

## Pakistan Growth Capital Roundtable Summary Paper

### **Background:**

Pakistan Stock Exchange, in collaboration with Paklaunch, hosted a Pakistan Growth Capital Roundtable to discuss the challenges faced by startups in their journey towards corporatisation and growth in Pakistan. This was an invite only, closed-door, online roundtable with participation of key stakeholders from Pakistan and overseas. Participants included investors, entrepreneurs, regulators and advisors. The Roundtable included two panel discussions on key areas of importance.

The discussions focused on the regulatory and commercial environment that a) best supports startups in fund raising, b) creates an ecosystem in Pakistan, including VCs and advisors, to support the innovation economy, and c) captures the value creation in Pakistan by listing on PSX. The discussion and recommendations are summarized below. We plan to hold such roundtables regularly to address the challenges faced by startups and work with all stakeholders to improve the funding and growth environment in Pakistan.

### **Objective:**

It is essential for the growth of the ecosystem to eliminate any disconnect between the Startup ventures environment and the formal corporate structure for listed entities on Pakistan Stock Exchange. The aim of the discussion was to introduce the option available for raising capital, regulatory framework awareness, bring to light structural issues to be addressed and educate the stakeholders.

### **Panel Discussions:**

1. Pakistan: An attractive destination for startups formation and capital raising?
2. Transition from Startups to Company

### **Key Takeaways and Recommendations:**

#### **Panel Discussion #1: Pakistan: An attractive destination for startups formation and capital raising?**

- Valuation method adopted by local listing advisors and institutional investors must be reviewed and modified to take into account the value creation and business potential of tech companies' growth opportunities.
  - Steps to be taken;
    1. Introduction of case studies of tech firms' valuations and models.
    2. Workshops to be organized for investors, local advisors and financial

institutions to understand the tech ecosystem and valuation models.

- International Investors find Pakistani laws to be complex. There also seems to be a lack of confidence in Pakistan's legal system due to transaction delays and laws governing capital and foreign funds.
  - Steps to be taken;
    1. Regular meetings between relevant lawyers, SECP, PSX, FBR, State Bank and BOI to discuss innovative changes & solution with regard to the regulations.
    2. Have a one window service and an investor booklet created and subsequently uploaded on relevant websites of SBP, BOI, SECP and PSX.
    3. Meet with foreign advisors & investors to build trust with respect to investing in Pakistan.
- Scheduled banks to implement State Bank reforms to assist foreign investment in letter and spirit.
  - Steps to be taken;
    1. Increased level of coordination with State Bank and SECP.
    2. Highlight instances and concerns where SBP rules are not being properly implemented.
    3. SBP needs to incentivize banks to adapt and comply with reformed regulations to ensure matters are managed speedily and as per the regulatory frameworks.

#### **Panel Discussion #2: Transition from Startups to Company**

- Startups tend to fall short in terms of Corporate Governance structure and their financial management.
  - Steps to be taken;
    1. Plan towards changing status to at least private limited company. Startups to evaluate the pros and cons of public limited status.
    2. Hire advisors at an early stage, who can provide guidance on their path to corporatization and listing on the GEM Board.
    3. Modify the GEM board governing regulations to meet the needs of companies and investors alike to increase liquidity and volumes.
- Foreign Exchange Manual limits companies to pay overseas vendors and undertake international acquisitions of foreign companies.

- Steps to be taken;
  1. FE manual needs to be changed so that Startup firms do not have to be creative to pay vendors through their foreign income.
  2. Startups should be able to use foreign investment received by the company when listing, to invest in foreign M&A. As these foreign investments flow through State Bank's SCRA accounts, they can be easily demarcated.
  3. SBP to review their regulations to help the above requirements of companies.
- Due to an intangible asset business model (assets cannot be collateralized), banks reject their loan applications. Audit Firms lack expertise to audit startups and tech companies' books. Rating companies also lack expertise to rate early stage companies.
  - Steps to be taken
    1. By listing on the GEM Board, start-ups can enhance their ability to raise debt from FIs.
    2. Regulations to be adapted and banks encouraged to undertake cash flow lending.
    3. SECP to provide guidance and trainings on the regulatory requirements pertaining to audit of Tech Startups.
    4. Rating agencies to develop expertise in early stage companies.
- Pakistani investors prefer & dedicate higher valuation to traditional industries rather than tech startups.
  - Steps to be taken
    1. Specific fund creation by local institutions for startups.
    2. Use compatible multiples to value & select startups.
    3. Brokerage firms to provide research reports on startups to educate and facilitate investors.

To be successful, this will require combined efforts from PSX, SECP, SBP and all other stakeholders.

## GEM Board Benefits:

- **Exit and Capital Raising**
  - GEM board provides an opportunity for the company to raise additional capital and for early stage investors to exit a portion of their shareholding.
- **Cost Effective**
  - Listing on GEM board involves reduced costs to raise capital with no SECP Fee and a minimal PSX initial listing fee capped at PKR 50,000.
- **Clear and well established FX Regulations**
  - The Exchange opened for foreign investors in 1991. Hence the regulations for FIs are clear and well established. Listing on GEM board can help attract investment from foreign investors.
- **Flexible Fund Raising**
  - Listing on GEM board allows raising capital from a large base of accredited investors. No requirement for term sheet, exclusivity clause and signing SHA as in a typical private fund raise.
- **Capital Gains Tax**
  - Listing the company on GEM results in lower taxes for shareholders. Income tax is applied on sale of shares of an unlisted company, whereas Capital Gains Tax is applied on selling of shares of a listed company.
- **Brand Building**
  - Listing on GEM board creates brand recognition and adds value to the profile of the company. This brings the company one step closer to the Main board.
- **Attracting and Retaining Talent**
  - ESOP schemes, critical for attracting and retaining top talent, are easier in a listed structure.