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BRIDGING THE REGULATORY DIVIDE: ADDRESSING CORPORATE GOVERNANCE IN START-UPS WITH INSIGHTS FROM GLOBAL BEST PRACTICES AND THE BYJU'S CASE STUDY

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I. INTRODUCTION

In the last decade, India Inc. has progressed at an exponential rate. Start-up culture and entrepreneurs-led companies are on the rise. Entrepreneurship is a high-stakes game, where the risk and the rewards are intertwined. Of late, the goal of many start-ups has been to raise capital and provide an exit to their initial investors through an Initial Public Offering ("**IPO**"). An IPO is a complex process that requires the fulfilment of a host of complex regulatory and legal requirements. One important aspect amongst these are the norms of corporate governance that guide a company. However, these norms ought to be followed by all classes of companies.

The norms of corporate governance refer to the system of rules, practices, and processes by which a company is directed and controlled. It maintains accountability in a company, as well as introduces checks and balances. However, these mechanisms are given more importance in publicly listed companies, owing to mandatory compliances and increased scrutiny of such companies by the Securities and Exchange Board of India ("**SEBI**"). However, such provisions are only limited to publicly listed companies. Private companies or unlisted start-ups are not governed by such rules and regulations and unknowingly it affects their company significantly.

In this paper, the authors will put forward the various existing cavities in the governance framework for private companies. This will be done by citing examples from the Byju's case. There are a host of stakeholders for private companies as well, whose interests need to be safeguarded by those who run the company. These include the shareholders, employees, customers, and other stakeholders.

The paper will first begin with giving a background of the overall growth in the start-up ecosystem in the country, and the role played by various classes of investors. It will then

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describe the journey of Byju's, the education platform started by the eponymous Byju Raveendran. The paper will then delve into the grave problems put forth by the mismanagement by those in charge of the company. In the penultimate part of the paper, possible steps for a way forward will be suggested, linking the solutions with the issues posed by Byjus in the past few years.

II. "STARTING" UP

The Indian start-up ecosystem has seen exponential growth over the last few years. Since getting its first unicorn in 2011, there are over 100 start-ups that have achieved "unicorn" status as of 2022.[3] This number will no doubt keep on growing, as Indian innovators and entrepreneurs continue to excel at the global stage. Some part of this growth can be attributed to the beneficial policies and liberal regulations introduced by the Union as well as several state governments. Beneficial policymaking has enabled start-ups to access greater capital and focus on their services and products, rather than on compliances and tackling a hostile regulatory framework. This liberalisation brought foreign investors and fund houses into India. They not only provided more capital but also possessed a greater appetite for risk-taking.

Private equity investing is regulated in India under SEBI's (Alternative Investment Funds) Regulations. India's private equity and venture capital investments surpassed $60 billion for a third time in 2023.[4] Private equity investments in India are constantly maturing which also reflects the confidence of investors in the country's favourable economic conditions. Venture Capital is one of the crucial reasons why start-ups are on the rise in India. As per the economic survey of 2021-2022, there were 61,400 registered start-ups in India, 108 of which were unicorns.[5] Many of these funds provide funds and mentorship to start-ups at their earliest stages which helps them grow and scale. In 2022, venture capital funding worth $20.9 Billion was announced.[6]

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[3] Indian Brand Equity Foundation. (2023). *The emergence of India as Global Startup Hub.* https://www.ibef.org/research/case-study/the-emergence-of-india-as-a-global-startup-hub

[4] Bain Company. (2023). India Private Equity Report. https://www.bain.com/insights/india-private-equity-report-2023/

[5] Ministry of Finance, Government of India. (2022, January 15) Economic Survey 2021-22 [Press Release]. https://www.indiabudget.gov.in/economicsurvey/ebook_es2022/index.html

[6] The Economic Times. (2023).VC investment in Indian startups plunge 38% in 2022. https://economictimes.indiatimes.com/tech/startups/vc-investment-in-indian-startups-plunge-38-in-2022/articleshow/97279702.cms?from=mdr

Over the past few years, the poster boy of the Indian start-up ecosystem was undoubtedly Byju's. Started by Byju Raveendran, an engineer turned teacher, the company gained immense growth and "success" to rapidly become one of the largest Education-Technology ("**Ed-tech**") companies in the world. Credit for the company's early success can be attributed to its class-leading technology and offerings catering to tech-savvy students, especially during the pandemic. This along with the "growth potential" for Ed-tech in India led to prominent companies like Sequoia Capital and Chan Zuckerberg Initiative invest in Byjus which took the start-up to deca-corn status.

Byju's turmoil started in November 2021, after they raised $1.2 billion via debt funding from the overseas market. Ever since then, it has not been the same. Aggressive acquisitions and irresponsible financial management have plunged the company into crisis, reducing its value by a staggering 98%.[7] Between 2017 and 2021, the acquisitions made by it did not generate the anticipated results. Resultantly, Byjus laid off over 5000 employees and has made massive expenditure cuts over the past year. Additionally, they have defaulted on the payment of loans from foreign lenders. It seems that Byjus bit more than they could chew, and now the chickens have come home to roost. A few key errors that stand out include significant expenses on marketing, which included hiring Shah Rukh Khan and Lionel Messi as brand ambassadors, hasty acquisitions across the globe, and last but not least abysmal mismanagement and corporate governance. These decisions could have had a better approach or possibly have been avoided with the help of proper corporate governance, and honest company practices.

III.KEY ISSUES AND PROBLEMS

This section of the paper will describe and analyse the key issues of the Byjus fiasco, through the lens of appropriate corporate governance norms. As already stated above, the meat of the matter revolves around the lack of strict enforcement mechanisms for start-ups, which enabled Byju's to perpetuate its wrongdoings, combined with malpractices by the company. The next section of the paper will put forth various solutions and illustrate a way forward for future corporate governance practices for Indian companies.

[7] Team Inc42. (2024, March 2). Macquarie Capital Trims Valuation Of BYJU'S By Nearly 98%. https://inc42.com/buzz/macquarie-capital-trims-valuation-of-byjus-by-nearly-98/

It must be kept in mind that the underlying theme of the issues which have plagued Byjus over the past few years come in the backdrop of the company operating in the socially important sector of education. The company's operations initially gained immense parental trust. However, since the pandemic-induced restrictions were reduced, this ecosystem has been in a vulnerable state. Without a clear policy framework, all industry participants operate with little oversight. This has led to a lack of transparency and accountability. Multiple reports have shed light on troubling practices within Byjus, including difficulties in obtaining refunds by consumers, reports of sales representatives harassing families and making disparaging comments about their intellect, and outstanding debts owed to customers.[8] While some were able to pursue legal action, for many others, limited resources left them powerless. After multiple complaints from consumers, the government stepped in, but in a limited manner. The government introduced "dos and don'ts" for consumers when transacting with Ed-tech platforms.[9] In January 2022, the Ministry of Education announced that it would establish regulations for the industry[10]. Apart from this, the Internet and Mobile Association ("**IAMAI**") announced the formation of the Indian Edtech Consortium, which aimed to adhere to a common 'Code of Conduct' under the auspices of IAMAI, as well as act as a redressal mechanism for consumers.

In addition to the industry-specific misgovernance that can be attributed to the company, there are a few glaring omissions on the part of the company's general governance. These range from the resignation of the statutory auditor of the company to the high attrition rate of key employees at the start-up.

[8] Ayesha Singh. (2023, July 31). The Byju's bust: Decoding the rise and fall of the once most valued start-up. *The New Indian Express.* https://www.newindianexpress.com/magazine/2023/Jul/22/the-byjus-bust-decoding-the-rise-and-fall-of-the-once-most-valued-start-up-2596842.html

[9] Ministry of Education. (2021, December 23). Advisory to citizens regarding use of caution against Ed-tech Companies [Press Release]. https://pib.gov.in/PressReleasePage.aspx?PRID=1784582

[10] Kritika Sharma. (2022, January 03). Modi govt working on policy to regulate edtech platforms, says Education Minister Pradhan. *The Print.* https://theprint.in/india/education/modi-govt-working-on-policy-to-regulate-edtech-platforms-says-education-minister-pradhan/794038/

1. Resignation of the statutory auditor: The company's statutory auditor, Deloitte Haskins and Sells LLP resigned from its position in 2023.[11] The firm stated in its resignation letter to the board of directors that "The financial statements of the Company for the year March 31, 2022, are long delayed… and we have not been able to commence the audit as on date." The resignation of an auditor, particularly one with essential powers and duties as given under section 143[12] of the Companies Act, 2013 ("**Act**"), is a significant indicator of the company's misgovernance and should be viewed as a critical red flag.

2. Non-compliance with reporting requirements: As stated above, there was an extremely long delay by Byjus in filing the financial statements with the Registrar of Companies ("**ROC**"), in gross violation of the provisions of the Act.[13] The company filed its financial statements for the financial year ending ("**FY**") 2021 in September 2022, after 18 months.[14] Along similar lines, the company only showcased a limited financial statement for FY 2022 at its annual general meeting, which excluded the data for various subsidiaries.[15] It goes without saying that a delay of this magnitude is unprecedented for any company.

3. High churn of top leadership: Another key issue was the high attrition in the company, especially in key roles. These included the Chief Financial Officer, a position which is part of the component of Key Managerial Personnel ("**KMP**") under the Act.[16] Additionally, there were a host of top level exits at both the parent company and its subsidiaries, which included the Chief Executive Officer of its subsidiary, Group Counsel, Chief Business Officer and many others.[17]

[11] Shivani Shinde. (2023, June 22). Troubles mount for Byju's, auditor Deloitte resigns over financial results. *Business Standard.* https://www.business-standard.com/companies/news/edtech-giant-byju-s-trouble-deepen-deloitte-resigns-as-statutory-auditors-123062200826_1.html

[12] Companies Act, 18 § 143 (2013).

[13] Companies Act, 18 § 137 (2013).

[14] Team Inc42. (2022, September 15). *Reading Between The Numbers: Decoding BYJU'S FY21 Financials*. https://inc42.com/features/byjus-fy21-financials-loss-revenue-analysis/

[15] Business today. (2024, January 23). *Byju's net loss soars to Rs 8,245 cr in FY22, revenue jumps 54.2%: Report.* https://www.businesstoday.in/entrepreneurship/start-up/story/byjus-net-loss-soars-to-rs-8245-cr-in-fy22-revenue-jumps-118-report-414543-2024-01-23

[16] Companies Act, 18 § 2(51) (2013).

[17] Jyoti Banthia. (2023, August 30). Top-level exits at Byju's continues. *The Hindu Businessline.* https://www.thehindubusinessline.com/news/education/top-level-exits-at-byjus-continues/article67252149.ece

4. Questionable practices: A host of other issues can be put within the umbrella of questionable practices practised by the company. This included the decision to acquire a whopping 17 companies over 5 years, investing close to $3 billion dollars. These acquisitions reeked of unchecked and unplanned expansion, and proved to be an extremely deadly gamble.[18] More interestingly, for all the talk of being an Ed-tech company, the financials of the company showcased that the highest share of the company's revenue came from selling "hardware" rather than from any service.[19] The company was also infamous for its aggressive revenue recognition practices, with the aim of suppressing losses and showing higher revenue than actuals, a practice which was flagged by its previous auditor.[20] Further, there were allegations of oppression and mismanagement by shareholders of the company against the promoters, along with syphoning off of funds raised.[21] These allegations are buttressed by the stake dilution of the promoters from 71.6% to 21.2% in seven years.[22]

IV. THE WAY FORWARD

This section of the paper will deal with suggesting possible solutions on how to tackle the various problems put forth by the Byjus fiasco. A possible way forward will be

[18] Suprita Anupam. (2024, February 23). BYJU's Acquisition Spree: A Costly, Deadly Gamble. *Team Inc42.* https://inc42.com/features/byjus-acquisition-spree-a-costly-deadly-gamble/#:~:text=Burnt%20By%20The%20BYJU'S%20Experience&text=WhiteHat%20Jr's%20standalone%20losses%20increased,dissolved%2C%20a%20source%20told%20us.

[19] Debjyoti Roy. (2021, September 03).Unicorn Byju's Losses Jump 30 Times; Sale Of Devices Now Biggest Revenue Churner. *VCCircle.* https://www.vccircle.com/unicorn-byju-s-losses-jump-30-times-sale-of-devices-now-biggest-revenue-churner

[20] Sneha Shah , Ranjani Raghavan, (2022, September 15). Byju's FY21 losses widen after change in revenue recognition. *Mint* https://www.livemint.com/companies/news/byjus-fy21-losses-widen-after-change-in-revenue-recognition-11663151849251.html#:~:text=Byju's%20said%20its%20loss%20widened,crore%20in%20the%20previous%20year&text=Think%20and%20Learn%20Pvt.

[21] Press Trust of India. (2024, February 27). Byju's investors allege $533 mn siphoned off, NCLT reserves order on rights issue [Press Release]. https://www.ptinews.com/story/business/byju-s-investors-allege-533-mn-siphoned-off-nclt-reserves-order-on-rights-issue/1320703

[22] Venkatesha Babu. (2023, July 04). Stake dilution. Byju's promoters have sold shares worth $408.53-m in secondary deals since FY16. *The Hindu Businessline.* https://www.thehindubusinessline.com/news/education/byjus-promoters-sells-shares-worth-40853-mn-in-secondary-transactions-since-2015-16/article67037613.ece#:~:text=Promoter%20shareholding%20down%20from%2071.6,cent%20in%20the%20seven%20years&text=Promoters%20of%20ed%2Dtech%20major,40%20secondary%20transactions%20since%202015.

considered by discussing the existing position of the law, as well as taking cues from global best practices from across the world.

The role of independent bodies and individuals like the auditors, company secretaries, legal counsel is to guide the company within the rigours of the law, while at the same time they need to safeguard the interests of all stakeholders. The role of the statutory auditor in the Byjus case is a case in point. It is considered that the auditor pre-emptively resigned, but there are serious questions and shortcomings in the accounting practices at the company during its tenure. For instance, PriceWaterhouseCoopers ("**PWC**") was the auditor involved in the Satyam scam. It was the United States Securities Exchange Commission ("**SEC**") which sanctioned the Indian arm of the accounting firm before action was taken by Indian regulatory authorities.[23] It was only in 2018, that SEBI took action against PWC.[24] However, even this action was considered "erroneous in law" by the Securities Appellate Tribunal in 2019.[25] In summary, there is an inherent need to be proactive and unbiased by "independent" bodies like the auditors themselves for all classes of companies, especially those involved in socially important sectors like education and healthcare. For example, similar cases of failure of corporate governance and accounting malpractices have resulted in firms getting severely punished. An illustration of this would be Arthur Anderson LLP ("**Anderson**"), the American accounting firm part of the Enron scandal.[26] Action taken against the firm eventually led to Anderson virtually going belly-up.[27] It is high time that contravention of accepted principles of governance, which include accounting practices and fulfilment of a fiduciary duty towards all stakeholders is punished severely. The existing provisions

[23] U.S Securities Exchange Commission. (2011, May 4). SEC Charges India-Based Affiliates of PWC for Role in Satyam Accounting Fraud. .https://www.sec.gov/news/press/2011/2011-82.htm

[24] Business today. (2018, January 11). Satyam case: SEBI bans Price Waterhouse for two years citing 'systemic problem' in audit process. https://www.businesstoday.in/latest/corporate/story/sebi-bars-price-waterhouse-auditing-listed-firms-two-years-99554-2018-01-11

[25] Palak Shah. (2021, December 07). SAT junks SEBI's order against PriceWaterhouse. *The Hindu Businessline*. https://www.thehindubusinessline.com/companies/sat-overturns-sebis-pwc-audit-ban/article29373635.ece

[26] United Nations. (2004). Enron and Internationally Agreed Principles for Corporate Governance and the Financial Sector. https://unctad.org/system/files/official-document/gdsmdpbg2420046_en.pdf

[27] Bill Mears. (2005, May 31). Arthur Andersen conviction overturned. CNN. https://edition.cnn.com/2005/LAW/05/31/scotus.arthur.andersen/

under the Act will not suffice to be adequate deterrence for any possible future wrongdoing.

An unprecedented aspect of the Byjus fiasco is the persistent delay in complying with the reporting requirements, as specified under the Act. It is accepted that compliance for a private company under Indian law is far lesser in comparison to a public company, especially if the company is a listed entity. This is attributed to the increased surveillance of SEBI and the involvement of retail investors and the like. However, despite the comparatively eased reporting requirements, Byjus failed to comply with them. Additionally, as per reports, representatives of the company dismissed any wrongdoing by flagging it as "technical issues like late filing of annual reports… and we anticipate the fines to be nominal, if any."[28] Statements like these, once again highlight the underlying issue. Although most companies comply with the provisions of the law as mandated, a few bad actors will always give no regard to the letter of the law. For the purposes of illustration, the authors are considering the monetary penalty for (i) late filing of annual reports with the ROC; (ii) late filing with the Reserve Bank of India as regards foreign investment received.

ticulars	**netary Penalty**
e filing of annual reports with the ROC	R 10,000 and a maximum of INR 2,00,0 e of a continuing failure.[29]
e filing of Form Annual Performance R PR) under the exchange control regulati	R 7,500.[30]

It is evident from the above, why a company like Byjus has been giving scant regard for the law. A penalty which extends to a thousand rupees for a company which has a

[28] Money Control. (2023). Byju's says ED notice flags delay in filing annual reports, queries technical in nature. https://www.moneycontrol.com/news/business/startup/byjus-says-ed-notice-flags-delay-in-filing-annual-reports-queries-technical-in-nature-11829951.html

[29] Companies Act, 18 § 137(3) (2013).

[30] Reserve Bank of India. (2022, September 20). Late Submission Fee for reporting delays under Foreign Exchange Management Act, 1999 (FEMA) https://rbi.org.in/Scripts/BS_CircularIndexDisplay.aspx?Id=12393

revenue of almost INR 5,000 crore, once valued at $22 billion dollars, and still valued at a north of a billion dollars, will obviously not serve to be an adequate deterrent. Therefore, it is suggested that far more serious penalties are imposed on erring companies. A key step in this regard would be temporarily 'striking-off' the name of the company by the jurisdictional ROC for non-filing of annual reports. This is a practice prevalent in other jurisdictions, which serves as an adequate deterrent for companies. For instance, in the state of Texas in the United States ("**US**"), the Secretary of State can revoke the registration of the company for non-filing of reports within the specified time.[31] This practice is prevalent in multiple states across the US.

Along similar lines, the government of the United Kingdom ("**UK**") has taken steps to regulate large private companies. The UK government has set out a draft Companies (Strategic Report and Director's report) (Amendment) Regulations 2023 ("**UK Regulations**"). The UK Regulations cover those companies with either more than 750 employees or an annual turnover of more than 750 million pounds. This is something which can be mirrored in India, so that large private companies which have statutorily lesser compliances can be bought under the ambit of better corporate governance practices, while still differentiating them from public companies. A regulation, along the lines of the UK Regulations would cater to 2 distinct issues. Firstly, companies with a minimum threshold of employees would be covered, thereby protecting the interests of employees. Secondly, companies exceeding a particular threshold of revenue or valuation would automatically come under the ambit of the law.

Another line of course correction can be through the regulation of privately held companies by SEBI. Under existing provisions, SEBI can regulate both listed and unlisted public companies, if one reads the provisions of section 11, 11A and 11B of the SEBI Act, 1992 along with section 2(h) of the Securities Contract (Regulation) Act, 1956. However, its powers do not extend to privately held companies. In contrast, the SEC regulates every offer and sale of securities, even if it is made to a single individual, and irrespective of whether it's a private or public company.[32] Albeit, it must be noted that

[31] Texas Business Organizations Code §9.101 (2010).
[32] U.S Securities and Exchange Commission. (2023). What does the SEC have to do with my private company? https://www.sec.gov/education/capitalraising/building-blocks/sec-have-do-my-private-company

private companies are regulated in a very limited sense and are granted exemptions in many respects. However, as suggested above, companies in specified "regulated sectors" are bound by additional reporting requirements, something which can be implemented in India as well.[33]

V. CONCLUSION

It goes without saying that not every start-up has a story like this. In the end, the results are a product of the decisions of a company. However, compliance with the law and following the highest standards of corporate governance norms must be considered as a sine-qua non for any organisation. Since liberalisation, India has seen multiple scams and company dissolutions which have not only eroded trust of stakeholders in the ecosystem, but also hampered the overall outlook of Indian corporate governance mechanisms across the world. As prominent investor Ronnie Screwvala said, the failure of "one rotten apple" should not affect the entire industry.

This paper dealt with the various issues plaguing what was once India's biggest start-up and deep dived into possible and pragmatic solutions for improving the framework for privately held companies in India, by comparing it with the Byjus case. Ultimately, the goal for company management in India should be what Nandan Nilekani once said in no uncertain terms:

"Good governance is about being fair and having a long-term vision. This can be done by maximising shareholder value, creating symmetry in information dissemination across stakeholder groups, and building a culture and value system.

[33] Zoeanna Mayhook (2019). Privately-Held Companies: Legislation, Regulation, and Limited Dissemination of Financial Information. DttP Documents to the People. https://journals.ala.org/index.php/dttp/article/view/7215/9864