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Unicorn Startups and Regulatory Oversight: Need for Reform?

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There has been a tremendous growth in the number of business enterprises that operate based on technologies, giving rise to what is popularly known as “unicorns.” Unicorns are those private companies whose value goes beyond the \$1 billion benchmark without issuing any shares publicly. India is one of the leading nations for the growth of unicorns, which currently numbers more than 110 according to data as of 2024. Such areas as fintech, edtech, healthtech, and e-commerce are some of the industries that represent these firms. Although such rapidly growing companies promote innovations, they are working in an environment not suited to their operations, considering aspects such as complex valuations and complex ownership structure. The lack of stringent regulations results in potential hazards to investors’ interests, market stability, and sound governance practices. In this paper, the researcher employs doctrinal analysis to conduct research on the regulation of unicorn startups in India using statutes, judicial decisions, and international examples. This work will concentrate on the functions of SEBI, the Companies Act, 2013, the Foreign Exchange Management Act, 1999, and the Startup India Initiative. Having considered some of the significant case studies on the matter, including the regulatory problems at Byju’s and product problems at Flipkart, alongside international examples, such as the troubles at WeWork, the authors of the article urge for comprehensive reform measures

Keywords: *unicorn startups, regulatory oversight, corporate governance, venture capital.*

INTRODUCTION

In the past two decades, there have been many transformations in the international startup space due to the convergence of digital technology, venture capital, and consumer behaviour. In this setting, one unique class of startups, called unicorn startups, has been subject to exceptional scrutiny from various stakeholders. Lee defined the concept of unicorn startup in 2013 in the context of venture capital investments to refer to an extraordinary phenomenon where privately-owned firms manage to reach a valuation threshold of one billion US dollars before their IPO.¹ Although there were only about forty unicorn firms at the time of Lee's writing, the total number of unicorn firms worldwide exceeded one thousand, two hundred by 2024.

India holds a unique place in the global startup space. India is currently the world's third-largest startup environment with over one hundred and ten unicorn firms after the US and China.² Some of India's top unicorns include Flipkart, Byju's, Paytm, Ola, Zomato, CRED, Nykaa, and Dream11, amongst many others. These firms have been known for disrupting traditional industries while attracting venture capital funds worth billions of dollars. Prominent Indian unicorns include Flipkart, Byju's, Paytm, Ola, Zomato, CRED, Nykaa, and Dream11, among others. These firms have been known for disrupting traditional industries while attracting venture capital funds worth billions of dollars. In the year 2021 alone, India added over forty new unicorn firms in what has been dubbed the "unicorn boom."

However, beyond the success story, there exists a set of unanswered regulatory questions. Unicorns function in an area where they are subject to multiple forms of regulations, corporate, securities, foreign investment, and sector-specific regulations, but lack a unifying regulatory structure altogether. Lack of clarity over valuation, power imbalances within corporate governance and risks to minority and retail investors are some of the areas that require greater attention, but which the existing legal structures cannot deal with.

The rest of this article seeks to examine such regulatory issues systematically. Starting with the identification and understanding of the meaning and attributes of unicorn companies, the paper goes on to examine the present regulatory regime for unicorns in India. It highlights the key

¹Aileen Lee, 'Welcome to the Unicorn Club: Learning from Billion-Dollar Startups' (*TechCrunch*, 02 November 2013) <<https://techcrunch.com/2013/11/02/welcome-to-the-unicorn-club/>> accessed 25 March 2025

² *Startup India Progress Report 2023* (Ministry of Commerce and Industry, 2023)

problems in regulating the unicorns by providing real-world examples from successful Indian unicorns as well as their international counterparts. Finally, the paper provides practical suggestions towards formulating an appropriate regulatory approach towards unicorns based on experiences in other jurisdictions, especially the US and UK.

MEANING OF UNICORN STARTUPS

The unicorn startup is described as a privately held company that is able to reach a valuation worth over one billion US dollars through repeated rounds of venture capital or private equity financing without being listed on the stock exchange for an initial public offering. This concept was introduced by Aileen Lee in her 2013 publication in TechCrunch, who used the metaphor of a unicorn to point out the rarity of such companies. In other words, valuation does not come from being financially sound but rather through negotiations made between the business and its financiers.

The start-ups that qualify as unicorns from India include companies such as Flipkart (online retail company), Byju's (education technology start-up), Paytm (financial technology firm), Ola (ride-hailing service), Zomato (online food delivery firm), CRED (fintech start-up), Nykaa (beauty/lifestyle products). The common characteristic of all these firms is that the reason behind their valuation lies in their growth potential rather than in their current financial health. It is one of the most important problems that the article covers.

GROWTH OF THE UNICORN ECOSYSTEM IN INDIA

The development of India as a major unicorn destination has been aided by various structures. India's young, large population and high levels of internet penetration (with 750+ million internet users as of 2024), coupled with increasing digital literacy, high mobile phone usage and affordability of data connectivity, have fostered a fertile demand base for digital offerings.³ The Unified Payments Interface (UPI) introduced by the National Payments Corporation of India has been revolutionary in terms of payment processing infrastructure, which has helped spawn fintech unicorns. Demonetisation of November 2016, despite its dubious effect on the Indian economy, acted as a catalyst in boosting digital payment systems.

³ *Annual Report 2023–24* (TRAI 2024)

Regarding the supplier base, from 2015 to 2023, there was an enormous amount of venture capital investments made into Indian startups. There were many venture capital organisations worldwide that made huge investments in Indian startups, thereby facilitating fundraising in multiple rounds at progressively higher valuations. Within the framework of the Startup India program, the Department for Promotion of Industry and Internal Trade (DPIIT) had recognised more than 1,14,000 startups by 2024. In addition, the Coronavirus disease epidemic accelerated the adoption of digital services within various industries.

IMPORTANCE OF REGULATION

There are several critical roles played by regulation within the unicorn economy. Firstly, regulations protect investors, both institutional and ordinary, from the dangers of fraudulent valuation, poor disclosure practices, and faulty corporate governance mechanisms. Secondly, strong regulatory regimes maintain stability within the market by limiting the possibility of speculative bubbles being created through excessive valuation. Thirdly, regulations provide consumer protection by ensuring that there are data privacy laws, competitive business practices, and adequate service delivery. Lastly, regulations protect the general public's interests by ensuring that there are no instances of regulatory arbitrage where firms engage in activities specifically to evade regulation. It is important to note that the need for such protective measures is highlighted by the numerous governance challenges and valuation crises that have been experienced by unicorns across the globe. This includes the collapse of WeWork⁴ and Theranos companies in the United States, alongside the current controversy surrounding the Indian firm, Byju's.

CONCEPT OF UNICORN STARTUPS

Characteristics of Unicorn Startups: Unicorns possess unique attributes that distinguish them from ordinary enterprises. First, they are characterised by extremely high valuation. This valuation does not come from any profitable activities since investors base their valuations on expected future value. Since valuation involves discounted cash flows and market sentiments, unicorns' valuation tends to be volatile and may easily be inflated.

⁴ The Securities Act 1933

Second, another attribute of unicorns is the ability to scale up fast. Such scaling is made possible through business models based on technology, where businesses do not require substantial investments in fixed capital to scale up. The ability to scale up is closely associated with the third attribute of technology dependence. In most cases, unicorns use advanced technologies such as artificial intelligence, machine learning, and network effects to create an advantage. This attribute makes it difficult for unicorns to comply with the regulations governing regular profit-making businesses that are asset-intensive.

Factors Leading to Unicorn Status: Several related variables define the journey towards becoming a unicorn. Firstly, access to venture capital and private equity financing is a vital facilitating factor. The nature of venture capital financing, whereby investments through Series A, Series B, and other Series at gradually increasing valuations, produces a positive feedback loop where each new financing round not only demonstrates but also boosts investor confidence in a startup's growth path. Involvement of prominent institutional investors works as proof of a company's value and attractiveness for more investors and specialists.

The second essential feature of the process is the innovation element in the development of disruptive business models. Startups that discover latent needs of consumers, address the inefficiencies of the existing industries, or redefine the process of offering services – such as Flipkart revolutionised the concept of an e-commerce store and Byju's redefined education, create the growth potential. Growing customer demand in rapidly digitised industries, like fintech, healthtech, and edtech, also facilitates the process of reaching unicorn status.

Risks Associated with Unicorn Startups: Even with the apparent commercial success of the unicorns, some inherent risks pose systemic problems. The overvaluation risk seems to be the most commonly noted one, which happens due to the overestimation of the company's worth against its financial realities. The disconnect can be clearly seen in cases where such companies are being listed publicly, where their worth tends to get corrected by the market, often leading to large losses for investors. Cases in point would be the performance of companies like Paytm, Zomato, and Nykaa after listing in India, as well as the failure of global unicorns such as WeWork and Theranos.

Another category of risk involves the governance problem that is associated with unicorn companies. This is usually because many such businesses have been formed and run by their

founder-CEOs, who have been able to control voting rights in the company using dual class shares. The case of Byju's is a good example of how problems arise when the governance of the company falls under one individual's purview. A financial risk associated with many such unicorns is their financial instability due to loss-making, and hence, they need continued external funding.

REGULATORY FRAMEWORK GOVERNING STARTUPS IN INDIA

The Startup India Initiative: The Startup India initiative was announced by the government of India on 16th January, 2016, under the leadership of DPIIT. The purpose of this project is to foster the creation of a viable ecosystem for start-ups through simplifications, incentives, and institution-building efforts. According to the eligibility conditions set by DPIIT, the business must either be a registered private limited organisation, a partnership organisation or a limited liability partnership firm; it cannot be older than ten years since its incorporation date; and it should have an annual turnover of no more than 100 crores during its first decade since incorporation. Under the scheme, recognised start-ups are eligible for several advantages, including income tax exemptions for three of their first ten years, exemption from angel tax under Section 56(2)(viib) of the Income Tax Act, 1961, as amended, self-certification of adherence to nine environmental and labour regulations, swift patent application processing, and a fund of funds made available by SIDBI. While the Startup India Initiative has succeeded in fostering a viable environment for start-ups, it has done nothing to address the problems that unicorn firms face, which exceed the threshold established by the DPIIT.

Role of the Securities and Exchange Board of India (SEBI): Moreover, the disclosure rules prescribed by SEBI, such as risk factors, related party transactions, and financial statements for firms seeking public money, become applicable to unicorn companies from the point of filing the IPO itself.⁵ Critically, however, these disclosure obligations do not extend to pre-IPO unicorns, creating a substantial information asymmetry between company insiders and external investors.

Role of the Ministry of Corporate Affairs: The Securities and Exchange Board of India, which was formed through the Securities and Exchange Board of India Act, 1992, acts as the

⁵ SEBI (Alternative Investment Funds) Regulations 2012, reg 2(1)(b)

main regulatory body for the securities market of India. The regulation of unicorn startups falls within the purview of SEBI along different dimensions. As for venture capital funds, Securities and Exchange Board of India (SEBI) governs the Alternate Investment Funds (AIFs) through the SEBI (Alternate Investment Funds) Regulations, 2012, according to which the provisions concerning the operations of the registered AIFs, including the venture capital funds and private equity funds, are set forth; and it is these organizations that provide finance to the unicorn firms.

Moreover, Innovators' Growth Platform (IGP), established in accordance with SEBI's Issue of Capital and Disclosure Requirements Regulations, 2018, is a platform where the "new age technology companies" may be listed in order to become public. It is worth mentioning that due to the lack of profit-making, these companies are not eligible for listing on the Main Board. The listing rule enables such companies whose 25% or more of the pre-issue capital is owned by the qualified shareholders for at least two years to make the Initial Public Offering. The Companies Act, 2013, governed by the Ministry of Corporate Affairs (MCA), is the primary governing law of the internal corporate business in India.

For instance, Section 166 stipulates that the directors have to undertake certain responsibilities, such as working in the best interest of the company, its workers, stakeholders, and the community. Sections 177 and 178 stipulate that certain companies must establish Audit Committees and Nomination and Remuneration Committees, respectively, in order to create minimum levels of corporate governance that prevent managerial misconduct.⁶

The Companies (Accounts) Rules, 2014, mandate that companies should keep books of accounts and prepare their financial statements based on the Indian Accounting Standards (Ind AS).⁷ The MCA also manages the Insolvency and Bankruptcy Code, 2016, which offers a framework for dealing with distressed unicorn startups that encounter solvency problems.⁸ However, there is an issue with non-compliance and delays in implementing the provisions of the legislation due to weak enforcement. Moreover, the fact that unicorn firms are privately held and exempt from making disclosures as publicly held firms is another key problem.

⁶ Companies Act 2013, ss 166(2), 177(1) and 178(1)

⁷ Companies (Accounts) Rules 2014; Companies (Indian Accounting Standards) Rules 2015

⁸ Insolvency and Bankruptcy Code 2016

FEMA Regulations: All foreign investments made in Indian startup unicorns are governed by the Foreign Exchange Management Act of 1999 (FEMA). FEMA oversees all transactions related to foreign exchange receipts, payments, and remittances. These transactions include foreign direct investments (FDI) and foreign portfolio investments (FPIs). The Non-Debt Instruments Rule of 2019 under FEMA outlines the maximum limits on sectors, the automatic or approval entry route that foreign investors can utilise, and price guidelines for foreign investments in Indian startups belonging to different industrial sectors.⁹ Many Indian unicorns are recipients of a large portion of FDI inflows from overseas venture capital and private equity funds in complex structures, where foreign entities invest in an offshore subsidiary based in countries such as Mauritius, Singapore, the Cayman Islands, and even Delaware. Although such complex structures may be allowed according to FEMA and tax treaties, they remain difficult to oversee for regulatory authorities in terms of ownership and tax compliance. Reporting requirements such as the Foreign Currency-Gross Provisional Return (FC-GPR) and Foreign Liabilities and Assets (FLA) returns help regulate foreign transactions to ensure transparency in cross-border capital flows. Nevertheless, multi-tiered structures used in foreign unicorn investments continue to remain difficult to regulate by authorities.

CHALLENGES IN REGULATORY OVERSIGHT OF UNICORN STARTUPS

Valuation Transparency Issues: The valuation of unicorn startups poses the first critical obstacle for regulation. In contrast to publicly traded firms, whose market capitalisation is computed based on the price at which their shares trade on exchange markets, unicorn valuations are set through private negotiations conducted between unicorns and their investors during each financing round. This process is not regulated by any requirement for mandatory oversight of the valuation procedures or an independent review of the underlying assumptions concerning growth projections. This lack of transparency gives rise to opportunities for deliberate inflation of valuations, or what can be termed “valuation gaming.” Both founders and investors have common motivations to increase valuations in subsequent financing rounds to demonstrate superiority in the market, attract employees by offering equity incentives, and secure future capital on favourable terms. Moreover, the practice of keeping secret financial statements makes the issue even more complicated. Private investors who buy stocks from

⁹ Foreign Exchange Management (Non-Debt Instruments) Rules 2019

unicorns on pre-IPO secondary markets or through ESOPs do not have access to the auditor-approved financial statements necessary to estimate the accuracy of valuations.

Corporate Governance Concerns: The failure of corporate governance practices is the greatest weakness of the unicorn ecosystem. The centralisation of decision-making processes in founder-owned firms, usually enabled by the use of dual-class stock that affords founders superior voting power, restricts the effectiveness of board oversight and investment from outside parties. This governance gap results in an environment where excessive managerial control, insider deals, and compliance issues may flourish unopposed for considerable lengths of time.

Byju's is the most compelling example of this trend in the Indian context. The parent firm of Byju's, namely Think and Learn Private Limited, established by Byju Raveendran, was valued at approximately USD 22 billion in 2022, making it the largest unicorn edtech firm in the country. From late 2022 onwards, however, the company was mired in numerous corporate governance scandals, such as failing to submit audited accounts for the financial year 2021-22 on time; Deloitte Haskins & Sells, its statutory auditor, resigning alongside three independent board members; being accused of fraudulently diverting a term loan amounting to USD 500 million obtained in the US market; and initiating legal action against it before the National Company Law Tribunal (NCLT) pursuant to the Insolvency and Bankruptcy Code, 2016.

Investor Protection Issues: The protection of the interests of the investors, especially small or retail investors, is of utmost importance in the unicorn environment. Institutional investors who participate in venture capital investments of startups have significant protection from liquidation preference clauses, anti-dilution, information rights, and pro-rata allocation in future rounds. However, such provisions are not available to retail investors who purchase unicorn equity securities either through secondary market transactions, a pre-IPO platform, or a public offering at the time of the initial public offering. Venture capital exit at the cost of retail investors poses significant risks to the retail investors. For example, between 2021 and 2022, many Indian unicorns made their initial public offering (IPO), such as Zomato, Paytm, Nykaa, and PolicyBazaar, at prices reflecting the peak valuation level of the private market instead of the financial position of the company. The trading performance of these stocks in subsequent periods has been poor compared to the issue price, causing losses to retail investors who did not possess sufficient financial analysis capability to evaluate the financial standing of the company.

While the information memorandum submitted by the company during IPO mentions risks, the disclosure does not enable retail investors to understand the governance weaknesses of the company.

Regulatory Arbitrage: Regulatory arbitrage, the use of any loopholes or ambiguities in the relevant legal framework, is a common feature among unicorn companies. Indian unicorns have often designed their business models within different regulatory jurisdictions to minimise compliance costs in each. For example, fintech unicorns providing integrated services for loans, payments, and investments may deal with the payment regulations of the RBI, the investment advisor regulations of SEBI, and IRDAI's regulations on insurance intermediaries while designing individual products in such a way as to circumvent the most stringent requirements in each area. The fragmentation in the regulatory regime in India, where regulation is conducted by various regulators like SEBI, RBI, MCA, DPIIT, CCI, TRAI, and many other regulators in individual sectors, coupled with a lack of inter-regulatory coordination and knowledge sharing, allows sophisticated unicorn companies to exploit regulatory gaps in their favour. Thus, investors and consumers may face issues arising due to such behaviour, which cannot be handled by any one regulatory body individually.

CASE STUDIES OF REGULATORY ISSUES IN UNICORN STARTUPS

Governance Challenges in Byju's: Byju's is the most detailed Indian case of how regulation can be impacted by governance concentration that goes unchallenged in a unicorn startup. Think and Learn Private Limited, trading as Byju's, was formed in 2011 and scaled quickly to become the highest-valued ed-tech firm in India, serving more than 150 million learners through its platforms and achieving its highest valuation of around USD 22 billion in the first quarter of 2022. Investors in the firm include well-known firms such as Sequoia Capital, Tiger Global, Qatar Investment Authority, BlackRock, and Chan Zuckerberg Initiative. Its unravelling started in late 2022 after the firm failed to furnish its audited financial results for FY 2021-22, even though the DPIIT had granted it startup status. In January 2023, the statutory auditor, Deloitte Haskins & Sells, resigned, along with three independent directors. Simultaneously, investigations were underway by the Enforcement Directorate under FEMA against the firm regarding foreign exchange earnings. Meanwhile, lenders in the USA filed claims against the firm concerning a USD 1.2 billion term loan facility due to defaults and abuse of funds. Claims

were filed against the firm at NCLT under the provisions of the IBC, 2016, and finally, the insolvency petition was admitted in 2024. The case of Byju's highlights, in particular, the problem of regulation with respect to big private firms, where none of the Indian regulators had the jurisdiction or data access necessary for tracking the decline in corporate governance.

Regulatory Concerns in Flipkart's Business Model: On the other hand, Flipkart, which was established in 2007 by Sachin Bansal and Binny Bansal and acquired by Walmart Inc. in 2018 for about USD 16 billion, poses yet another unique but equally educational regulatory issue. From its very inception, Flipkart operated a marketplace and controlled inventory through affiliated companies, which led to perpetual queries about whether such a business strategy could be considered compliant with FDI regulations governing e-commerce. In response, the Press Note 2 of 2018 by DPIIT, along with amendments to the FDI policy for e-commerce, explicitly prohibited marketplace firms from owning or controlling the vendors who sell their products on their platforms.¹⁰ Further, Flipkart's highly layered corporate structure involving companies incorporated in Singapore, the United States, and India created issues surrounding compliance with FEMA rules, determining beneficial ownership, and properly categorising internal group transactions. Eventually, CCI launched investigations against Flipkart (and Amazon) concerning their preferential treatment of selected vendors selling products on their platforms, leading to raids conducted by CCI in 2022. All these issues reflect the difficulties associated with unicorn firms that conduct their operations across different regulatory spaces in a complicated manner.

Global Examples: The WeWork Governance Crisis: The governance failure at WeWork presents the best example in the world of how failures in regulation and market lead to serious problems for unicorns. As a company offering co-working spaces, WeWork, which was founded by Adam Neumann in 2010, reached a valuation of USD 47 billion in January 2019. This valuation is mainly attributed to the big stake purchased by SoftBank at that valuation. The filing of the S-1 by the company with the Securities and Exchange Commission (SEC) of the US before its initial public offering (IPO) in August 2019 showed that the company was one with huge losses in operations (USD 1.9 billion in 2018), had some questionable related-party transactions, featured a dual-class share structure allowing Neumann to have enormous influence on

¹⁰ *Review of the policy on Foreign Direct Investment (FDI) in e-commerce* (Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, 2018)

decisions, and was not really a technology firm but a real estate company. SoftBank then spearheaded a bailout deal for the firm based on an extraordinarily discounted valuation of the company. WeWork finally made its IPO debut in 2021 by means of a SPAC merger, valued at around USD 9 billion, less than a tenth of its valuation in 2019 and filed for Chapter 11 bankruptcy protection in November 2023 in the US. The WeWork debacle shows how disclosure rules mandated at the time of an IPO can bring into the open problems that have been kept under wraps due to the opacity of private markets for many years beforehand.

NEED FOR REGULATORY REFORMS

Stronger Disclosure Requirements: The most significant change needed in the regulation of unicorns in India lies in establishing mandatory disclosure requirements for private firms above a certain threshold value. While private firms have to submit their financial statements to MCA annually, they are exempt from having to follow the rigorous disclosure norms followed by listed firms regulated under SEBI LODR regulations. An enhanced disclosure structure will minimise information asymmetry existing in the current regulatory environment, where companies are supposed to share relevant information about valuation, related party transactions, and other major events. The need for enhanced disclosure norms includes specific measures regarding the valuation of companies. The raising of funds by companies whose valuations cross a certain mark can mandate a valuation report from an independent auditor registered as Category I merchant banker under SEBI or a registered valuer under IBBI. This measure will help to validate the valuation figures provided by companies.

Corporate Governance Standards: Mandatory corporate governance rules must be put in place for startup unicorns above a certain level. They must mandate having an adequate number of independent directors, whose numbers constitute at least a third of the total members of the board, who are truly independent of the company's founders and lead investors. Independent audit committees, consisting only of independent directors, must be established to undertake audits of financial statements, review related party transactions, and manage internal auditing functions. Two-class share structure, whereby the founders of the firm have greater voting power in comparison with their ownership stakes, must be allowed, but should include provisions of sunseting in case certain events take place, like an IPO, a change of control, or after a certain period (five to seven years). This would enable accountability without totally excluding the need

for the founder's strategic management. These measures are patterned after those used in countries such as the United Kingdom and Singapore.

Protection of Investors: The investor protection regulations must target the unique weaknesses that exist in retail and minority investors in the unicorn industry. The SEC must expand its investor protection policies, which presently apply exclusively to listed corporations, to include secondary transactions made in the primary issuance phase of stocks issued by unicorn firms. Platforms that sell unlisted shares to retail investors must be registered with the SEC, adhere to KYC and AML requirements, and give buyers standardised risk warning papers before completing any transaction. The implementation of an official procedure for protecting minority shareholders, similar to that provided under Section 245 of the Companies Act 2013¹¹, for listed companies, would give retail and minority shareholders of unicorn startups a significant legal route to take if there were any instances of governance breaches or valuation fraud. SEBI must also contemplate imposing mandatory lock-up arrangements on pre-IPO investors who want to cash out using the IPO route, guaranteeing that early-stage investors, who have profited from the private market rally, are not routinely dumping their shares on retail investors at the peak.

Monitoring Venture Capital Investments: The existing regulatory regime for the Alternative Investment Fund (AIF) category, as stipulated in the SEBI (AIF) Regulations, 2012, needs to be enhanced further to ensure better supervision of venture capital investment in unicorn startups. It is imperative for SEBI to mandate Category II AIFs, and I engaged in venture capital investments in unicorn-stage ventures to report on their portfolio companies' valuations every quarter through prescribed methods. The said reports shall remain confidential but available to SEBI for supervision purposes and shall help SEBI to spot valuation concerns before they become a reality. Furthermore, SEBI must create a cell or division that would oversee the regulatory dynamics, liaise with other regulators like RBI, MCA, and CCI, and issue sector-specific guidelines for unique business models. Such a division can help unicorn startups obtain regulatory clarity while facilitating SEBI's effective supervision over innovative business practices.

¹¹ Companies Act 2013, s 245

COMPARATIVE INTERNATIONAL REGULATORY APPROACHES

United States: The SEC Framework: In response to the difficulties presented by unicorn startups, the United States Securities and Exchange Commission (SEC) has formulated an intricate legal framework. The SEC's Regulation D rule includes provisions like 506(b) and Rule 506(c) that allow firms to raise money from accredited investors through exempt offers. But the 2012 Jumpstart Our Business Startups (JOBS) Act and follow-up legislation established regulations, such as Reg Crowdfunding, which allows firms to raise a certain amount of funds from the general public subject to disclosure, and Regulation A+, which allows businesses to issue securities worth USD 75 million to the general public with reduced disclosure needs.¹² Relevant here is the SEC's Rule 12g, which requires private companies whose assets exceed USD 10 million and that have one class of equity securities held by 2,000 or more individuals (or 500 non-accredited shareholders) to comply with the reporting requirements applicable to publicly traded firms. While this helps to plug a major loophole in the Indian regime regarding unicorn regulation, it is notable that the SEC has enforced strict rules and penalties against fraudulent private firms through legal actions filed against the likes of Theranos and its CEO, Elizabeth Holmes.

United Kingdom: The FCA Framework: The UK regulator, the Financial Conduct Authority (FCA), has a well-articulated regulatory framework for facilitating innovation and protecting investors at the same time. One such framework is the sandbox initiative of the FCA, which the FCA has established within the ambit of its co-created initiative, the Global Financial Innovation Network (GFIN). It enables fintech startups to experiment with their new offerings in a regulatory sandbox supervised by the FCA. While RBI and SEBI have taken up the concept in India, it can be more rigorously implemented with respect to unicorn firms. The FCA also has a regulatory framework for facilitating the trade in privately-held securities through the regime of appointed representatives and Recognised Investment Exchange. These two frameworks help provide a structured mechanism to conduct secondary trading in privately held stocks with protections available for investors. The FCA has also provided the UK government with the power to assess foreign investments in strategic sectors of the economy through the National

¹² Jumpstart Our Business Startups (JOBS) Act 2012

Security and Investment Act 2021. The model can apply to India since it has many foreign VCs investing in Indian unicorns.

Lessons for India: There are many useful lessons that India can derive from its international counterparts with regard to the regulatory landscape for unicorn startups. One such lesson from the experience of the SEC comes in the form of adopting a trigger similar to the Rule 12g model, where the company has to mandatorily adhere to stricter disclosure and reporting requirements, even without being listed, depending upon the asset size, number of investors, or the valuation of the company. Another lesson that emerges from the FCA is that regulatory frameworks do not always stand at loggerheads with innovations; rather, an appropriate regulatory framework can foster innovations. From the international comparative analysis, one can deduce the necessity of coordinated regulation. While it is true that a unicorn startup interacts with a number of agencies, interregulatory coordination prevents these firms from taking advantage of any possible fragmentation in regulation. This is achieved through mechanisms of coordination, such as the agreement of information exchange and joint enforcement strategies. In India, the FSDC and the Sub-Committee established within the ambit of the FSDC can take inspiration from the FSOC of the US.

RECOMMENDATIONS

Based on the foregoing analysis, this article advances the following recommendations for regulatory reform in India –

Mandatory Disclosure Framework: SEBI and MCA should jointly introduce a “Significant Private Company” (SPC) designation, applicable to privately held companies with a valuation exceeding INR 1,000 crore or revenues exceeding INR 500 crore. SPCs should be required to file independently audited annual financial statements with SEBI and MCA within 180 days of each financial year-end, publish related-party transaction disclosures, and notify material events, including changes in valuation of more than 15%, departure of statutory auditors, and changes in beneficial ownership, within 48 hours of occurrence.

Independent Valuation Requirements: For companies seeking funds at a valuation greater than INR 1,000 crore, there must be a condition that they seek an independent valuation of their company by a registered Category I Merchant Banker under the SEBI regulations and/or a

Registered Valuer under the IBBI regulations before concluding each round of fundraising. The methodology of valuation, along with its important assumptions, must be furnished to SEBI.

Corporate Governance Mandate: It is recommended that SPCs be mandated to form boards with not less than one-third of its directors being independent, have an independent audit committee, and have policies regarding related-party transactions, whistleblower protection, and board diversity. The dual-class structure must also have mandatory sunset clauses that will kick off when certain triggering events occur, such as the IPO, within ten years of incorporation.

Retail Investor Protection in Pre-IPO Markets: It would be advisable for SEBI to have a regulation that requires such platforms dealing in the trading of secondary market unlisted securities for retail investors to have regulatory mechanisms such as risk documentation, compliance with know-your-customer (KYC) and anti-money laundering (AML) obligations, as well as set limits on retail investors' investments in unlisted securities. Investors buying stocks before an IPO should be locked into those stocks for at least one year after an IPO.

Strengthened AIF Reporting: SEBI must make amendments to the AIF Regulations, 2012, to provide for quarterly reporting to SEBI on the valuation of portfolio companies by Category I and Category II AIFs through the use of methodologies that SEBI shall lay down. An Innovation and Startup Regulatory Cell must be set up by SEBI with responsibility for monitoring systemic risks within the unicorn ecosystem.

Inter-Regulatory Coordination: The Unicorn Start-up Oversight Working Group needs to be formed by the FSDC Sub-Committee, which will include people from SEBI, RBI, MCA, DPIIT, CCI, and IRDAI. This will be responsible for framing the information sharing structure, coordinating on enforcement actions with regard to cross-regulation issues, and releasing a yearly assessment of risks posed by the unicorns.

Regulatory Sandbox for Emerging Business Models: SEBI and RBI must work together in expanding their respective sandbox structures to account for unicorn companies that run on unique business models. There should be increased surveillance and information sharing among sandbox firms, with lessons learned being integrated systematically into the regulatory framework within a stipulated period.

CONCLUSION

Unicorns have become the hallmark of the modern-day Indian economy, being a confluence of innovative technology, entrepreneurial ambition, and capital flows from around the world that have resulted in significant economic creation, job creation, and technological development. It is no exaggeration that India, being the third largest home to unicorns in the world, is reason enough for its national pride and a key sign of the country's growing economic dynamism. At the same time, the unicorn ecosystem faces serious regulatory challenges.

As has been shown throughout this paper, the current regulatory regime in place in India, comprised of the Startup India Initiative, SEBI's AIF and ICDR Regulations, the Companies Act, 2013, and FEMA, 1999, has never intended to deal with the specificities of regulating unicorns and their particular risks. Indeed, the lack of clarity regarding valuation, regulation on corporate governance, and investor protection, along with the lack of inter-regulatory cooperation, creates the basis for governance failure, valuation manipulation, and investor abuse. The recent events associated with the governance problems at Byju's and regulatory issues raised by Flipkart as well as other examples from across the globe, including the case of WeWork, are clear signals that without proper regulation, the path forward requires a calibrated and comprehensive reform agenda one that introduces proportionate regulatory requirements at defined thresholds, mandates meaningful governance and disclosure standards, protects the interests of retail and minority investors, and establishes robust mechanisms for inter-regulatory coordination. Such reforms need not, and should not, impede innovation or entrepreneurship. In contrast, the presence of effective regulation through the reduction of informational asymmetry, curtailment of overreach in governance, and protection of the interests of investors will provide the environment in which innovation may be sustained in the long run.

There are a few other countries where the creation of a healthy startup ecosystem has become more imperative and more urgent than in India. It will depend upon the regulatory measures adopted today whether the Indian ecosystem will continue to grow on sustainable grounds of transparency and integrity, or whether it too will be susceptible to the boom-and-bust cycle witnessed by less regulated ecosystems elsewhere. Establishing an innovative yet balanced regulatory framework is indeed both possible and necessary for India's success as a global innovation ecosystem.