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Business Focus | Startup

Seven Key Legal And Business Issues Every Startup Founder Needs to Know

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It's no surprise to learn that the founders of new startups often spend a majority of their time focused on growing their business by developing, refining and marketing their product or service, hiring great people, and working tirelessly to get potential investors excited enough about their ideas and business plan to make an investment. However, in the rush to move things forward as quickly as possible, many other important matters are swept to the side at the early stages on the basis that they are not critical. Also, due to cost concerns, hiring lawyers and other professional advisors is usually out of the question.

Many startup founders are hesitant to negotiate investment contracts in any meaningful way for fear of being seen as too difficult or demanding. The fear of losing potential funding is often acute, which sometimes leads founders to make poor judgment calls or to accept investment terms that are onerous and unfair. As a result of funding and other pressures, investment agreements and other important legal documents are often signed without first having been properly reviewed, relevant laws and regulations are not adequately researched and/or understood, and other important legal and tax matters are either ignored or put on a "to do" list, to be actioned at some future date. But a word of warning – ignoring and/or failing to deal with these and other important legal, regulatory, and tax issues at the beginning of your startup journey can often result in difficulties and even disaster later down the road.

To ensure that problems do not arise in your startup, we would urge startup founders to make sure they understand and appreciate the importance of the following seven legal and business issues before it's too late.

1. Choosing a suitable legal entity for your startup business

Securing funding is a rite of passage for every successful startup. While your immediate family and friends may invest in your ideas and support you with funds at the initial stages, usually in the form of gifts or personal

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loans, investors in the next stage of your growth will typically expect to invest and take an equity stake in a separate legal entity, often a limited liability company. For this and for other reasons, some of which will be discussed below, it is important for founders to set up their legal entity in the early stages of their startup journey.

In Thailand, the most suitable vehicle for startups is a private limited company, which is a separate legal entity whose capital is divided into shares, each with the same value. A private limited company must have a minimum of three shareholders. As its name suggests, the liability of the shareholders is "limited" to any amounts unpaid on the shares held by them. Investors, on the whole, feel confident investing in a company rather than in an individual person.

2. Agreements among founders and other shareholders

Conflicts are detrimental to the success of any business, even more so when building your business from scratch. How can you minimize conflicts that may arise among the founders and other shareholders of your startup company? One of the most important ways to avoid conflicts is to be upfront about the roles and responsibilities of the various parties vis-à-vis each other and the management and operation of the startup company. The clearer (and the earlier) these matters are set out in the shareholders' agreement among the various parties, the better.

A good shareholders' agreement will be comprehensive in nature, be drafted by a professional legal consultant experienced in working with startups, and should, at a minimum, deal with the following major areas: the rights, duties, and liabilities of each of the shareholders, equity contributions and ownership, business purpose, the role and status of directors and shareholders, how the company is to be managed and by whom, meeting and quorum requirements, whether there will be any share transfer restrictions or other share lock-up mechanism, company dividend policy, rights of first refusal and tag-along and drag-along rights, if any, how are disputes among the directors and/or the shareholders resolved, what happens when someone exits the business or when a particular founder/shareholder is not living up to expectations etc. When conflicts arise between shareholders, the shareholder's agreement serves as a focal point on issues that are mutually agreed upon – which will, hopefully, help minimize conflicts.

3. Tax planning

Startups normally run on a shoestring budget. Without fully understanding the importance of proper tax planning, startups risk exposing themselves to taxes and other fees that perhaps could have been avoided. In general, the maximum rate of corporate income tax (CIT) in Thailand is fixed at 20 percent of net profits. Startups established as a limited liability company or a registered partnership with a registered capital not exceeding THB 5 million, and who have revenue from the sale of products or services with an annual turnover of not more than THB 30 million will be exempted from the first THB 300,000. For companies whose net profits exceed THB 300,000 but are less than THB 3 million, a reduced CIT of 15 percent will apply. In addition, startups may be eligible to receive certain other tax privileges from the Revenue Department (RD) such as tax measures to promote research and development of technology and innovation, tax measures to encourage SMEs to use computer programs, etc. For Value Added Tax (VAT), companies having revenue exceeding THB 1.8 million per year must register for VAT with the RD.

The Thai Government has also been working hard to promote investment in startups, especially as part of “Thailand 4.0”, which is the plan to move away from a largely agrarian economy to one which is focuses on innovation, technology and entrepreneurship. As part of this, Thailand’s Board of Investment (BOI) actively encourages and provides incentives to both foreign and Thai startups engaged in technological innovation, digital platforms, e-commerce, software development, and other specific high-tech industries. Approved projected are entitled to both tax and non-tax incentives, including lengthy exemptions from the requirements to pay CIT.

Startup founders should seek legal advice to determine whether or not their business is eligible to receive promotion from the BOI – which, apart from the economic benefits, may also act as a significant incentive to attract early stage investors.

4. Protecting intellectual property rights

New technology and innovation are at the core of most startup businesses. The risks associated with losing your proprietary rights over the inventions you have so tirelessly created are insurmountable. Thus, from the outset, it is critical that you have a clear understanding about what kind of intellectual property rights (such as trademarks, copyrights, patents or trade secrets) you possess and how they can be protected from being stolen or otherwise illegally used by third parties.

Investors will want to see that any intellectual property associated with your business is protected and that it is actually owned by your startup company. Often times, intellectual property is owned by the individual founders and not the company itself. In such instances, the IP will need to be transferred from the individual owners to the company. In addition, founders should make sure that their employees have a clause in their employment contracts which automatically assign to the company any IP created by the employee during the course of their employment. By doing this, you will avoid disputes in the future with employees who may claim any IP created by employees during the course of their employment as their own.

Investors will look into these matters in detail before agreeing to make an investment in your company so it is important to deal with these critical matters at the outset.

5. Employment contracts

Your employees are your assets. Although startups usually start out with a very limited number of employees, you should always be sure to enter into a written agreement with them – even if they are your friends!

Employment contracts do not need to be lengthy but they should at a minimum set out the basic terms of employment such as job description, working hours/days, salary, probationary period, if any, bonus, and other entitlements, confidentiality requirements, assignment of IP provisions, and any other matters agreed between the employer and the employee. Other privileges and benefits should be provided as required by the labor law including provident fund contributions under the Provident Fund Act.

Potential investors will expect to see written employment agreements with your employees. If you do not have such contracts in place, it is best that you create them prior to having any investor come in and do due diligence on your company. Failure to have these basic issues in order may make you look unorganized and unprofessional – and may ultimately tip the scales against you in the eyes of an investors, especially if there are also other matters of concern about your business.

6. Complying with specific laws

There are specific laws governing industries such as finance and banking, food, education, insurance, medicine, agriculture and tourism, etc. Startups should be aware of and comply with these specific laws governing their businesses, including with respect to the licenses, certificates and approvals required to operate your business. One of the most recent pieces of legislation that has impacted almost every business in Thailand is the Personal Data Protection Act (PDPA).

Startups that collect personal data from their customers via applications or cookies are required to obtain consents from their customers in relation to the collection, use or disclosure of personal data to third parties in order to comply with the PDPA, which is scheduled to come into effect on June 2021. Failure to comply with the provisions of the PDPA could result in hefty penalties.

7. **Beware of exclusivity arrangements**

As noted above, the ability to obtain funding from investors is a critical element to the successful growth of any startup company. Unfortunately, the scramble to secure funding often results in startup founders executing MOU's or term sheets with matching agents that contain onerous provisions. Matching agents are firms who claim to have access to networks of high net worth individuals, angel investors, VC's or corporate investors. Before entering into any agreements with matching agents, a founder should conduct sufficient due diligence to determine whether or not the matching agent has a track record of successfully finding investors for startup companies, particularly in the same or similar industry.

In particular, founders should think carefully before signing agreements that contain exclusivity provisions which effectively prevent the founders from seeking investors from other sources during the pre-agreed "exclusivity period". Before signing any document that gives exclusivity to a matching agent, a startup should agree upfront the general terms of any investment that it is prepared to accept, including the valuation and amount of equity it is prepared to give away to an investor.

In addition, any period of exclusivity should be relatively short – otherwise the startup may be stuck for long periods of time without the ability to source investors itself. Finally, to the extent that the startup founder is already in discussions with potential investors at the time it executes an agreement with a matching agent, such potential investors should be carved out as exceptions to any exclusivity arrangement.

Startup Practice

Since our representation of over 40 Startups under the DTAC ACCELERATE program, Kudun and Partners understands the legal obstacles and complexities faced by Startups. They appreciate our efforts in not only conducting critical and deep down business analysis for them but also providing comprehensive legal solutions including opportunities for funding to ensure sustainable business continuation. Our mission focuses on empowering founders and stimulating innovations, help grow startups and connect investors with great startup companies.