Newsletter

Sharp View

October 2024

OCTOBER 2024

October marks the beginning of the festive season in India, bringing with it a notable increase in consumer demand and spending. It also signals the end of the monsoon, followed by a brief period of warmer days before the onset of winter.

8th October holds special significance as it marks the establishment of the Indian Air Force (IAF) in 1932. Over nine decades, the IAF, also known as ‘Bharatiya Vayu Sena,’ has grown into a formidable force. Below are some key facts about the IAF:

- **Role:** Beyond its primary role in defence, the IAF plays a critical role in providing aid during natural disasters.
- **Headquarters:** New Delhi, with seven regional commands across India for effective operations.
- **Supreme Commander:** The President of India holds the honorary rank of Supreme Commander of the IAF.
- **Motto:** ‘Touch the sky with glory’
- **Aircraft strength (2024):** A total of 1,645 aircraft, comprising 632 fighters, 438 helicopters, 250 transport aircraft, 304 trainers, 7 aerial tankers, and 14 aircraft designated for special missions.*
- **Global ranking (2024):** Indian Air Force is ranked 6th globally, with a stable to positive outlook in its overall standing.*

(*Source: World Directory of Modern Military Aircraft (WDMMA).

CONSULTING

Impact of due diligence on startup success

Due diligence plays a crucial role in survival and systematic growth of a business. Indian start-ups face certain challenges including lack of financial management, robust legal systems and risk management. Ms. Shivanshi Tripathi (Vadodara office) discusses the importance of due diligence, its benefits in the start-up ecosystem and certain case studies in the implementation of due diligence.

CONSULTING

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In today's fast-paced startup ecosystem, investors are constantly looking for the next unicorn. However, beneath the excitement of innovation and disruption lies a critical challenge: insufficient due diligence can lead to disastrous consequences. From deceptive financials to unsound management practices, many promising startups hide serious vulnerabilities that only thorough due diligence can uncover. Many startups fail not due to their ideas but due to overlooked financial, legal, or operational risks. This article explores key case studies where due diligence made—or broke—the deal. By focusing on these lessons, entrepreneurs and investors alike can better navigate these challenges, ensuring smarter investments and more resilient startups.

Who Needs Due Diligence and Why?

Due diligence is an essential practice for businesses across various sectors, particularly those engaging in:

- **Financial Services:** Banks, insurance companies, and other financial institutions rely on due diligence to meet regulatory requirements such as KYC (Know Your Customer) and AML (Anti-Money Laundering), while also reducing the risk of fraud.
- **Mergers & Acquisitions:** When evaluating potential acquisition targets, a thorough due diligence process helps uncover hidden risks, liabilities, and assess the overall health and viability of the business.
- **Strategic Partnerships:** Before entering into joint ventures or collaborations, conducting due diligence on potential partners helps minimize risks by providing a clear understanding of their background and credibility.
- **High-Value Transactions**: In large financial transactions, due diligence is critical in preventing fraud and ensuring compliance with anti-money laundering regulations, safeguarding the integrity of the transaction.

Benefits of Due Diligence

Establishing a thorough due diligence process brings several key advantages for businesses:

- **Risk Mitigation:** By identifying potential warning signs early, businesses can minimise financial losses and protect their reputation from the damage caused by fraudulent or unreliable partners.
- **Regulatory Compliance:** Implementing due diligence ensures businesses stay compliant with KYC/AML regulations, helping them avoid costly fines and legal penalties.
- **Better Decision-Making:** Having a detailed understanding of potential business partners empowers leaders to make more informed, strategic decisions, reducing the chance of unforeseen problems.
- **Trust and Longevity**: Conducting proper due diligence builds transparency and trust, fostering stronger, more resilient partnerships over time.

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Common Challenges in Venture Capital Due Diligence

To secure venture capital (VC) funding, startups must present a compelling and well-organised business case. However, many obstacles leading to investor rejections often relate to factors beyond a startup's direct influence, particularly concerning growth potential. Here are some critical issues that frequently arise during the due diligence process:

1. **Intellectual Property Protection:** For tech startups, strong intellectual property (IP) protection is essential. Investors may hesitate if a company lacks robust safeguards, as this could allow larger competitors to replicate the product. If IP protection exists, its scope and coverage become vital considerations. Additionally, some innovations may not qualify for patents, resulting in a "first come, first served" scenario in emerging markets.

2. **External Stakeholder Insights:** VC investors often tap into their extensive networks for insights when assessing new investment opportunities, particularly in unfamiliar sectors. If feedback from these trusted sources is not favourable, even a potentially promising startup may be overlooked. This reliance on external validation underscores its significance in the investment decision-making process.

3. **Team Cohesion:** A startup's management team's ability to effectively navigate the rigorous demands of due diligence serves as a strong indicator of their competence. A united team that maintains enthusiasm and focus during this process reassures investors that they are backing capable individuals. Conversely, signs of disarray or an inability to engage the team can raise concerns for potential investors.

Preparing Startups for Successful Due Diligence

First impressions count

The due diligence procedure typically consists of three stages: screening, business check, and legal business check. Investors will examine the company briefly during the screening phase and then determine whether or not to proceed further.

Making the best possible first impression is essential if a start-up wants to move past this initial stage. This calls for meticulous attention to detail in its pitch deck and preliminary materials, as well as making sure that its digital real estate—which includes the website, search engine optimization, and social media presence—is presenting the concerned start-up in the best possible light.

If the start-up can complete all those tasks, it will be in a much better position to move on to the business check, required to highlight its strengths and address any potential issues. The proposed investors will also perform a legal business check to ensure that everything that is claimed is consistent with the records/ books.

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Putting forward the best effort

In the startup funding area, 'back the jockey, not the horse' is a well-known proverb. A startup's technical foundations, including its product, market fit, and business model, are essential, but a more reliable gauge of its chances of success is usually the founding team's capacity to clearly articulate their vision, prove that they possess extensive domain knowledge, and display successful management techniques. These qualities greatly increase the startup's appeal as an investment opportunity in addition to assuring investors of the team's capacity to steer the business to success.

Knowledge of the market and the product

Investors seek out a variety of kinds of knowledge, though. Investors assess the founding team's comprehension of the market dynamics that are pertinent to the startup, in addition to their inherent attributes. It is essential to prove that there exists a thorough understanding of the market environment by analysing demand, spotting unmet needs, and developing a focused strategy that sets your company apart from competitors. This method of doing a market analysis not only highlights the startup's potential to take market share and increase it, but it also greatly increases investor confidence in the venture's feasibility.

To demonstrate the product's value proposition and place in the market, founders must also make use of exact measurements. In the end, it comes down to effectively communicating how the product caters to a particular market.

Get the legal, financial, technical and business documents ready

During due diligence, a start-up will need to prove that its business model is strong, financials are reliable, technology is robust, and legal foundation is sound. Having well-organized and readily available documentation to back these claims is critical. Being prepared means not only ensuring that all relevant documents are in order but also being able to provide them swiftly when investors request them. Timely and detailed responses build trust, showcasing careful planning, operational competence, and readiness to handle investor questions efficiently.

Case Study 1: Bridging Financial Expertise Gaps

Scenario

In the due diligence (DD) evaluation of an Indian startup in the B2B e-commerce sector, focusing on connecting suppliers and retailers,, a critical gap in the founder's financial expertise was identified. While the founders had a strong technical background and clear vision for the platform, they lacked experience in managing the financial aspects of scaling the business. This raised concerns about the startup's ability to handle growth and ensure long-term financial sustainability in India's competitive manufacturing and retail sectors.

Key Findings

- **Skill Deficiencies:** Limited experience in financial planning and management.
- **Focus Areas**: Need for improved financial oversight, budgeting practices, and cash flow management.
- **Strengths**: Significant technical expertise, innovative ideas, and a clear product roadmap.

Strategic Impact and Management

To address the identified financial gaps, a strategic plan was implemented:

1. **Mentorship and Advisory:** Established a connection with a seasoned CFO to provide ongoing guidance and develop tailored financial strategies for the B2B marketplace model.
2. **Recruitment Support:** Assisted in hiring a financial director with experience in scaling B2B platforms, ensuring robust financial oversight.
3. **Financial Training:** Participated in financial management workshops, equipping the founder with essential skills to monitor financial performance effectively.

By addressing these skill shortages, the founder was positioned to make informed decisions, secure funding, and manage growth sustainably, thereby enhancing the partnership's trust and commitment.

Case Study 2: Strengthening Leadership and Team Dynamic

Scenario

During the due diligence (DD) evaluation of an Indian startup providing a B2B Start-up as a service ('SaaS') platform aimed at automating procurement processes for companies in the **manufacturing and logistics** sectors, a visionary founder with a strong background in procurement technology was identified. Despite the founder's technical expertise, challenges related to leadership and building a cohesive company culture were evident. Issues such as difficulty in delegation and maintaining team morale raised concerns about the startup's ability to scale effectively in India's fast-growing SaaS environment.

Key Findings

- **Skill Deficiencies:** Challenges in leadership and team-building, especially regarding delegation and morale.
- **Focus Areas**: Need for enhanced leadership skills, a positive company culture, and improved team dynamics.

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- **Strengths**: Deep industry knowledge, innovative product ideas, and a strong commitment to the company's mission.

Strategic Impact and Management

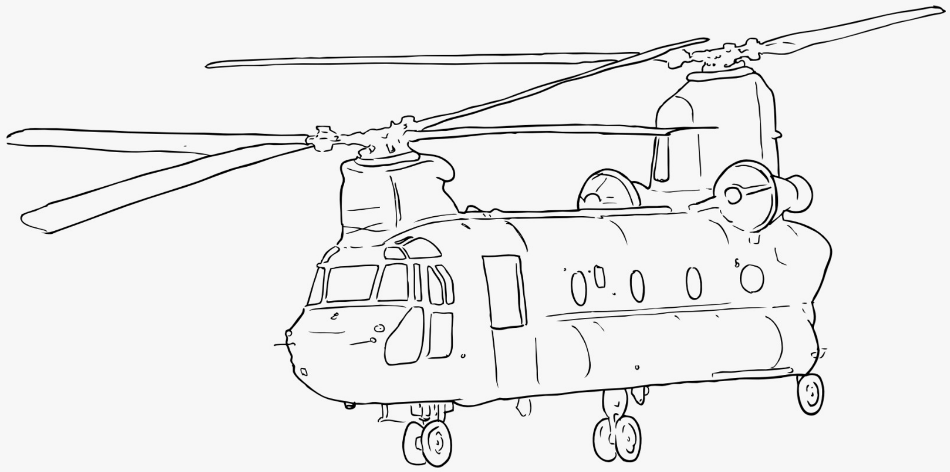
To tackle these leadership challenges, a comprehensive support strategy was established:

1. **Leadership Coaching**: Conducted workshops with a leadership coach focusing on delegation, effective communication, and team motivation.
2. **Team Building Initiatives**: Organised workshops to improve team cohesion through activities, conflict resolution training, and establishing clear communication channels.
3. **Regular Feedback Mechanisms**: Instituted periodic feedback sessions to address team issues promptly, allowing the founder to refine their leadership approach.

Prioritising these areas helped the founder develop himself into a more effective leader, enhancing team performance and morale. This approach not only resolved immediate challenges but also positioned the company for sustainable growth and long-term success.

Conclusion

In the fast-paced world of startups, rigorous due diligence is essential for unlocking potential and ensuring sustainable growth. By identifying vulnerabilities in financial acumen and leadership, both entrepreneurs and investors can make informed decisions that mitigate risks and foster resilience. The insights from our case studies underscore that thorough evaluations not only build trust but also pave the way for long-term success. Ultimately, embracing a culture of due diligence is not just a protective measure; it is a strategic imperative that empowers startups to thrive in a competitive landscape.



TAXATION

Amendments to the TDS provisions coming into effect from 1 October 2024

The Finance Act, 2024 amended various tax deducted at source ('TDS') and tax collected at source ('TCS') provisions with effect from 1 October 2024. Ms. Meena Narayanan (Chennai offices) gives a quick summary of the provisions..

Taxation

Amendments to the TDS provisions coming into effect from 1 October 2024

The Finance (No 2) Act, 2024 introduced amendments to simplify the provisions in relation to TDS in the Income-tax Act, 1961 ('the Act'). Several of these changes come into effect from 1 October 2024.

Tax Collected at Source ('TCS') to be considered while deducting tax from salaries

Employees may disclose details of TCS to their employers and employers shall consider credit for such TCS while deducting taxes on salary of employees.

Prior to this amendment, employees could claim credit for TCS only at the time of filing their tax returns.

Change in applicable TDS rate

TDS of 2 percent would apply for several payments which were earlier subject to TDS of 5 percent. Such payments include:

- **Payments under life insurance policies** - Payments to residents under life insurance policies, including bonus will be subject to TDS at 2 percent. It may be noted that there is no requirement to deduct taxes on payments under life insurance policies that are specifically exempt under Section 10(10D) of the Act.

- **Commission on lottery tickets** - Payment of commission exceeding INR 15,000 to any person who has been stocking, distributing, purchasing or selling lottery tickets will be subject to TDS at 2 percent.

- **Commission or brokerage** - Payment of commission (not being insurance commission) or brokerage exceeding INR 15,000 in aggregate in a financial year, except in certain situations will be subject to TDS at 2 percent.

- **Rent -** Payment of rent exceeding INR 50,000 per month or part of a month, to a resident by individuals and Hindu Undivided Families ("HUFs") as per Section 194IB of the Act will be subject to TDS at 2 percent.

- **Certain payments by individuals or HUFs** - Payment by individuals or HUFs to a resident for carrying out work pursuant to a contract, as per Section 194M of the Act will be subject to TDS at 2 percent.

- **Payments by e-commerce operator to e-commerce participant** - TDS of 0.1 percent will apply on certain payments by e-commerce operator to e-commerce participant which are subject to TDS under Section 194O of the Act. Tax on such payments were earlier required to be deducted at 1 percent.

No TDS on certain payments

The requirement to deduct tax on certain payments has been done away with. Such payments include:

Taxation

Amendments to the TDS provisions coming into effect from 1 October 2024

- **Interest on specified securities** – No tax is required to be deducted on interest from Floating Rate Savings Bonds, 2020 (Taxable) or any other specified securities of the Central Government or State Government.
- **Repurchase of units by Mutual Funds or Unit Trust of India ('UTI')** – Requirement to deduct tax in relation to payments on account of repurchase of units by Mutual Funds or UTI in respect of which deduction has been claimed under Section 80CCB(1) has been done away with.

Clarification in relation to TDS on transfer of certain immovable property

As per existing provisions of the Act, no tax is required to be deducted on transfer of immovable property where the consideration for transfer and stamp duty value are both less than INR 50 lakh.

It has now been clarified that where there is more than one transferor or transferee, then the consideration shall be the aggregate of the amounts paid or payable by all the transferees to the transferor or all the transferors.

Decriminalization of delays in payment of TDS if payments are made within time prescribed for filing TDS returns

Where taxes deducted are remitted to the Central Government within the timelines prescribed for filing the TDS returns, provisions in relation to imprisonment etc under Section 276B of the Act, in relation to failure to pay tax, will not apply.

Other changes

While the changes summarized in the above paragraphs come into effect on 1 October 2024, the Finance (No 2) Act also introduced a few other changes to the TDS provisions.

- **Units purchased in foreign currency, foreign currency bonds, etc.** - Changes to rates of TDS under Sections 196B and 196C in relation to units purchased in foreign currency, foreign currency bonds or shares of Indian company came into effect from 23 July 2024.
- **Payment by firm to partner -** A new Section 194T provides for a firm responsible for payment of any sum in the nature of salary, remuneration, commission, bonus or interest to a partner of the firm, to deduct tax at 10 percent, where aggregate of such sums credited or paid during the financial year is INR 20,000 or more. This provision will be applicable with effect from 1 April 2025.
- **Timeline for filing of correction statement** – With effect from 1 April 2025, no correction statement can be filed in relation to a TDS return after the expiry of 6 years from the end of the financial year in which the TDS return is required to be filed.

Amendments to the TDS provisions coming into effect from 1 October 2024

To conclude

Persons responsible for deduction of taxes need to take note of the amendments and implement necessary changes to their processes and systems to ensure deduction of tax at the appropriate rates and filing of correct TDS returns, etc.

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