

Promulgation of an enabling regulatory framework to facilitate startups in Pakistan

With the objective to promote growth in the startups sector of Pakistan, it is necessary to make relevant changes in Company Law to facilitate the incorporation process for the startups and provide a conducive regulatory environment.

A) Proposed changes in the Parent legislation (Companies Act)

i) Definition of Startups

In the Third Schedule to the Companies Act, the following category is proposed to be added:

An entity shall be considered as a Startup:

- a) Upto a period of 10 years from the date of incorporation/registration
- b) Turnover of the entity for any of the financial years since incorporation/registration is not greater than 100 Million Rupees
- c) 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.

Provided further that an entity formed by splitting up or reconstruction of an existing entity or a separate company with similar objects and ownership shall not be considered a "Startup Company"

- i) Amendment in the Section "83 - Further issue of capital"** to offer "Employee Stock Option Scheme (ESOS)" shall help address the employee retention and reward issues being faced by startups.

The following new proviso is proposed to be added:

"Provided that the directors of private limited company may allot the declined or unsubscribed shares to its employees under "Employees Stock Option Scheme", on such conditions, as may be specified."

- ii) Amendment in the clause "88 – Power of a company to purchase its own shares"** shall facilitate ESOS option and shall facilitate buy back of shares by companies, since they do not have a secondary market. It would also facilitate startups in case, any founding member needs to exit from the company by allowing return of shares to a company.

B) Changes required in Companies (Further Issue of Shares) Regulations, 2018

- i) Amendment in the clause "7. Application to the Commission for issue of shares other than right"** is a consequential change whereby no application for approval shall be required to be made to the Commission under Section 83 of the Act, by a Private Company, and shall only

be required to maintain and file the documents with the Commission not later than two months from the decision to issue such shares, as specified in sub-regulation (2) below.

ii) Conditions for issuance of shares with differential rights

The requirement for the company not defaulted in filing financial statements and annual returns for three financial years immediately is being changed to preceding the financial year in which it is decided to issue such shares.

iii) Furthermore, for a private limited company, the valuation mechanism of non-cash consideration and further conditions, if any, will be amended in Companies (Further Issues of Shares) Regulations, 2018.

Introduction of Regulatory Sandbox

Regulatory Sandbox is a tailored regulatory environment for conducting limited scale, live tests of innovative products, services, processes, and/ or business models in a controlled environment for a limited period of time so as to assess their viability to be launched on full-scale, and to determine the compatible and enabling regulatory environment that will be conducive for the innovative solutions. The objective of these Guidelines is to purposefully meet the above.

The Regulatory Sandbox is primarily applicable for new products, services or business models which have not been addressed under existing laws and regulations; or these new ideas bring an innovative approach to the market and there exists considerable uncertainty in terms of unexpected adverse outcomes or existing regulatory framework does not fully address the solutions proposed to be experimented through the regulatory sandbox.

The Commission has issued draft guidelines for introducing Regulatory Sandbox, which are available at:

<https://www.secp.gov.pk/document/secp-regulatory-sandbox-guidelines-2019/?wpdmdl=37476>

Please provide feedback, if any, on the above to:

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