common features include a threshold on the number of years an enterprise has been in operation; the requirement that the product or service is an innovation and improvement upon the current or mode of offering in the market; and the businesses is scalable in terms of the markets it operates in and the number of employees on its payroll.

Exhibit 1: Key Features of Startup Definitions Across the Globe



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The views expressed in this document are by the author and do not necessarily reflect the views and policies of Karandaaz Pakistan or the donors who have funded the study.

[1] The genius works. Peter Fisk. October 18, 2019. https://www.thegeniusworks.com/2019/10/the-3billion-global-startup-economy-where-and-how-startup-ecosystems-are-driving-new-growth/

[2] Forbes, Nish Acharya, Small Businesses Are Having A Bigger Impact on Job Creation Than Large Corporations. May 5, 2019. https://www.forbes.com/sites/nishacharya/2019/05/05/who-is-creating-jobs-in-america/#70d6225b597d

[3] Organization for Economic Co-operation and Development (OECD), Directorate of Science, Technology and Innovations. No Country for Young Firms. June 2016. https://www.oecd.org/sti/ind/Policy-Note-No-Country-For-Young-Firms.pdf

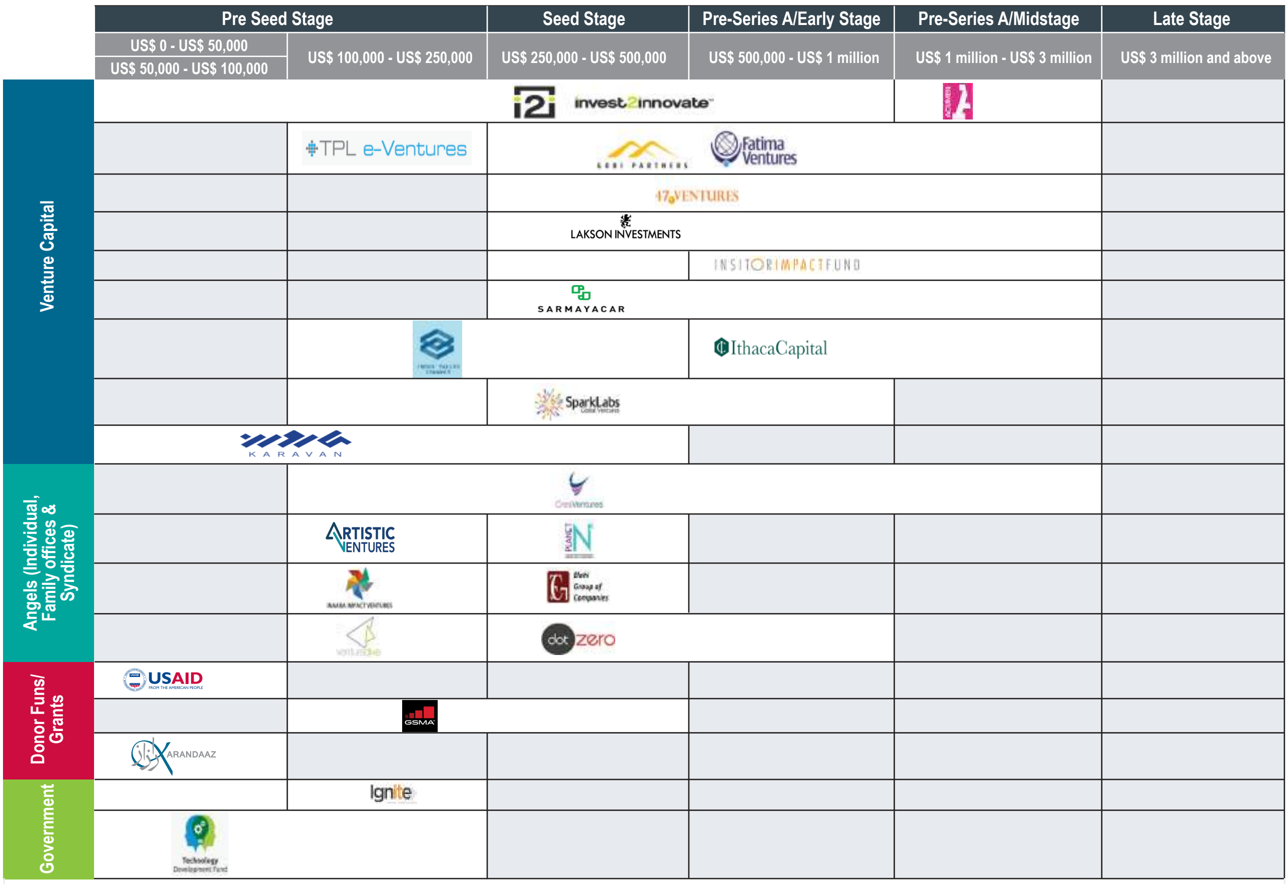
[4] Crunchbase News. Jason D. Rowley, The Q4/EOY 2019 Global VC Report: A Strong End To A Good, But Not Fantastic, Year. January 8, 2020. https://news.crunchbase.com/news/the-q4-eoy-2019-global-vc-report-a-strong-end-to-a-good-but-not-fantastic-year/

After a series of stakeholder consultations in 2019, the Securities and Exchange Commission of Pakistan (SECP) amended the Companies Act, 2017 to provide legal clarity around startups, protect the interests of their founders and make compliance easier for new and innovative businesses. On the investment side, it has made amendments to the Private Fund Regulations, 2015 as a measure to improve access to finance to startups. After a brief overview of the startup landscape of Pakistan, this paper analyzes the legal framework and enabling policy, while tracking the changes and amendments that have been made over time. It also provides in-depth parallel examples from other countries over the past decade to put the measures taken by the SECP into context and answer questions such as: How have countries strengthened their existing laws or introduced new ones to provide an impetus to startups and enable them to thrive; and what sort of benefits are conferred on these businesses as a result of such measures?

Overview of Pakistan's Startup Landscape and Funding Challenges

Pakistan's startup landscape is nascent with most progress occurring in the last 5-8 years. Recent indicators suggest that it is moving in the right direction. In 2012, only two major business incubators and accelerators were in operation with no funding sources or investors. By 2019, 24 incubators and accelerators and 20 formal investors (High Net Worth Individuals, Family Offices and Institutional Investors) were operating in this space. 47 deals took place in 2018-19 alone, compared to 54 in the three-year period between 2015-18. Total amount raised in the five years between 2015-19 was $165 million. 82 companies were funded in this period mostly in E-Commerce (25%), Health and Health Tech (12%), Ed-Tech (11%) and Fintech (11%). Angel investors who are vital for early stage investment funded 60% deals while Venture Capitalists were responsible for 25% among others that included incubators/accelerators and international investors not in the VC or Angel Investor category[5]. As of 2019, there were 20 formal investors in the startup ecosystem in Pakistan that provide pre-seed (up to $250,000) and seed stage funding ($250,000 to $500,000)[6].

Exhibit 2: Startup Financing Landscape in Pakistan (2019)



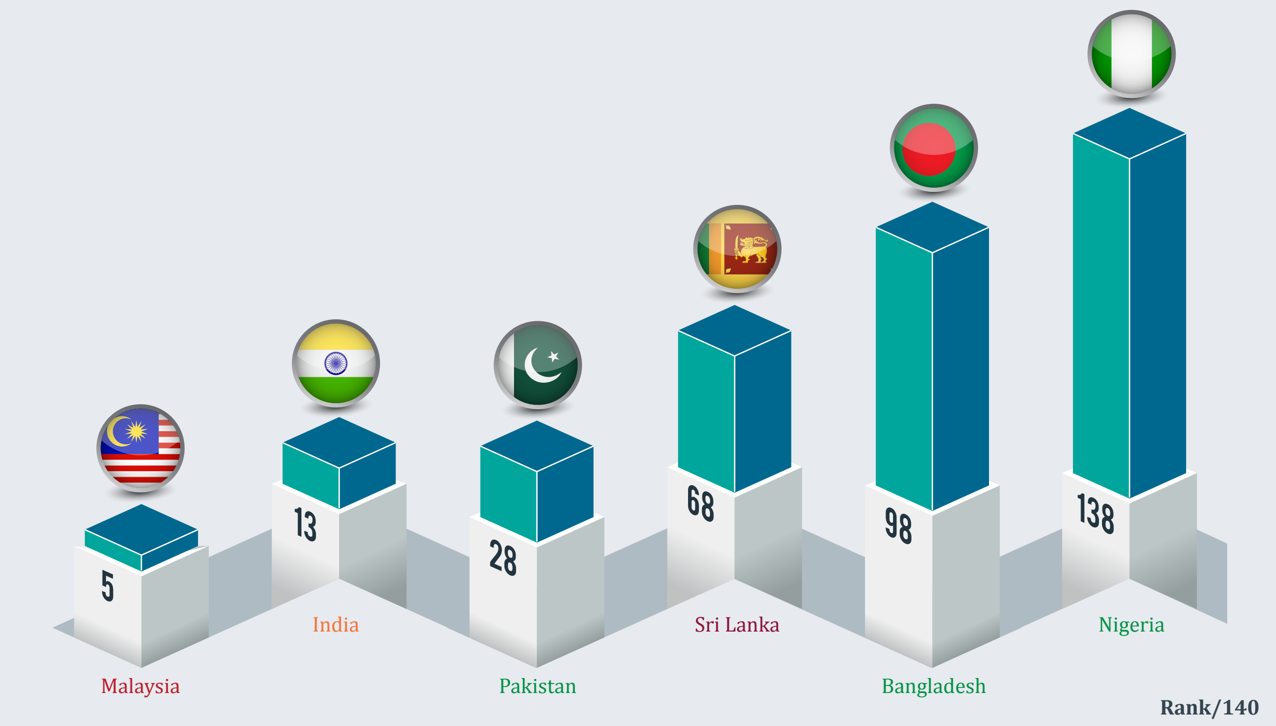
Source: Invest2Innnovate 2019

The Global Competitiveness Report 2018 ranked Pakistan 28 out of 140 countries on the availability of venture capital which is higher than Bangladesh, Sri Lanka and Nigeria.

[4] Invest2Innovate. Ambareen Baig, Kalsoom Lakhani and Areej Mehdi. Pakistan Startup Ecosystem Report, 2019. October 29, 2019. https://invest2innovate.com/download/1280/.

[6] Ibid

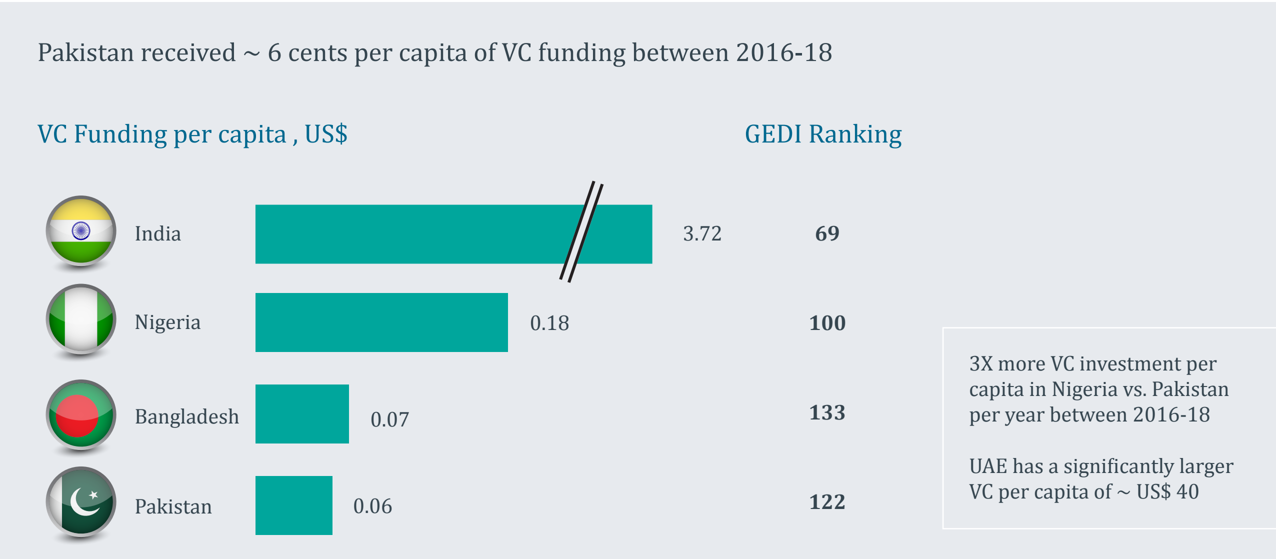
Exhibit 3: Ranking of Pakistan alongside other countries on Venture Capital Availability



Source: Global Competitiveness Report 2018

While this indicator is encouraging, Pakistan still has a lot of ground to cover in the access to finance area. Between 2016-18, Pakistan received only $0.06 per capita of VC funding from 20 formal investors. This is 3 times less than Nigeria ($0.18 per capita) and 62 times less than India ($3.72 per capita).

Exhibit 4: VC Funding in Pakistan Compared to Other Countries



Source: Global Entrepreneurship Development Institute 2019

Based on Global Innovation Index's 2020 report, Pakistan ranks 77 out of 81 countries on venture capital deals sliding 5 places down from 72 in 2019, and below all its South Asian peers except Sri Lanka. Moreover, a breakdown of the deals from 2015-19 shows that most investments were not in the early or pre-seed stage when founders are often reliant on personal sources of funds. Over 11% of investments were seed stage (when the company has been launched and working on proof of concept) or Series A (54% - when a startup expands its user base and product offerings) compared to pre-seed (6%).

Legal Framework for Startups in Pakistan

In 2017, the government, through the Finance Act 2017 made amendments to the Income *Tax Ordinance, 2001.* One of these amendments was related to the introduction of the concept of startups [Section 2(62A)]. A startup was defined as:

> *"a business of a resident individual, Associations of Persons (AOP) or a company that commenced on or after first day of July, 2012 and the person is engaged in or intends to offer technology driven products or services to any sector of the economy provided that the person is registered with and duly certified by the Pakistan Software Export Board (PSEB) and has turnover of less than PKR 100 million in each of the last five tax years;"*

To provide incentives to startups, a tax exemption was granted on the profits earned by businesses (incorporated on or registered after July 1, 2012) in the year in which they are certified by PSEB and two subsequent years. An exemption from levy of minimum tax was also granted to startups through the *Finance Act, 2017*[7].

The definition in the Income *Tax Ordinance, 2001* is very narrow and restrictive as it only covers technology related companies that are certified with PSEB. After extensive stakeholder consultations in 2019, SECP introduced several changes in the *Companies Act, 2017* that include the introduction of a definition of a startup. SECP's definition for a startup has been broadened compared to the one in the Income *Tax Ordinance, 2001* to be sector and industry agnostic, the ceiling for annual revenue has been increased (from PKR 100 million to PKR 500 million) and a limit placed upon the number of years of incorporation (up to 10).

> A "startup company" is a company that a) *is in existence for not more than 10 years of its incorporation; b) has an annual turnover of not more than PKR 500 million or any other amount specified by SECP; and c) is working towards the innovation, development or improvement of products or processes or services or is a scalable business model with a high potential of employment generation or wealth creation or for such other purposes as may be specified or d) such other companies or classes of companies as may be notified by the Commission: Provided that a company formed by the splitting up or reconstruction of an existing company shall not be considered as a startup company.*

Aside from a broadened definition, other changes relate to employee stock options, issuance of relaxation of compliance, share buy-back and protection of minority shareholders. They are briefly discussed below.

- **Stock Options (Section 83A) and Buy Back (Section 88):** Previously, employees' stock options were only allowed for private limited companies and shares could only be issued to the business's founders. Under the new changes, startups can now set up an employee stock option pool to reward valuable and high preforming employees. Similarly, share buy-back was also allowed for public limited companies. With the amendments, the business can now buy back shares from founders who decide to leave the company. These shares are either cancelled or held as treasury shares.

- **Fund Raising (Amendment to Section 17):** The changes have also allowed founders to delay putting money in the business if they have a shortage of funds. This was done with the removal of the condition that required subscription money to be paid within thirty days. This measure will enable businesses to focus on product development before fund raising.

- **Compliance (Amendment to Section 17):** the requirement to immediately engage a chartered account has been eased. This will enable the business to incorporate itself without bearing the burden of such costs.

- **Minority Shareholders (Section 140):** To protect minority shareholders, the changes allow owners with 5% of voting power to have a say in the resolutions that are put forth at a general meeting. Previously, only shareholders having 10% of voting rights were eligible.

The aforementioned changes will provide an enabling environment for a startup culture in Pakistan through focused interventions, regulatory frameworks and regulatory relaxations for startups. The set of amendments will provide legal cover to startups in the negotiation and execution of contracts.

[7] Federal Board Revenue (FBR). Finance Act 2017 – Explanation of Important Amendments Made in The Income Tax Ordinance, 2001. September 6, 2017. http://download1.fbr.gov.pk/Docs/201796149402990CircularNo04of2017.pdf

Exhibit 5: Legal Framework for Startups in Pakistan

	Year of Amendment	Definition			Benefits
		Annual Revenue Threshold	Sector	Age Threshold	
Income Tax Ordinance, 2001	2017	< PKR 100 million	Technology	Registered on or after July 1, 2012	3 Year Tax Exemption on Profits when certified from PSEB, Exemption from Levy of Minimum Tax
Company Act, 2017	2020	< PKR 500 million	No Restriction (Innovation and Scalable Business Model)	< 10 Years from date of incorporation	Employee Stock Options, Buy Back of Shares, Ease of Compliance and Fund Raising, Protection of Minority Shareholders

Legal Framework for PE/VC Companies in Pakistan

In 2008, SECP introduced the first Private Equity (PE) and Venture Capital (VC) Fund Regulations to boost foreign investment and ease access to finance for new businesses. Even though the focus of VC and PE investment is somewhat different—the former engaging with businesses at a nascent stage while the latter in established entities or businesses at a mature stage—the regulations don't differentiate between the two.

The clubbing of VC/PE Regulations is not dissimilar to legal framework in other countries but there are some exceptions. In India for example, funds are classified as Alternative Investment Funds (AIF) and regulated under Alternative Investment Funds Regulations (with the exception of funds in existence before these regulations came into effect. They are grandfathered under a separate regulation). VC (and other early stage funds) are AIF Tier 1, PE funds are AIF Tier 2 with complex trading such as Hedge Funds falling under Tier 3. The difference between the tiers is the tax treatment, life of the fund and rules around using funds raised through foreign investment[8].

However, in USA, both PE and VC funds are registered as limited partnership with no differentiation in the governing rules[9]. Similarly, in the UK, both PE and VC funds operate under a GP/LP structure[10].

In the 2008 PE/VC Regulations in Pakistan, the fund was required to have PKR 30 million paid up capital with a minimum fund size of PKR 250 million. It was required to incorporate with SECP as an unlisted Non-Bank Finance Company (NBFC) with a maximum life of 15 years. Moreover, minimum investment per investor was set at PKR 10 million. The benefits for PE/VC Funds were provided through the Finance Act 2008. They included reduced capital gains tax from 35% to 10% on sale of assets and shares of a private company, alongside a tax free status for the fund for 6 years[11].

In 2015, SECP introduced the Private Fund Regulations to replace the PE and VC Regulations 2008. Like the previous regulations, the fund was required to be managed by an unlisted NBFC. The primary aim was to provide further easement to the investment landscape. As per the amendments the minimum investment amount per investor was reduced from PKR 10 million to PKR 3 million[12]. Following the amendments of 2015, Pakistan's first ever PE/VC fund was granted a license in 2016[13].

The restructured legal framework circa 2015 still did not have the desired impact. As of June 2020, only 4 PE/VC Companies and 5 PE/VC Funds had been licensed by the regulator. In 2019 SECP undertook another review of the regulations. As a result of industry-wide consultations with startups, fund managers and companies, amendments to the 2015 regulations were introduced in 2020. The paid up capital requirement was decreased from PKR 30 million to PKR 10 million. In addition, startups were required to be valued every two years instead of every quarter[14].

[8] Thomson Reuters Practical Law. Pratish Kumar, Sumitava Basu and Diya Dhage, Juris Corp. Private equity in India: market and regulatory overview. July 01, 2020. https://content.next.westlaw.com/Document/Ieb4a24e91cb511e38578f7ccc38dcbee/View/FullText.html?transitionType=SearchItem&contextData=(sc.Search)&firstPage=true

[9] Thomson Reuters Practical Law. Daniel S. Kim and Young-Nam Jun, Orrick Herrington & Sutcliffe LLP. Venture capital investment in the United States: market and regulatory overview. May 01, 2020.
https://content.next.westlaw.com/7-501-0057?__lrTS=20200815130655605&transitionType=Default&contextData=%28sc.Default%29

[10] British Private Equity & Venture Capital Association. FAQs in Private Equity.
https://www.bvca.co.uk/Our-Industry/Private-Equity-Explained/FAQs-in-Private-Equity.

[11] Securities and Exchange Commission of Pakistan (SECP). Internal & External Communication Unit. SECP's Major Initiative – Private Equity & Venture Capital Fund Regulations, 2008. August 19, 2008. https://www.secp.gov.pk/wp-content/uploads/2016/05/PE_VC_initiative.pdf

[12] SECP. Private Funds Regulations, 2015. November 25, 2015. http://mufap.com.pk/pdf/secpnotifications/2015/Noti20152.pdf.

[13] Dawn. First License for Private Equity Fund Approved. October 19, 2016 https://www.dawn.com/news/1290814.

The *Income Tax Ordinance, 2001* was updated to exempt all PE/VC funds from tax on profits and gains from 1 July 2000 to 13 June 2024[15]. This change was enacted in 2012 when the exemption deadline was increased to 2024.

Exhibit 6: Timeline of Changes to PE/VC Regulations

Mode of transaction	Private Equity and Venture Capital Fund Regulations, 2008	Private Fund Regulations, 2015	Private Fund Regulations, 2015 (Amended in 2020)
Minimum Equity	PKR 30 million	PKR 30 million	PKR 10 million
Minimum Fund Size	PKR 250 million	-	-
Maximum Life	15 Years	-	-
Minimum Investment per Investor	PKR 10 million	PKR 3 million	-
Number of Investors	Minimum 5	Maximum 30	Maximum 50

It should be noted that the rules around creating PE/VC funds meant to facilitate financing in startups are not completely divorced from how funds are raised and the ease of their mobility. The latter falls into the domain of the State Bank of Pakistan (SBP) under the Foreign Exchange Manual. This manual has guidance around how foreign domiciled funds can make invest in businesses based in Pakistan. Due to the macroeconomic conditions, particularly those relating to adverse balance of payments, the repatriation of foreign investment, dividends and profits is laden with complex documentation and procedural issues. As an example, in the case of convertible debt, investors have to wait at least 3 years till the investment can be converted into equity[16]. Even for capital inflow, PE/VC companies have to go through registration and approval processes of SBP that have no specific timelines on the part of the regulator. These rules also have to be reviewed for expedience and degree of complexity if access to finance is to be eased for startups. Otherwise, investors will prefer other jurisdictions over Pakistan for incorporating their funds.

In addition, both since the startup legislation encompasses both SECP and SBP, the staff in both organizations should be provided with the requisite training in enforcing training to administer the policy in accordance with its true spirit. In SBP's case this would be the Foreign Exchange Manual while in SECP's case, this would be the Company Law as well as the Private Fund Regulations.

Country Context

A number of countries have policies that aim to improve the ecosystem within which Startups are nurtured and operated. These policies include rules around procurement, tax incentives, winding up, and patent applications, among others. There is also an important component relating to access to finance.

To become eligible for benefits under these policies, startups have been given a definition. However, in some instances the definition is not rooted in any legal framework. This is the point of departure in the way startups are defined in countries within a legal framework (e.g. Startup Law, Company Law) and those with enabling policies only. In the former, new businesses are required to be structured in accordance with their country's Company Law e.g. sole proprietorship, partnership, corporation, etc.

Countries with Enabling Startup Policies

Some countries with enabling policies are discussed below.

Singapore:

Startup Singapore (SG Singapore) is an initiative of the Government of Singapore. Established in 2017, SG Singapore provides a single platform with the primary objective of promoting local startups (nationally and internationally) while providing a common platform to the startup community to facilitate dialogue on improvements in the ecosystem. SG Singapore defines startups to have a threshold on the number of years of operations (5 years), requires businesses to prove substantial innovative and intellectual property, be incorporated as a private limited company in Singapore and have a minimum amount of paid up capital (S$ 50,000).

[14] SECP. Amendments to Private Funds Regulations, 2015. June 10, 2020. https://khilji.net.pk/wp-content/uploads/2020/06/Notification-PF-Regulations.pdf

[15] Federal Board of Revenue, /Income Tax Ordinance 2001, Second Schedule, Part 1, Clause 101. https://www.ma-law.org.pk/pdflaw/ITO%202001.pdf

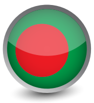
[16] State Bank of Pakistan, Foreign Exchange Manual Chapter 19. http://www.sbp.org.pk/fe_manual/pdf/2018/Chapter-19.pdf

In addition, certain sectors such as gambling and tobacco are excluded. All programs and assistance schemes for funding startups and providing mentorship have been consolidated under SG Singapore. It is worth mentioning that the Singaporean government will co-invest with 11 partners in businesses that require significant capital outlay and may take a longer time to be commercially viable[17].

Australia:

In Australia, Early Stage Innovation Companies (ESIC) with high growth potential are provided with tax incentives if they have been incorporated in the previous 3 years, have an assessable income of no more than $200,000 in the prior year and have been locally incorporated. There is also a cap on the total expenditure stated in the tax return and a requirement to have an Australian Business Number[18].

Bangladesh:



Government of Bangladesh's Startup Bangladesh Program provides mentorship, advisory and financial assistance through a fund to provide seed and growth stage funding to local businesses. Eligible businesses are required to demonstrate technology based innovation through product or service delivery. The fund also invests in training programs to create a skilled resource pool in the technology sector[19].

United Kingdom:

UK's Seed Enterprise Investment Scheme (SEIS) matches startups with investors that get equity in return for their investment. A business that is not more than 7 years old from the time of its first sale can raise GBP 5 million each year (for a maximum of GBP 12 million) if it is an unlisted UK based company that does not control or is controlled by another company. There is a limit on the amount of gross assets (GBP 15 million before issuance of shares) and number of employees (maximum of 250 full-time employees). Investors get a variety of tax breaks 3 years after their initial investment that include income tax relief (45% of initial investment), capital gains exemption (100% exemption), capital gains tax exemption from liquidating other investments into SEIS startups (50% exemption), loss of investment relief (loss off-set against other tax on other income) and inheritance tax relief (100% relief against value of shares after two years)[20].

Malaysia:

In Malaysia, there are two funds that invest in startups at the seed and pre-seed stage--Cradle Fund and Malaysia Venture Capital Management Bhd (MAVCAP), both under the purview of the Finance Ministry. As a VC, MAVCAP makes direct investments with fund size ranging from RM 1 million to RM 20 million and even participates actively in the management and operations of these companies. Cradle offers a maximum seed funding of up to RM 500,000 to help technology companies attain commercialization.

The Government of Malaysia has also introduced tax breaks to encourage private investments in startups as well as promote the setting up of high-tech companies in Malaysia. For example, the Angel Tax Incentive allows angel investors who have invested in early-stage startups to qualify for tax exemption. This would indirectly see more fund flows to startups and also encourage eligible angels to participate in the ecosystem. Additionally, there are incentives for ventures that have obtained MSC status[21] - a recognition by the Government of Malaysia for ICT and ICT-facilitated businesses that develop or use multimedia technologies to produce and enhance their products and services. These incentives include a 100% investment tax allowance and duty-free importation of multimedia equipment.

Israel:

Foreign investors that invest in Israel based VCs can get exemption from capital gains, interest and dividend through a tax ruling provided that the VC firm invests in a non-listed technology company. In addition, an amendment was made to the Israel Income Tax Ordinance in 2011 to allow investors to deduct their investment in a qualifying Israeli company from their taxable income from all sources. This deduction was capped at 5 million Israeli Shekels and can be taken in the year the investment was made and two subsequent years[22].

[17] Enterprise Singapore. https://www.enterprisesg.gov.sg/about-us/overview

[18] Australian Taxation Office, Australian Government. Tax incentives for early stage investors. August 20, 2020. https://www.ato.gov.au/Business/Tax-incentives-for-innovation/In-detail/Tax-incentives-for-early-stage-investors/.

[19] Startup Bangladesh. https://startupbangladesh.gov.bd/.

[20] Seedrs. Seed Enterprise Investment Scheme (SEIS) Tax Relief Explained – The Complete Guide. https://www.seedrs.com/learn/guides/seis-tax-relief.

[21] MSC Malaysia status is a recognition by the Government of Malaysia through the Multimedia Development Corporation (MDeC), for ICT and ICT-facilitated businesses that develop or use multimedia technologies to produce and enhance their products and services.

[22] Thompson Reuters Practical Law, Venture Capital Investment in Israel: Market and Regulatory Overview, December 2015

Countries with Enabling Legislation

Some countries with enabling legislation are discussed below. These can be split into two categories: In the first category, a custom made law exists around startups; and the second where amendments have been made to the country's Company Law to insert specific provisions on startups.

Italy:

Italy was the first country to introduce a specialized legislation[23] – Italian Startup Act in 2012 to spur innovation and growth through an entrepreneurial culture. The legislation defines startups as private limited companies that have been incorporated for 5 years or less, have an annual turnover not more than €5 million and must not distribute their profits. In addition, these businesses must be working towards the development of innovative products and services with a clear technological component. There are numerous benefits provided to qualifying businesses. They include free digital incorporation, some relief from financial and reporting compliance, exemption of annual duties and fees, stock options for employees as remuneration, tax incentives for equity investors, fundraising through equity crowdfunding campaigns and access to a public SME guarantee fund (that covers up to 80% of loans issued by financial institutions) among others[24].

Tunisia:

Tunisia passed a Startup Act in 2018 to support startups in funding, provide exemptions from corporate taxes, filing international patents and a government stipend for the founders who have taken time off from their jobs. The Act defines a startup as a company that: has not more than 8 years old from the time of incorporation; not more than 100 employees; more than two-thirds of the founders as investors; have an innovative business model that is preferably technology based; and contributes to economic growth[25].

Senegal:

Senegal passed a Startup Act in 2019 to support startups in myriad ways that include tax relief, subsidization of registration cost, protection of intellectual property and facilitating support from incubators. On the financing side, a major benefit is government guarantee on loans, equity financing made by private institutions or individuals. Fiscal relief includes a 3-year tax exemption. To qualify as a startup under the Act, a company must be an innovative and disruptive private or public company that has been registered for not more than 8 years, founded in Senegal with one-third owners of Senegal nationality, residence or conducting business in Senegal. Expats can also create a startup under the law if they have 50% ownership[26].

India:

Although India doesn't have a specialized legislation, it has made changes to its Company Law to accommodate startups. Amendments to this law in 2017 resulted in a definition of a startup which is a business incorporated as a private limited company, a partnership firm or a limited liability partnership in India. Further, it is required that the business should not be in existence for 10 years from the date of incorporation and its annual revenue must not exceed INR 100 Crores (increased from INR 25 Crores in 2019 through another amendment[27]) for any of those 10 years. The business must be working on an innovative product or service with a scalable business model that has potential for employment generation and creation of wealth. Major benefits to qualifying entities are provided under Indian's national policy – Startup India which provides tax exemption for three years, easy winding up, fast tracking of patent application and access to the online portal for exchanging knowledge and forming partnership[28].

Egypt:

In Egypt, amendments were made to the Companies Act to allow for incorporation of single member companies or sole proprietorship with all provisions of a limited liability company. This allowed the business to operate as a separate legal entity from its owner. Under the amendments, the owner of the business was empowered to hold general meetings, take decisions regarding the increase of decrease of capital, make employment appointments, wind up or convert the company into another structure[29].

[23] Disrupt Africa. Tom Jackson. Senegal becomes 2nd African nation to pass Startup Act. December 30, 2019. https://disrupt-africa.com/2019/12/senegal-becomes-2nd-african-nation-to-pass-startup-act/.

[24] Italian Ministry of Economic Development. Directorate General for Industrial Policy, Competitiveness and SMEs. The Italian Startup Act Italy's policy framework to support innovative startups. July 8, 2019. https://www.mise.gov.it/images/stories/documenti/Executive%20summary%20ISA%2007_2019.pdf

[25] Arabnet. Roudy Chamy. Tunisian Startup Act Redefines Entrepreneurship in the Country. November 30, 2018.
https://www.arabnet.me/english/editorials/entrepreneurship/tunisian-startup-act-redefines-entrepreneurship-in-the-country

[26] African Heroes. Charles Rapulu Udoh. How Senegal 's New Startup Act Intends To Help Startups Succeed. March 2, 2020. https://afrikanheroes.com/2020/03/02/how-senegal-s-new-startup-act-intends-to-help-startups-succeed/

[27] Khurana & Khurana Advocates and IP Attorneys. Shubham Borkar and Lakshay Kewalramani. India: All New 2019 Startup Policy Of The DPIIT/DIPP (Widened Definition And Modified Norms). March 11, 2019.
https://www.mondaq.com/india/corporate-and-company-law/787456/all-new-2019-startup-policy-of-the-dpiitdipp-widened-definition-and-modified-norms

[28] Startup India. Ministry of Commerce and Industry, India. https://www.startupindia.gov.in/

[29] Riad-Riad. Substantial Amendments To Egypt's Companies Act. February 01, 2018.
http://www.riad-riad.com/en/publications/substantial-amendments-egypts-companies-act

Zambia:

Similarly, a reform in the Companies Act in Zambia increased the protection of minority shareholders[30] and reduced the discretionary powers of the government with regards to business entry and exit. For instance, amendment of articles of association that has an impact on shareholder rights requires a special resolution. Additionally, a resolution has to be passed by a three fourth majority of votes cast by members entitled to vote for the alteration of company's share capital[31].

Exhibit 7: Summary of Benefits to Startups due to Enabling Policy and Regulatory Frameworks

Conclusion

There is ample evidence that shows startups are important to a positive paradigm shift in economies all over the world. Even with a high level of attrition, startups that cross a certain time threshold of years in operation have a high tendency of continuity. This enables them to contribute through income generation, tax contribution and employment creation. As a collective, their contribution to the global economy is $3 trillion with proportion of employment as high as 21% in OECD countries.

Startups are recognized the world over as disruptive business that have thrown out the playbook on traditional ways of doing business by introducing technology oriented scalable businesses models. The evolution through which old businesses processes become obsolete and are replaced by new and efficient ones is what sets them apart. This cognizance is reflected in the manner through which regulators and policy makers create, support and nurture startup eco-systems of incubators, accelerators, investors, academics and innovative businesses.

Even though the first set of formal regulations around the establishment of PE/VC Companies were introduced in 2008, the growth on the financing side was very sluggish. These regulations went through a round of changes in 2015 but it was not until 2016 that the first PE/VC Company was granted a license. As of 2019, there are 20 formal investors but only 4 are registered as PE/VC Companies. While there have been 101 deals in the last 5 years, Pakistan lags behind its peers in financing contribution on a per capita basis. The PE/VC Regulations went through another round of changes in 2020 with revised provisions on minimum capital requirement.

[30] A record number of 24 economies strengthened minority investor protections in 2018/19 under World Bank's Ease of Doing Business Reforms.

[31] OECD. Africa Investment Initiative. Highlights of the Policy Framework for Investment in Zambia. April 27, 2011. https://www.oecd.org/investment/investmentfordevelopment/47662751.pdf.

Concurrently, as part of the state's initiative to promote startup culture in Pakistan, SECP amended the Companies Law in 2020 to provide legal status to innovative businesses through a formal definition, introduction on provisions to protect the interests of the founders, employee stock options and compliance. This paper analyzed SECP's initiatives in light of the efforts made by other countries through enabling policies and regulatory frameworks. The thinking around classifying and categorizing startups is strikingly similar across the globe – they are nascent entities (number of years' threshold) with a cap on revenue (revenue threshold) and have a scalable and innovative business model that results in creation of wealth and employment generation. There is a slight deviation on the definition across countries but the overarching themes are quite common.

It was also found that countries with enabling environment can be split into two – ones that have a structured legal framework around startups and others that recognize startups through policy alone. The former can further be split into – countries that have made changes to their Companies Law or Act while others that have introduced a specialized legislation e.g. Startup Act to classify startups as legal entities. The incidence of specialized legislation is high in African and is still increasing.

The objective of such initiatives is the same i.e. to confer benefits in the form of tax breaks or holidays to investors and businesses, easy compliance, protection of intellectual property, financial support through government sponsored programs and access to knowledge networks and mentorship programs. While the end objective is the same, a well-defined legal form is very necessary for new businesses.

Such structure will have important bearings on fundamental issues related to personal liability, taxation and financing among others. As an example, if a single member company is allowed to operate with limited liability company (LLC) provisions, it is important to understand at the forefront on how long can those benefits be enjoyed. Similarly, some governance provisions relating to are very onerous e.g. appointment of company secretaries and board of directors. It is not feasible for a new business to comply to those requirements.

Aside from the implications, startups rarely have enough resources to bear legal and consulting fees that will need to be incurred to find the best fit for their business in terms of structuring an entity. A strong Companies Law can help businesses save time and resources through a predictable process of incorporation.

By making simultaneous changes to the Companies Law and VC/PE Regulations, SECP has provided strong support to the eco-system on both the business as well its financing side. Provisions in such as buy-back options for startups have a duel effect of positively impacting startups as well its investors. The implications of the changes as whole remain to be seen but there is evidence from other countries that shows that startup culture can potentially thrive when both businesses and investors have proper legal cover, a friendly fiscal regime and are able to raise funds from jurisdictions other than their country of domicile. For the latter, SBP's rules around investment from foreign funds will need to be reviewed. For now, SECP has put a strong building block in place that can potentially provide an immediate impetus to startups in Pakistan.

About Karandaaz

KARANDAAZ PAKISTAN is a Section 42 company established in August 2014 and focuses on fostering economic growth and creating jobs through financial inclusion of unbanked individuals and unserved enterprises, with a special focus on women and youth. The company has four verticals:

Karandaaz Digital

Focuses on expanding the poor's access to digital financial services in Pakistan by working across the ecosystem with all stakeholders.

Karandaaz Capital

Provides wholesale structured credit and equity-linked direct capital investments to micro, small and mid-size enterprises (MSMEs) that demonstrate compelling prospects for sustainable business growth and employment generation in Pakistan.

Karandaaz Innovation

Manages the Innovation Challenge Fund and Women Entrepreneurship Challenge, providing risk capital and grants to partners with the aim to generate innovative solutions in areas of financial inclusion and entrepreneurship.

Knowledge Management and Communications

Supports the company's core financial inclusion goal by developing and disseminating evidence based insights and solutions.

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