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Minister of State /
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Subject:- **FACILITATION OF STARTUPS**

Dear Sir

السَّلَامُ عَلَيْكُمْ وَرَحْمَةُ اللَّهِ وَبَرَكَاتُهُ

As you know, the Board of Investment (BOI) is mandated to facilitate new and existing, local and foreign investors in Pakistan. We are focused on doing so. In particular, we are keen to strengthen the entrepreneurial ecosystem for startups, and seek your assistance in facilitating startups. Initially, we would like to focus on four areas:

- Providing a structure for giving sweat equity through using Employee Stock Options (ESOPs)
- Assisting startups to issue convertible debt
- Facilitating startups to convert from a partnership to a company
- Facilitating startups to use electronic signatures

1. Provision of sweat equity through ESOPS

Employee Stock Option Program (ESOP) is one of the best ways to attract and incentivize talent. It is one of the most potent tools startups and small/medium businesses have to attract top talent for which they compete with leading organizations. Currently, ESOP is only available for public companies. SECP can also allow private companies to set it up. It is important to ensure that the spirit of the proposed change - to allow companies to easily allocate stock options to their employees - is encapsulated in the change that is enacted by the SECP. By using an existing structure, which is the ESOPs for public companies, this change can be enacted quickly and easily.

2. Use of convertible debt by startups

The manner in which convertible debt can be used by a startup is illustrated by the following example:

- a. A startup raises PKR 1 million from an investor through a convertible note, without getting into a valuation debate;
- b. In terms of the convertible note, the startup and the investor agree that PKR 1 million will convert into equity upon occurrence of a trigger event (could be the subsequent round of funding) at a valuation determined by a specific

method described in the convertible note. This method includes a valuation cap (for taking an early risk, the convertible note holder is privileged to having the debt converted into equity at a capped valuation, which gives a large benefit to the note holder if the company really does well and raises funding at a very high valuation) and a discount (this gives a benefit to the note holder for taking an early risk even if the valuation is low); and

- c. Upon occurrence of the trigger event, the startup issues shares in the company to the investor on a valuation calculated in accordance with the convertible note.

Currently there is no clear mechanism by which a convertible note can be issued. Transactions are structured whereby the company takes a loan from the investor. Upon occurrence of the trigger event, the company issues the calculated shares to the investor at par value (lowest amount) and in return the investor writes off the loan given to the company. This procedure is unnecessarily complicated. If the SECP were to issue guidelines endorsing this mechanism, or revise the relevant law to allow for a simple conversion of debt to equity, this will greatly assist the startup to use convertible debt easily.

3. Converting from a partnership to a company

Currently, when shares are being issued to a shareholder, a chartered accountant is required to certify that the shareholders to whom the shares are being issued have paid the share issue price. This creates a particular problem in the scenario where partnerships are converting into private limited companies (very frequent for startups).

Guidelines and directions may be issues to such chartered accountants to allow for partnerships to transfer all the funds from the partnership account to the private limited company's account, and have this be counted as equity contribution by each shareholder (who is also the partner).

4. Use of electronic signature

Electronically signed documents are legally recognized and enforceable under Pakistan law. The Electronic Transactions Ordinance 2002 ("ETO") specifically mandates that the requirement of affixation of signatures under any law is deemed to be satisfied where electronic signatures are applied. The ETO also exempts electronically signed documents from the requirement of witnessing, attestation, and notarization. It further recognizes that the requirement for any document, record, information, communication, or transaction to be in written form is satisfied if the same is in an electronic form and accessible for subsequent reference.

While the law is on the books, a mechanism for using electronic signatures on documents and filing them with the SECP does not exist. Developers have communicated to us that they have solutions whereby documents can be electronically signed and filed with the SECP. A mechanism needs to be agreed upon with the SECP on how they want to verify an electronically signed document. Developers tell us that there are many simple methods, hence we would like to obtain the views of the SECP on this subject.

The inability to electronically sign documents is a particular pain point for foreign investors and startups. A lot of valuable time may be lost coordinating and signing documents and amendments in the traditional way.

Please let us know your thoughts for each of these four areas. It will be very helpful if you can lay out a roadmap as to how we can make progress in each of these areas. Thank you for looking into this.

With warm regards,

Yours sincerely



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