

# Why are tech start-ups not going for IPOs



**T.V. Mohandas Pai**  
*Chairman*  
Aarin Capital Partners



**Siddarth M. Pai**  
*Co-Founder*  
3one4 Capital

India has a very large tech start ups ecosystem, around 30,000 start ups have created 100b\$ of value with over 450,000 employees (as per YourStory). In 2017 India saw around 13.7b\$ of investment in tech companies. Every year around 5000-6000 start ups come up of which around 1500 get funding. This is the third largest tech ecosystem globally after the US and China. These are across various verticals and across technologies.

There are nearly 300 tech funds in India investing in these start ups. All VC's have a defined life span for their funds and need exits to return Capital back to their investors. Exits do happen through acquisitions, mergers, buy outs or by listing globally. But

in India listing has not been a preferred option for these companies. India's capital markets are large, wide and deep and offer good liquidity. Every year around 50b\$ is invested in the secondary markets through mutual funds and FPI's and about 15b\$ raised in the primary market. India also has a SME market where over 300 companies are listed with around 5b\$ of market capitalisation. Despite such a large liquid market there have been few IPO's of these start ups.

In order to encourage many more listings, the Regulator, SEBI came out with liberalised norms for listing tech start ups but found no takers. There are many reasons for this lackadaisical response.

There are no role models of successful listing of start ups in India. Every new category gets started by a great listing as IT services was led by the Infosys listing or telecom by the Bharti listing or the new private banks by the HDFC listing. Both the stock exchanges, NSE and BSE, have historically done a poor job of getting start ups to list and marketing the benefits of listing. Nasdaq and NYSE do a great job of marketing, targeting cos to list and helping them accelerate the process. There is a surprising lack of knowledge amongst the Founders and VC's about listing in India. Many believe the markets are not liquid enough, not wide enough nor receptive to high tech cos still making losses! This can only be bridged by aggressive marketing.

There is another big challenge. Not enough of local Indian capital has gone in the big tech Unicorns. Of the 20 Unicorns or would be Unicorns, about 15 have chosen to be domiciled outside India and operate through their subsidiaries in India. They are majorly owned by overseas capital, who have no love for an Indian listing and have chosen to be registered overseas for ease of investment and movement of capital. These Unicorns are driven by overseas VC's who lack belief in the Indian markets and always talk of an overseas listing. India's tough foreign exchange regulations, the bureaucratic procedures and regulatory filings, have been an impediment for their being registered in India. Though matters have improved over the last 3-4 years, there are too many restrictions on the forms of securities, transfer of capital etc. Added to this there is the great fear of tax terrorism. They also believe that being registered overseas gives greater flexibility for acquisitions, mergers, buy outs, listing globally and financial flexibility, all of which are true and logical.

A relook of foreign exchange regulations, filing and other procedures is called for. RBI is very rigid in its views and sometimes hostile to new ideas for fear of misuse and slow in its response. The lack of understanding and knowledge about start ups and their needs is a major reason for driving away innovative companies to overseas jurisdictions. ISPRIT, a think tank for start ups started a movement to change regulations to keep the starts ups in India, which did change regulations but has now fizzled out. This is a pity because India's future innovative companies are being driven away by an uncaring Regulator.

Tax terrorism is a stark reality in India. Tax rules are applied opaquely, Founders are ill treated and sometimes threatened with consequences, benefits of government policies are denied arbitrarily. India has a broken tax assessment system and a broken appeal system. A whole sale reform is called for mostly to improve tax payer services and stop tax terrorism. The challenge is the attitude of the tax officers. The recent 'Angel Tax' issue is still fresh in investors minds!

The listing regulations regarding promoter holding, definition of promoters, controlling shareholders, lock in etc are big impediments for start ups to list. SEBI had considerably eased all these conditions but some more needs to be done regarding lock up after listing. The best way is to follow the Nasdaq rules on lock up for cos where majority of the holding is by VC's who are regulated either in India or in a recognized overseas jurisdiction. For VC's long lock

ins are a big risk as they could be at the end of their fund life. But the SME market is favourable for listing by start ups except that the cap on amount that could be raised is too low. Maybe the cap can go up to say 100m\$ with a minimum listing of at least 10% of the total capitalisation, going up to 25% over say 3 years as a carve out for tech companies with majority VC holding. It is a semi institutional market with a minimum investment and trading of Rs 1 Lakh and needs to be liberalised for those cos which have majority investment by VC's.

There are other peculiar issues too. Most start ups have preferential, differential rights to the VC's and later investors which will be removed on listing. Many investors are unwilling to give them up as it gives them 'protection'. Also the VC's are obsessed by valuation concerns as their model gives stability in value for elongated periods of time. They can raise capital from other

VC's on a negotiated basis rather than be transparent and subject to liquid markets which move on economic conditions. They are uncomfortable about valuations which are beyond their 'control'. As the decision to exit is driven largely by VC's and not Founders, their views, thesis and peculiarities drive listing decisions. Many are still not sure whether Indian markets are receptive and deep enough, which is a pity.

The biggest barrier to listing of start ups has been the lack of a role model and a block buster listing! There is nothing like some 'Greed' to drive listing decisions. That is where aggressive targeted marketing by NSE and BSE is needed. Right now both seem very comfortable with the Status Quo as they have a very large market to serve.

To make the listing of start ups more attractive we need the listing conditions to be tweaked a bit more, the SME exchange further liberalised with a larger limit on a fund raise. As protection of small investors, those investing below Rs 200,000 in an IPO, seems to drive many regulations of SEBI, there is a need to make the listing of such companies an institutional listing with no allocation for retail investors. Institutions are knowledgeable and need no outsize protection by the regulator.

To further drive liquidity, it would be important for Mutual Funds in the small and midcap space to have an SME and Startup focus. This will help bring the SME exchange into the mindscape of investors and drive liquidity and trading on these stocks. The lot size of Rs 1 lakh for any investment in the SME exchanges leaves many smaller investor wary of committing large concentrations on single investments.

RBI needs to deeply study why so many Unicorns have chosen to be domiciled overseas, why very many are seeking overseas domicile even now and tweak its rules. RBI also needs to improve its service and response to stakeholders and be much quicker in response. There is a big need to create a service focused, customer focused culture in its operations where citizens reach out for approvals, queries, or ease of doing business. Tax terrorism is a national issue, solving which needs a very focused strategy by Government.

But all this, though very real in its impact, will cease to be material excuses for not listing in India if we have a block buster listing!

---