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Corporate Governance in Startups Post IPO: Governance Failures and Gaps in Recent Indian Listings

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Abstract

India has seen a wave of startup listings since 2021, as young technology and consumer companies moved from venture funding to the public markets. Many of these companies arrived on the stock exchanges with strong founder influence, loss making business models and board structures built for private investors rather than public shareholders. This article examines whether Indian corporate governance law is ready for that shift. It looks at the Companies Act, 2013, the SEBI Listing Obligations and Disclosure Requirements Regulations, 2015, the SEBI Issue of Capital and Disclosure Requirements Regulations, 2018 and the leading judicial decisions on boardroom conduct. It then studies two recent episodes, the Paytm matter involving One97 Communications Ltd and the Gensol Engineering matter, to show where the framework has been tested. The article argues that the law on paper is reasonably strong, but weaknesses remain in the independence of directors, the treatment of founders as promoters, the control of related party dealings and the reliance on settlement after the damage is done. It ends with modest and practical reform suggestions.

Keywords: corporate governance, startups, initial public offering, SEBI, independent directors, promoter classification, related party transactions, India

I. Introduction

For a long time, the Indian stock market was home to old business houses and family controlled firms. That changed in 2021 and the years that followed, when several well known startups listed on the exchanges. Paytm, whose parent company is One97 Communications Ltd, went public in November 2021 at an issue price of ₹2,150 per share, and its shares later fell far below that level.[1] The excitement around these listings was matched by a sharper question. Once a startup is owned by thousands of public investors, who watches the founders?

Corporate governance is the set of rules and practices by which a company is directed and held accountable. In a private startup, a small group of founders and venture investors usually make decisions through shareholder agreements and informal trust. After an IPO, that arrangement meets a new reality. Retail investors, mutual funds and foreign investors expect transparent boards, honest disclosure and fair treatment. The founders, however, often remain powerful, and the company may still be growing fast with weak internal controls.

This article asks three questions. First, what legal framework governs a newly listed startup in India? Second, where has that framework failed or been tested in recent listings? Third, what can be done to close the gaps? The method is doctrinal. It relies on statutes, regulations, committee reports, judicial decisions and published regulatory orders, together with reliable news reports where official texts are not easily accessible. The discussion is limited to the Indian context and focuses on listed companies that began as startups or grew in a startup style.

II. Why Startups Face Special Governance Risks

A startup that lists is not the same as a mature blue chip company. Three features explain the difference.

The first is founder dominance. Founders usually built the business and carry its vision, so boards often defer to them. This is useful when the founder is honest and capable, but it becomes dangerous when the board stops asking hard questions. The second is the presence of private equity and venture investors who negotiated special rights, such as board nomination rights, veto powers and information rights, in private rounds. Some of these rights do not fit comfortably with the principle of equal treatment of all shareholders once the company is listed. The third is the nature of the business.

[1] *Paytm Shares Sink 9% on Reports of Sebi's Show Cause Notice to Vijay Sharma*, Bus. Standard (Aug. 26, 2024), https://www.business-standard.com/amp/markets/news/paytm-shares-plunge-9-on-reports-of-sebi-s-show-cause-notice-to-founder-124082600393_1.html.

Many startups are loss making at the time of listing. Indian law permits such companies to go public through the book building route if a large part of the issue is allotted to qualified institutional buyers, so the market relies heavily on institutional judgment.[2]

Indian governance reform has a long history, and it was often driven by scandals. The Kumar Mangalam Birla Committee in 2000 recommended the framework that became Clause 49 of the listing agreement.[3] The Satyam fraud in 2009 shook confidence again and led to a stronger role for independent directors and audit committees in the Companies Act, 2013. More recently, the Kotak Committee on Corporate Governance in 2017 recommended stricter rules on board independence, related party dealings and the separation of the roles of chairperson and managing director.[4] Some of those proposals were later softened, which shows how difficult it is to push through firm change. None of these reforms was designed specifically for startups, yet startups now test them the most.

III. The Legal Framework for Listed Startups

A. The Companies Act, 2013

The Companies Act, 2013 is the base of Indian company law. Section 166 sets out the duties of directors, including the duty to act in good faith and in the interest of the company and its shareholders. Section 149 deals with the board and the independence of directors, and section 149(12) limits the liability of independent directors to acts or omissions that occurred with their knowledge, attributable through board processes, or with their consent or connivance, or where they did not act diligently. Sections 177 and 178 require listed companies to constitute an audit committee and a nomination and remuneration committee. Section 188 regulates related party transactions, and section 447 punishes fraud. Section 143(12) requires auditors to report suspected fraud.[5]

B. The SEBI Listing Regulations

For listed companies, the most important instrument is the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, commonly called the LODR Regulations. Regulation 4 states the core principles, including the equitable treatment of shareholders and the responsibility of the board to monitor conflicts of interest. Regulation 17 deals with board composition, regulation 18 with the audit committee, regulation 19 with the nomination and remuneration committee and regulation 23 with related party transactions.[6]

A recent addition is regulation 31B, introduced by the 2023 amendment. It requires that any special right granted to a shareholder of a listed entity be approved by a special resolution of the shareholders once every five years.[7] This matters for startups because their private shareholder agreements often contain exactly such rights.

C. The Issue of Capital Regulations and the SEBI Act

The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 govern the offer document and the conditions for going public. These rules define who counts as a promoter and require the issuer to make full and true disclosure.[8] The Securities and Exchange Board of India Act, 1992 gives SEBI the power to investigate, issue directions and impose penalties, and the Prohibition of Fraudulent and Unfair Trade Practices

[2]Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, reg. 6(2) (India).

[3]Sec. & Exch. Bd. of India, Report of the Kumar Mangalam Birla Committee on Corporate Governance (2000) (India).

[4]Sec. & Exch. Bd. of India, Report of the Committee on Corporate Governance (Oct. 5, 2017) (India) (Kotak Committee).

[5]Companies Act, 2013, No. 18, Acts of Parliament, 2013, §§ 143(12), 149, 166, 177, 178, 188, 447 (India).

[6]Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, regs. 4, 17, 18, 19, 23 (India).

[7]Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Second Amendment) Regulations, 2023, SEBI/LAD-NRO/GN/2023/131 (India) (inserting reg. 31B); *see Key Amendments to SEBI LODR Regulations*, AZB & Partners (Oct. 3, 2023), https://www.azbpartners.com/bank/key-amendments-to-sebi-lodr-regulations/.

[8]Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 (India).

Regulations, 2003 prohibit manipulative and deceptive conduct.[9] Rules on employee stock options are found in the Share Based Employee Benefits and Sweat Equity Regulations, 2021, which restrict promoters from receiving such options.[10]

D. Judicial Guidance

Indian courts have not decided many cases specifically about listed startups, but older decisions still shape the approach. In *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.*, the Supreme Court explained that oppression and mismanagement require conduct that is burdensome, harsh and wrongful, and that courts look at the real substance of boardroom behavior.[11] In *Tata Consultancy Services Ltd. v. Cyrus Investments Pvt. Ltd.*, the Supreme Court stressed that the articles of association are the binding terms among shareholders and the company, and that the court should be careful before interfering with commercial decisions of the board.[12] This restraint is important. It means that legal remedies after the fact are limited, and that governance depends mostly on rules applied in advance and on active regulators.

On the standard of proof before the regulator, the Supreme Court in *SEBI v. Kishore R. Ajmera* held that securities fraud can be established on the preponderance of probabilities and does not need proof beyond reasonable doubt.[13] In *SEBI v. Sahara India Real Estate Corp. Ltd.*, the Court confirmed the strong investor protection purpose of securities law.[14] Together these cases give SEBI room to act, though they also remind the regulator to respect fair procedure.

IV. Case Studies from Recent Listings

A. Paytm (One97 Communications Ltd)

The Paytm matter is the most visible example of governance questions arising after a startup IPO. It has two connected parts.

The first part concerns the associate entity Paytm Payments Bank. On 31 January 2024, the Reserve Bank of India acted under section 35A of the Banking Regulation Act, 1949 and barred the bank from accepting fresh deposits and top ups after a set date, citing persistent non compliance and continued material supervisory concerns.[15] The listed parent saw its share price fall by more than forty percent soon after.[16] Later, the parent and the bank discontinued various inter company agreements, and Vijay Shekhar Sharma stepped down as non executive chairman of the bank.[17] The episode showed how a listed company can be exposed to regulatory risk through an associate whose governance is closely tied to the founder.

The second part concerns SEBI proceedings. SEBI issued a show cause notice in February 2024 about the eligibility of the founder to receive employee stock options. The allegation was that Mr. Sharma had been described as a promoter in earlier annual returns, but was shown as a non promoter public shareholder in the offer documents, which allowed him

[9]Securities and Exchange Board of India Act, 1992, No. 15, Acts of Parliament, 1992, §§ 11, 11B, 15HA (India); Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 (India).

[10]Securities and Exchange Board of India (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 (India).

[11]Needle Indus. (India) Ltd. v. Needle Indus. Newey (India) Holding Ltd., (1981) 3 SCC 333 (India).

[12]Tata Consultancy Servs. Ltd. v. Cyrus Invs. Pvt. Ltd., (2021) 9 SCC 449 (India).

[13]Sec. & Exch. Bd. of India v. Kishore R. Ajmera, (2016) 6 SCC 368 (India).

[14]Sec. & Exch. Bd. of India v. Sahara India Real Estate Corp. Ltd., (2013) 1 SCC 1 (India).

[15]*Paytm Will Continue to Work Beyond Feb 29: Vijay Shekhar Sharma After RBI's Order*, Inc42 (2024), https://inc42.com/?p=440826 (reporting the RBI action of Jan. 31, 2024 under Banking Regulation Act, 1949, No. 10, Acts of Parliament, 1949, § 35A (India)).

[16]*Sufficient Time Given to Non Complying Entities: RBI Governor over Clampdown on Paytm*, Deccan Herald (2024), https://www.deccanherald.com/amp/story/business%2Fsufficient-time-given-to-non-complying-entities-rbi-governor-over-clampdown-on-paytm-2885922.

[17]*Paytm Nixes Inter Company Pacts with PPBL*, Money9 (Mar. 2024), https://money9.com/news/exclusive/paytm-nixes-inter-company-pacts-with-ppbl-130557.html.

to receive options that a promoter cannot receive.[18] Separate notices were reported to have been served on former directors who were part of the IPO.[19] SEBI further alleged that independent directors on the nomination and remuneration committee did not act with an impartial and independent approach when decisions benefiting the managing director and his relatives were taken, in breach of regulation 4(2) of the LODR Regulations.[20]

These matters ended through settlement. The company and the founder settled without admitting or denying the findings. Mr. Sharma agreed not to accept fresh options from any listed company for three years, and the options granted to him and his brother were cancelled.[21] Several former directors and a former compliance officer also settled by paying amounts to SEBI.[22] These are allegations resolved by settlement, and no final finding of wrongdoing was made. Even so, the episode raises real governance questions about how a founder is classified, how pay is approved and how independent the committee members really were.

B. Gensol Engineering Ltd

Gensol is not a typical venture funded unicorn, but it is a young and fast growing clean energy and electric vehicle leasing company, and its story is a clear warning about governance in growth stories. In an interim order dated 15 April 2025, SEBI found prima facie that the promoter directors had diverted company funds in a fraudulent manner, and it barred the company and the two promoters from the securities market and from holding director or key managerial positions.[23] SEBI observed that loans meant for buying electric vehicles were routed to related parties and used for unconnected expenses, and that the company submitted forged conduct letters said to be issued by its lenders.[24] The order described a culture of weak internal control. Reports also noted that the number of shareholders rose from 155 in FY20 to about 110,000 by March 2025, while promoter holding fell from 70.72 percent to 35 percent.[25] The matter began after a complaint in June 2024 and became public only after credit rating downgrades. This shows that early warning systems inside the company did not work, and that the audit committee, auditors and lenders did not raise the alarm in time.

Gensol is at an interim stage, and the findings are prima facie. The point here is not to declare guilt, but to illustrate the risk where a small group controls a rapidly growing listed company.

V. Governance Gaps Identified

The two matters, together with the wider legal framework, point to five recurring gaps.

1. Independence of directors is often formal rather than real. The law requires independent directors and committees, but the Paytm allegations concern the very committee that decides executive pay. A director can meet every technical test of independence and still defer to a powerful founder. The Companies Act protects independent directors who act

[18] *Paytm Owner, CEO Vijay Shekhar Sharma, Brother Settle ESOP Case with Sebi*, PTI, The Week (May 8, 2025), https://www.theweek.in/wire-updates/business/2025/05/08/dcm78-biz-sebi-paytm.html.

[19] Business Standard, *supra* note 1.

[20] *Paytm's 7 Ex-Directors, Compliance Officer Pay Over Rs 3.74 Crore to Settle Case with SEBI*, Moneylife (2025), https://moneylife.in/article/paytms-7-exdirectors-compliance-officer-pay-over-rs374-crore-to-settle-case-with-sebi/76132.html; Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, reg. 4(2) (India).

[21] *Paytm's Vijay Shekhar Sharma Barred from Receiving ESOPs for 3 Years in SEBI Settlement Order*, Moneylife (2025), https://moneylife.in/article/paytms-vijay-shekhar-sharma-barred-from-receiving-esops-for-3-years-in-sebi-settlement-order/77082.html.

[22] *Paytm Top Officials Pay Rs 3.32 Crore to Settle SEBI Norms Violations*, Bus. Today (Jan. 17, 2025), https://businesstoday.in/latest/corporate/story/paytm-top-officials-pay-rs-332-crore-to-settle-sebi-norms-violations-461257-2025-01-17.

[23] Interim Order in the Matter of Gensol Engineering Ltd. (SEBI Apr. 15, 2025), https://www.sebi.gov.in/enforcement/orders/apr-2025/interim-order-in-the-matter-of-gensol-engineering-limited_93458.html; *Gensol Eng Tanks 5 Pc, Hits Lower Circuit Limit as Sebi Bans Firm, Promoters from Securities Market*, PTI, The Week (Apr. 16, 2025), https://www.theweek.in/wire-updates/business/2025/04/16/dcm42-biz-stocks-gensol.html.

[24] *Gensol Promoters Used Firm Like Personal Piggy Bank: Sebi Order*, PTI, The Week (Apr. 16, 2025), https://www.theweek.in/wire-updates/business/2025/04/16/dcm46-biz-sebi-gensol.html.

[25] *Sebi Bars Gensol Engineering Promoters for Alleged Fund Diversion*, Bus. Standard (Apr. 15, 2025), https://business-standard.com/markets/news/sebi-bars-gensol-engineering-promoters-for-alleged-fund-diversion-125041501266_1.html.

diligently, but it gives little guidance on what diligence means in practice for a technology business with complex group structures.[26]

2. The founder and promoter line is unclear. Under the issue regulations, promoter status brings restrictions such as the bar on stock options. Founders of startups often hold small stakes after several funding rounds and may prefer to be called professionals. When a founder who controls decisions is not formally a promoter, the rules built around promoters lose their force. The Paytm matter shows how this classification can decide who gets stock options and what the offer document says.[27]

3. Special rights and control survive the listing. Shareholder agreements from the private stage can give investors or founders influence beyond their shareholding. Regulation 31B is a good step, but it gives a long period, up to five years from its commencement for existing rights, before shareholders must approve them.[28] During that time, rights that sit awkwardly with equal treatment of shareholders may continue.

4. Related party dealings and group structures are hard to monitor. The Paytm Payments Bank example shows how dependence between a listed company and an associate can become a source of risk. The Gensol order shows an even more serious version, where funds moved to related parties. Section 188 of the Companies Act and regulation 23 of the LODR Regulations require approval and disclosure, but they work well only when the audit committee examines the substance of a transaction and not just its paperwork.[29]

5. Enforcement is slow and often ends in settlement. In both matters, regulators acted after the share price had already fallen. Settlement is useful because it saves time and secures compliance, but it can also leave the market without a reasoned judgment that future boards could learn from. As the *Kishore Ajmera* decision allows a relatively flexible standard of proof, SEBI has the legal means to act more firmly and publish clear reasons.[30]

There is also an important caution. Corporate governance cannot be reduced to compliance alone. Startups benefit from founder vision, and excessive rigidity could harm innovation. The aim of reform should be balance and not suspicion toward every founder.

VI. Suggestions for Reform

Based on this discussion, the following measures may help. They are modest and are meant to work within the existing structure.

First, SEBI could issue clearer guidance on promoter classification for founder led companies, so that the status of a founder is decided by actual control and not by labels. This would also reduce disputes about stock options and disclosure at the time of the offer document.

Second, committees that decide the pay and conditions of founders should be required to record their reasoning in detail, including the benchmarks used and the dissent, if any. This would make it easier to test whether independent directors acted independently. Training programs for independent directors in startup specific risks, such as complex group structures, would also help.

Third, the period for ratifying existing special rights under regulation 31B could be shortened for companies that list through the startup route, so that equal treatment of shareholders is reached sooner.

Fourth, audit committees should be asked to give a short yearly statement on related party and group company exposure, including associates that are regulated by other authorities. Better coordination between SEBI and sectoral regulators such as the RBI would help, because the Paytm episode began with a banking regulator and not the securities regulator.

[26]Companies Act, 2013, § 149(12) (India).

[27]*See supra* note 18.

[28]Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Second Amendment) Regulations, 2023, reg. 31B (India); *see supra* note 7.

[29]Companies Act, 2013, § 188 (India); Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, reg. 23 (India).

[30]*See supra* note 13.

Fifth, settlement orders in significant governance cases could carry a short public summary of the issues involved, even where there is no admission, so that other boards can learn from them.

VII. Conclusion

India has built a detailed legal framework for listed company governance, drawn from the Companies Act, 2013, the LODR Regulations, the issue of capital rules and the decisions of the Supreme Court. The recent listings of startups, however, show that rules alone do not guarantee good governance. The Paytm matter raised questions about founder classification, committee independence and group exposure, while the Gensol matter shows how weak internal control can allow serious misuse of funds in a fast growing company. Both matters were reached only after the market had suffered losses.

The lesson is that governance has to be built into the company before the IPO and not added afterwards. Founders, boards, investors and regulators each have a part to play. Clearer promoter rules, more demanding committee processes, faster removal of legacy special rights and better regulatory coordination can help make the Indian startup story one of trust as well as growth. Since both matters discussed here are either settled without admission or at an early stage, this article draws no final conclusion about individual conduct. Its purpose is to point to structural gaps and to encourage further research as more cases reach a final decision.

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