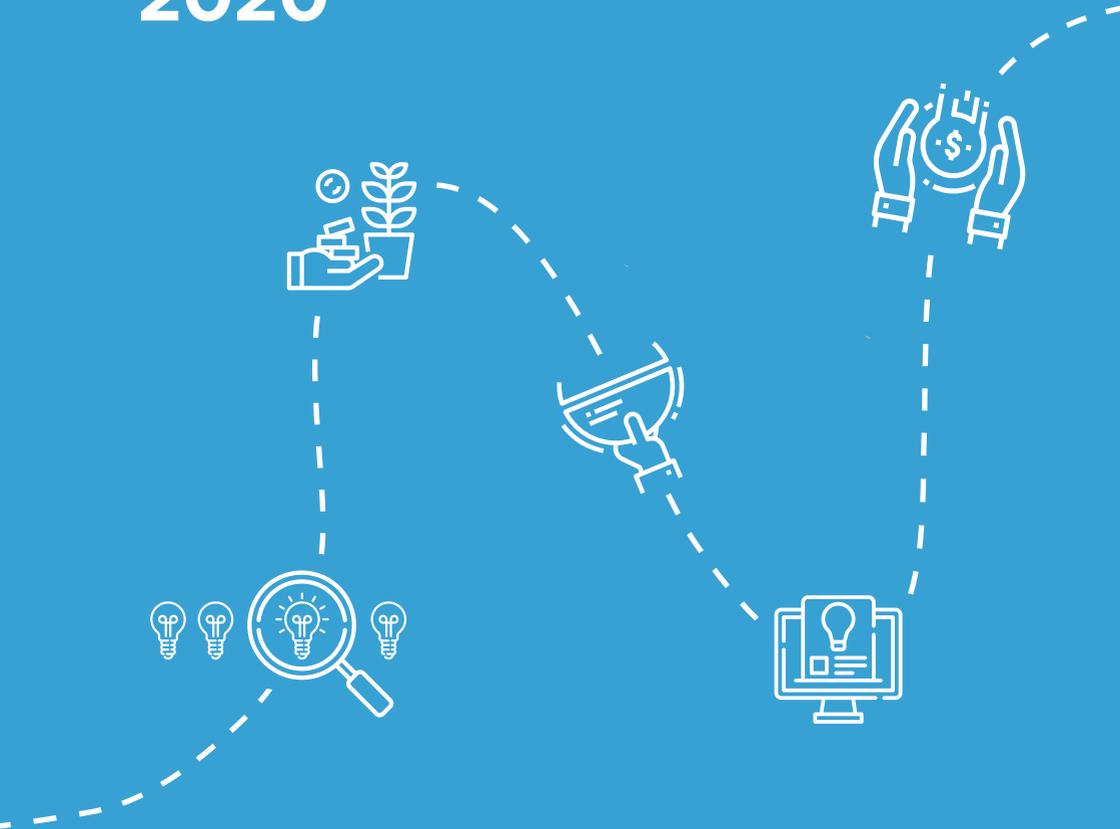


THE EARLY-STAGE INVESTOR'S GUIDE TO PAKISTAN

2020

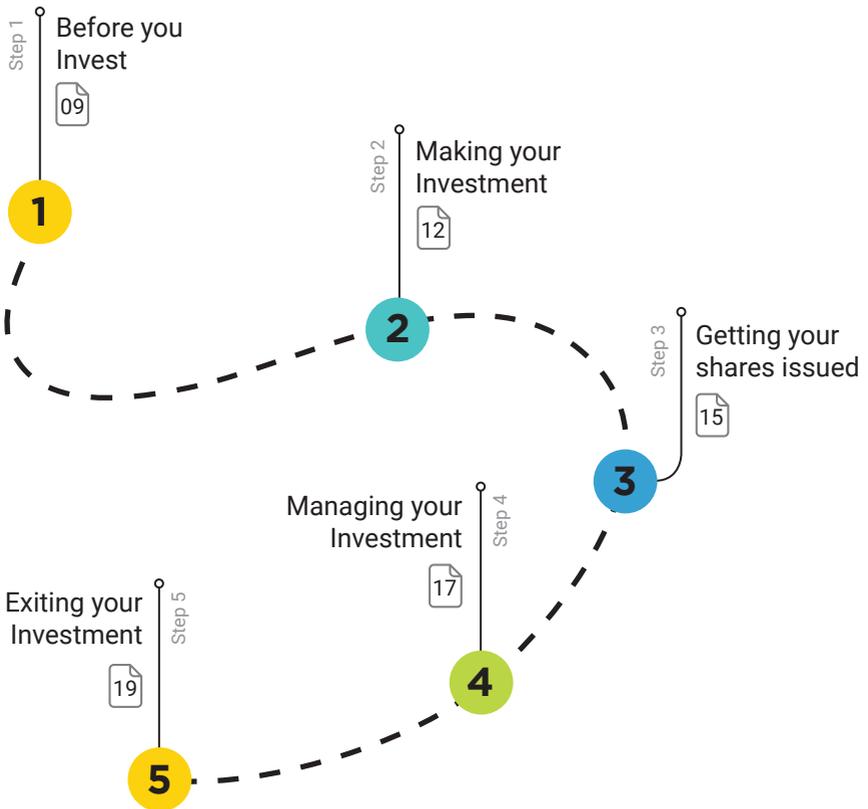


03 About the Authors

06 Introduction

Contents

Investor's Journey



20 Conclusion

About the Authors

Mubariz Siddiqui

Mubariz is a legal practitioner with extensive experience working with technology startups, angel investors, and VCs investing in Pakistan. He has represented various startups and investors in financing deals across different stages. Currently he is General Counsel at Sarmayacar, a Pakistan focused venture capital fund.



He has been practicing law since 2008. In his last position at Hubco, Mubariz was the head of legal for two CPEC power projects in Thar with a cumulative project cost of more than US\$ 1 billion. Previously, Mubariz worked at RIAA Barker Gillette, and Orr Dignam & Co.

Kalsoom Lakhani

Kalsoom is the Founder of Invest2Innovate, which she founded in 2011 to support and unleash the potential of young entrepreneurs in growth markets like Pakistan. She's now Co-founder & General Partner at i2i Ventures, an early stage VC fund for Pakistan, and the country's first female-led institutional fund. She has trained young entrepreneurs, changemakers, and civil society leaders in Kosovo, Nepal, Cambodia, Bangladesh, Ukraine, and Kazakhstan, and has spoken at numerous venues, including the World Economic Forum, Aspen Ideas Festival, and SXSW. Kalsoom is currently a nonresident Senior Fellow at the Atlantic Council and a member of the American Pakistan Foundation's Leadership Council.



About Sarmayacar



Sarmayacar is a Netherlands-domiciled Venture Capital fund that began operations in October 2018. It is an early stage fund focused on investing in tech and tech-enabled startups in Pakistan through Pre-Seed to Series B.

Sarmayacar's investors include the International Finance Corporation (part of the World Bank Group) along with family offices, high net worth individuals and professionals from US, Europe, Middle East and Pakistan.

Their existing portfolio includes Bykea (Ride Hailing), Dot & Line (Ed-Tech), Dawaai (Health Tech), Revolving Games (Mobile Gaming), Simpaisa (Digital Payments), ProCheck (IoT and Analytics) and Patari (Music Streaming).

About i2i Ventures



i2i Ventures is a seed-stage Venture Capital fund for Pakistan, launched by Kalsoom Lakhani and Misbah Naqvi in August 2019. It is sector agnostic, focused on supporting amazing founders in technology and technology-enabled high-growth sectors in Pakistan, and builds on the work of i2i Ventures' sister entity, Invest2Innovate, which was founded (by GP Kalsoom Lakhani) in 2011 to support the startup ecosystem in Pakistan and in the region.

i2i Ventures leverages a decade of experience in the Pakistan startup space, Invest2Innovate's ongoing startup entrepreneurship support programs and comprehensive ground-breaking research on the market, to not only take an evidence-based approach in its work, but provide a unique value proposition to its portfolio companies.

THE EARLY-STAGE INVESTOR'S GUIDE TO PAKISTAN

2020

Disclaimer

The Early Stage Investor's Guide to Pakistan highlights questions that our funds have come across while operating in Pakistan. However, no aspect of this document constitutes investment advice, legal advice, or any other form of professional advice to be relied upon by any potential investor or otherwise as a determinative factor in making investment decisions. i2i Ventures and Sarmayacar disclaim any and all liability whatsoever with respect to the contents of this document and strongly encourage readers to consult professionals, including attorneys, well-versed in Pakistani law, prior to making any investment decisions. It is also important to note that laws and policies in Pakistan can change at any time, and be subject to different interpretations.

Introduction



**THE EARLY-STAGE
INVESTOR'S GUIDE
TO PAKISTAN**

2020

In the last five years, the Pakistan entrepreneurial ecosystem has grown tremendously, with the rise in the number of startups, incubators & accelerators, coworking spaces and investment funds. The resulting activity has been exciting - since 2015, startups have raised **over \$200 million** in funding. In 2020, despite the COVID-19 pandemic that led to business shutdowns globally and predictions of a slowdown in venture capital activity, startups in Pakistan raised **\$47.6 million** via 34 deals (as of December 4, 2020) compared to **\$47.5 million** in 2019 via 30 deals, a number that is likely to increase by the end of the year.

While the Pakistani regulatory environment still restricts the growth of the overall startup ecosystem, there have been improvements in the last year alone that are worth noting. The State Bank of Pakistan (SBP), for example, recently amended its policies to make it easier for foreign investors to repatriate divestment proceeds; i.e., if you exit your investment, it is now easier to get your money out of the country. The Securities and Exchange Commission of Pakistan (SECP) also introduced amendments to the company law to facilitate startups, including allowing for Employee Stock Ownership Plans (ESOPs), different classes of shares, and the issuance of sweat equity, among other items.



\$200 MN

raised in funding by Pakistani startups, since 2015



\$47.6 MN

raised in 2020 via 34 deals, despite the COVID-19 pandemic



SBP has now made it easier for foreign investors to repatriate divestment proceeds

According to the World Bank's Doing Business rankings 2020, Pakistan is now ranked at 108, 28 points better than its 136 ranking in 2019. Specifically, the country performs well on protecting minority investors, ranking in the top 30 economies globally.



According to the World Bank,

Pakistan “earned the maximum possible points on the extent of ownership and control index, which measures governance safeguards protecting shareholders from undue board control.”

For both international and domestic investors - current and prospective - the landscape is exciting and promising. Pakistan boasts the 5th largest population in the world that is young, increasingly connected and technologically savvy. At the same time, given how opaque this regulatory environment is, we recognize that while many want to invest in startups in Pakistan, many may also not know how.

That is what the **Early Stage Investor's Guide to Pakistan** aims to do. As two local venture capital funds in Pakistan, we want to lower the barriers and mitigate the risk for other investors looking to enter this market but don't know where to begin. We believe that more investment activity in the Pakistani startup ecosystem will benefit all of us, and a step in that direction is giving you all the right information to invest alongside us in a market and potential we believe in.

This guide will break down the early investor's journey, giving you the basic steps and legal guidelines to consider at every step; from conducting due diligence to deploying your capital in Pakistan to all of the procedural requirements to your minority rights as an investor to exiting your investment (hopefully!). Whether you're a foreign investor looking to make your first investment in Pakistan, or a local investor wanting to understand the steps you must undertake, this dynamic and evolving guide is for you.

FAQ BEFORE WE BEGIN



ISN'T IT EASIER TO GET THE FOUNDER TO SET UP A HOLDING COMPANY OUTSIDE OF PAKISTAN?

*This is the most common question we receive, so we thought it best to address it at the outset. Mubariz writes more about this topic [here](#), but the **TL:DR** version is this: A Pakistani tax resident cannot actually own shares in a company outside of Pakistan without obtaining prior approval from the State Bank of Pakistan (SBP). This approval can also*

*only be given to a **company** incorporated in Pakistan (not an individual) to own shares in an entity abroad, as long as the aforementioned company complies with certain criteria (see the link above for details). Individual founders cannot own shares in a holding company abroad if they are tax residents of Pakistan.¹*

¹ The SBP recognizes that the current framework is restrictive and is working to change this, in part due to the advocacy of Sarmayacar, i2i Ventures and other prominent investors in the market.

1 Step

BEFORE YOU INVEST



**THE EARLY-STAGE
INVESTOR'S GUIDE
TO PAKISTAN
2020**

You don't have to be an accredited investor to invest in a Pakistan-based company. An individual investor or a company - foreign or local - can hold shares in a company that has been legally incorporated in Pakistan. Foreign and local investors can sell shares and transfer ownership in accordance with the Companies Act 2017, which governs the establishment and operations of companies in Pakistan. Any foreign investor or investment firm, however, requires approval from Pakistan's Ministry of Interior to become a shareholder or director in a company registered in Pakistan. This approval can be granted after the investment, though, so it's not necessary to wait prior to deploying your money².

If an investor is investing in a business legally incorporated in Pakistan, that business should be set up as a **Private Limited Company**. Founders can set up as sole proprietorships or partnerships, but under Pakistani law, **only a Private Limited Company (and other incorporated companies) is a separate legal entity with limited liability that allows the entrepreneur to sell shares as equity and raise capital.** An investor's money is relatively more protected under a Private Limited Company, and they can subsequently exit their investment by selling their shares.

While commercial due diligence on a company varies by investor preferences, the **legal due diligence** process typically begins after you (the investor) have made the commercial decision to invest. We recommend you engage local counsel for this process, or if there is a local fund/investor leading the deal, review their legal due diligence.

Overall, you should ensure that the entity you're investing in actually owns all the assets of their business. This is important because typically, at an early stage, founders start a business without incorporating their entity³. When they do incorporate, it is common for part of their business to still remain with the founders as individuals. This could include contracts with early customers or suppliers, and/or applications filed for registration of intellectual property.

² The startup you invested in typically is approached by the Ministry of Interior following investment; the startup provides information on the investors/shareholders. Before a foreign investor becomes a director or shareholder, though, you (the investor) must **submit an undertaking** that in the event you don't receive MOI approval, they will resign as director or sell your shares.

³ Setting up as a sole proprietorship or a partnership do not count as incorporating entities.

THESE ARE THE OTHER THINGS YOU SHOULD EXPLORE IN YOUR PROCESS

1



Intellectual Property

You (or your lawyer) should ensure that all intellectual property (trademarks, copyrights & patents) of the business are owned by the company.

2



Warranties

You should obtain warranties from the founders that there is no outstanding liability against the company.

3



Contracts

You should check that all supplier, partner, customer, and employee contracts are with the company (including payments and receivables) and not with the founders directly or with employees (i.e., as individuals). This is to protect against potential leakages; i.e., if revenue being earned by the company isn't actually going to the company.

4



Licenses/Permits

If the business operates in a regulated space for which a license is required to operate, you should ensure that all such licenses and permits are in the name of the company.

5



Regulatory compliance

You should check (or obtain warranties to the effect that all regulatory filings (SECP, Tax etc) have been made by the company.

Step 2

MAKING YOUR INVESTMENT



**THE EARLY-STAGE
INVESTOR'S GUIDE
TO PAKISTAN
2020**

For any investor looking at a potential investment in Pakistan, you should first carefully review and approve the corresponding term sheet and shareholder's agreement, otherwise known as an SHA, which is a detailed agreement regulating the relationship of the shareholders of the company (founder(s) and investor(s)).



For a foreign investor, specifically: Once you've made your investment, the company (through their bank) needs to apply to the SBP for registration of your investment on a repatriable basis. Along with submitting a V-95 form (the form to apply for this registration), you also submit a **Proceeds Realization Certificate (PRC)**, which is issued by the bank as evidence of the payment having been received from abroad and its purpose.

There are two main instruments for investing into a privately-held company in Pakistan, particularly for investors (local or foreign) looking to make early-stage investments into startups:

1 EQUITY

The subscription of and holding of shares in a company, in anticipation of income from dividends and capital gains, dependent on the performance of the company.



2 DEBT

A loan to a company, in which your profit is not directly related to the performance of that company. It is important to note that debt investments made by a foreign investor are regulated by the State Bank of Pakistan, particularly the conversion of the loan, term, and the interest rates.





Investors can also enter into a convertible note or a **“SAFE”**, a simple agreement for future equity, in which the investment is initially given as a debt which will convert into equity at a certain trigger event. To read more about SAFEs, see [here](#), via YCombinator⁴.



In the case of foreigners (individuals or entities), structuring an investment as a convertible note/ SAFE would require:

1. The term of the debt and interest rate must be in line with the SBP manual;
2. Special approval from the SBP prior to the conversion of the loan into equity.

Note for foreign Investors:

*You should ensure that when remitting your funds, you do it in a foreign currency (e.g. US Dollars (USD)) and not in Pakistani Rupees (PKR). **You should also ensure that the stated purpose of the remittance is written as “Investment” in the case of a priced round and “Loan” in the case of a convertible note / SAFE when you are instructing your bank (done via Form R).** This helps with the SBP registration of shares on a repatriable basis⁵.*

⁴ Some investors are now exploring [KISS](#) agreements (Keep It Simple Securities). It would operate similarly to structuring a convertible note or a SAFE.

⁵ You (the investor) should also make sure that the company receiving your investment does the same thing at their bank's end; i.e., mention 'investment' and 'repatriable' in Form R.

Step 3

GETTING YOUR SHARES ISSUED



**THE EARLY-STAGE
INVESTOR'S GUIDE
TO PAKISTAN
2020**

If you invested in a priced round, the **Shareholders Agreement** and the **Share Subscription Agreement** will determine the terms on which shares will be issued to you. Under Pakistani law, shares can only be issued **once the funds have been received by the startup.**

However, before transferring your funds, you must ensure that all required documentation and filings with regards to a rights issue of shares have been completed by the startup you're investing in. This includes the increase of authorized capital (*aka 'nominal capital', the maximum capital a company is allowed to issue*) (if required), passing of the requisite board resolutions, and obtaining consent from existing shareholders that they will not be exercising their right to pro-rata subscription.

Upon making your investment and completing these formalities, you should confirm the shares were allotted to you by reviewing Form 3, (aka, a confirmation of the allotment of shares by the SECP). In some cases, physical shares can also be issued.



The appointment of a board director (if that has been agreed on with the startup) can be confirmed by reviewing Form 29 filed with the SECP.

Step 4

MANAGING YOUR INVESTMENT



**THE EARLY-STAGE
INVESTOR'S GUIDE
TO PAKISTAN
2020**

Once you are a shareholder or noteholder (in case of a convertible note/SAFE), you can monitor your investee to the extent the following rights have been secured in the investment documentation:

 **Information Rights** Obtaining relevant information from the startup as frequently as was agreed. Typically, investors require a monthly or a quarterly update along with management accounts, in addition to the audited annual statements (also required by the law).



 **Reserve Matters** These are matters which the startup cannot go ahead with without the approval of their investor. If the parties have agreed to such matters in the investment documentation, it is important for you and the founders to ensure that your specific approval is obtained before going ahead with any matter.



 **Tag/Drag Along** If the investor has secured tag/drag along rights in the investment documentation, it is important to ensure that those rights are exercised (or not) at the time of sale of shares by any shareholder of the Company.



 **Pro Rata** Under the Companies Act, every time a private limited company issues new shares, all existing shareholders have the right to subscribe to new shares in proportion to their shareholding.



 **Right of First Refusal** Under the Companies Act, whenever a shareholder of a private limited company intends on selling its shares, it is required to offer those shares to the remaining shareholders, in proportion to their existing shareholding in the company.



5

Step

EXITING YOUR INVESTMENT



**THE EARLY-STAGE
INVESTOR'S GUIDE
TO PAKISTAN
2020**

If you're looking to exit your investment, at the time of selling your shares, regardless of whether the buyer is local or foreign, if you (the investor, or seller) is a resident of Pakistan, **the payment for the sale of shares has to be made in Pakistan.**



Foreign investors, on the other hand, can receive funds abroad. In the event the buyer is also a resident outside of Pakistan, the payment can easily be made abroad. If you are a foreign investor, but the buyer is a resident of Pakistan, the SBP has recently streamlined the process to allow for such payments to be remitted by the authorized dealer (bank) if the transaction is deemed legitimate.

CONCLUSION

As investors operating in Pakistan, we are already convinced of the country's startup and innovation potential, but know that we cannot do this work alone. We are also deeply aware of Pakistan's opaque regulatory environment that can increase the risk perception of the market. At the same time, things are progressing; as noted earlier, while Pakistan's Doing Business ranking is still 108, the country ranks in the top 30 economies globally on protecting minority investors. As early-stage investors, that protection is key, and is a positive sign. The SECP and State Bank of Pakistan are also very open to changing legislation and adapting reforms, as indicated by recent policy changes, and there are indications that more will come in the near future. While there is much left to be done, we are moving in the right direction.

This guide aimed to address the information asymmetry and answer the most commonly asked questions to make your own investor journey easier. As the landscape evolves, so will this guide, and our hope is it enables more investment to occur in this exciting and growing startup ecosystem.



**THE EARLY-STAGE
INVESTOR'S GUIDE
TO PAKISTAN
2020**