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Legal Issues Related to the Investment of Capital for Startup Company in Vietnam

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Abstract: For start-up enterprises, the issue of raising capital from investors in the early stages is very important and necessary. However, after the Startup has been put into operation and business, the issue of sharing interests between investors and founders of startups faces many obstacles and legal issues can lead to disputes and conflicts such as: legal status of parties, ownership and management, disbursement progress, anti-dilution of investment, divestment priority order, valuation from time to time, commitment to founding members, gender Investors' rights, access to information, intellectual property, information security, etc. In this paper, the authors will not only analyze legal issues related to startups and investors but also analyze some practical case-study. After analyzing the current legal limitations and shortcomings, the authors will propose solutions to further improve the legal framework for this issue.

Key words: legal issues; investment; capital; startup enterprise; Vietnam
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1. General introduction

In recent years, Startup is becoming a trend for youth not only in Vietnam but also around the World when somebody begins a new business or establish a company. Being the Founder and CEO of a startup is one of the most challenging roles out there. Your job is to build a product customers love; recruit a team; find funding from customers, partners, or investors; and guide the overall prioritization of work. You're also in charge of incorporating, finding a place to work, creating the foundations of your culture, hiring your first employees, setting up a bank account, creating a web site, finding early stage funding, and taking out the trash. You're basically the Chief Everything Officer at this early stage. For start-ups, the issue of raising capital from investors in the early stages is very important and necessary. However, after the business has been put into operation and business, the issue of sharing interests between investors and founders of startups faces many obstacles and legal issues can lead to disputes and conflicts such as: legal status of parties, ownership and management, disbursement progress, anti-dilution of investment, divestment priority order, valuation from time to time, commitment to founding members, gender Investors' rights, access to information, intellectual property, information security, etc. Therefore, the Government must have the regulations to govern this problem. In Vietnam, besides law on enterprise, law on investment, National Assembly has been enacted some new law to govern the investment

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activities of investors for startup company (Law on Supporting Small and Medium-sized Enterprises 2017 and Decrees guiding implementation). In this paper, the authors will analyze legal issues related to startups and investors, analyze some practical case-study. After analyzing the current legal limitations and shortcomings, then the authors will propose solutions to further improve the legal framework for these issues.

2. Literature Review

2.1 Understanding About Start-up Company

The Clause 2, Article 3 of the Law on Supporting Small and Medium-sized Enterprises 2017 has a definition about Startup Enterprises as following:

> "Small and medium-sized innovative-startup enterprises are small and medium-sized enterprises established to implement ideas on the basis of exploitation of intellectual property, technology, new business model and ability to grow fast."

Thus, startups are newly established businesses with small scale to implement new business models and ideas, usually to exploit intellectual property, new inventions in technology. These are usually potential businesses and are capable of growing fast and strong in a very short time.

According to author Bill Aulet in The Disciplines Entrepreneurship book, startup entrepreneurs are the ones who create a new, unprecedented business. Currently, there are two types of start-up businesses in the world:

First type, starting small and medium enterprises (SME — Small and Medium Enterprises). This type of business is usually founded by a founder to serve the local market and will become a small and medium-sized enterprise operating within that locality. Businesses are organized in a small, closely related group, possibly a family business, where close control of the business is important. Basically, this type of business does not need to call for much capital. When capital is invested in these SMEs, the result is an immediate increase in revenue and creation of more jobs. This SME is usually a service or retail business of other company's products. The key factor that distinguishes other types of startup businesses is their focus on the local markets.

Second type, launching a breakthrough invention enterprise (IDE — Innovation Driven Enterprises). This type of business is more risky and also more ambitious. IDE entrepreneurs aspire to go beyond local markets to global markets or at least in the region. These entrepreneurs often work in teams to build businesses based on new technologies, processes, business models, or innovations that give them a significant competitive advantage over existing companies more interested in creating wealth and value than controlling the company and often sell the company stock to pursue its ambitious development plan. This IDE business initially grows more slowly than SME but will achieve exponential growth when it has attracted customers (in the case of Facebook, Google, Apple or Uber). To achieve their ambitions, these companies must grow rapidly to serve the global market.

2.2 Investor

Investors for small and medium-sized innovative start-ups include innovative start-up investment funds, domestic and foreign organizations and individuals that conduct business activities through capital contribution to establishment and stock purchase, the stakes of small and medium-sized startups.

According to Article 2 of Decree 38/2018/ND-CP:

- Investing in small and medium-sized innovative start-ups (hereinafter referred to as innovative start-up investments) is an investment by an investor in order to carry out business activities through the establishment of capital contribution, buying shares and capital contributions of small and medium-sized innovative start-ups is not yet a public company.

- Creative start-up investment fund is a fund formed from capital contributed by private investors to make creative startup investments.

- Capital contributed by a fund is the total value of assets contributed by investors to an innovative start-up investment fund.

- The company performing the management of an innovative start-up fund is a company established under the law on enterprises, having creative startup fund management industries.

Regarding the Fund for creative start-up investment, the Decree stated that: The start-up investment fund has no legal status, as a maximum of 30 investors contribute capital on the basis of the fund's charter. Creative start-up investment funds may not contribute capital to other creative startup funds.

Contributed assets may be in Vietnam Dong, gold, land use right value and other assets which can be valued in Vietnam Dong. Investors must not use loan capital to contribute capital to establish an innovative start-up investment fund.

In addition to investment funds, individual investors can invest in startups. In the world, these individual investors are often called Angel Investors. Angel investors are understood as individual investors who make initial investments for startup businesses. Besides venture capital funds, angel investor play an important role in the development of startups today.

2.3 Relation Between Investors and Founders of Startup Company

Investing in small and medium-sized innovative start-ups (hereinafter referred to as innovative start-up investments) is an investment in which an investor invests in business activities through capital contribution to establish and purchase. Shares, Stakes of small and medium-sized innovative start-ups are not public companies.

Under the provisions of Decree 38/2018/ND-CP, investors can conduct investment activities in startups through the following forms:

- Contributing capital to establish, buy shares, capital contributions of small and medium-sized start-up businesses;

- Establishing and contributing capital to the creative start-up investment fund to make investments.

Normally, when investors make investments in startups, they will require the investor to accept the investor as a capital contributor/shareholder of the enterprise with the capital contribution initially accounted for about 10% of the charter capital of the business. Depending on the agreement between the founders of Startup and Investors, how much is this capital contribution and how it changes after the company comes into operation, grows and calls for new investment capital from other investors. Normally, in a capital contribution contract, the investor usually requires a provision on anti-dilution to preserve the percentage of ownership of his/her stake in the startup when the startup receives more contributed capital from new investors when developing and expanding in the future.

3. Results and Discussion

3.1 Some Issues Related to the Relationship Between Start-up and Investors

The failure of The KAfe and Dao Chi Anh after raising $ 5 million from investors is a typical financial lesson for start-ups when raising capital. This failure stems from many causes. The first reason can be mentioned is the inappropriate investor selection. There are investors called Sharks, whose acquisition targets are not their companions. They came to take over and with the goal of making a short-term profit from controlling the company and selling the company, not towards long-term investment. Many financial investors aim for this goal. Therefore, the priority order of investor selection should be the same industry Partner or Investment Fund of the same industry or the Financial Investment Fund. Currently, in fact, there are Vietnamese businesses that receive investments in the amount of millions of dollars, but also receive new products from partners, new technologies from partners, administrative support from partners to develop the Vietnamese market. That will be the goal towards. Meanwhile, the nature of the financial investment fund is that they will have a term of investment and pressure to divest from the fund's shareholders, so the time these funds invest in Startup will be much shorter. Second, many startups are inexperienced, or are not careful in negotiating terms of investment, causing disputes over ownership and startup management. This is the key point in The KAfe' s failed deal. Receiving investment money will be accompanied by a series of conditions of investors, especially they will make a request for full financial control. Meanwhile, Founders are often not very good at this. Investors will impose acquisition targets, and if Founders do not meet the targets, they will increase the ownership and acquisition of the company. Start-ups do not usually build their active financial strategies from the beginning, so when they are lack of capital, they will blindly accept every investor’s request. In addition, they will often forget to negotiate an Incentive package (income, including salaries and bonuses) for the Founders. Incentive packages are normal in every deal, but investors often deliberately ignore this issue, and start-ups do not know to ask for negotiations. Third, as a startup, this enterprise often lack or have not built a standard corporate governance mechanism. Even many founders of start-ups still do not understand what and how to govern a corporate. An unstable corporate governance mechanism will cause conflicts between the executive and the investor, especially pure financial investors. When conflicts occur, unclear mechanisms make the conflict worse. And like The KAfe, founder Dao Chi Anh had to leave the company shortly after receiving the capital, causing the company to collapse. The fourth reason is that the Startups Founders did not develop a viable business plan after raising capital. Incomplete or unreasonable business plans, even without a well-planned, detailed and feasible business development plan of the company, are very serious problems for start-up businesses. Especially, for startups, there is only one Founder. When alone, the founder of Startup can do anything he wants. But when there are more founders, they need to guarantee the interests of all. At that time, a detailed and feasible business plan from which the parties will base on which to implement and will help meet the benefits, or at least use that as the basis of “co-suffering and suffering”. On the contrary, if there is no reasonable business plan and corporate governance, it is easy to contradict Founders and Investors. In addition, Founders need to understand the nature and purpose of investors pouring capital into a serious working attitude, constantly learning and perfecting products, developing the company, not considering it as a source. ODA funding is not refundable because when Investors feel their interests are affected, and they will take action. At this time, bad governance mechanism will lead to ends for the parties. In addition, the lack of ability to carry out business plans is also one of the causes of startup failures. Many Founders after receiving capital need to be properly aware of the ability and reality of the business to have business plans and operate it effectively every day. The company must be streamlined and designed. It is these initial effects that will help startups build their brands. Besides, the lack of financial management and good cash flow are also a cause of Startup's failure. For example, tax issues: Previously selling F&B, all retail customers should declare low. Now, you must declare enough revenue, tax expenses soared. Founders see how much money they spend, they don’t see much benefit, only large scale, much work and low efficiency. Cash flows ran wild, not knowing how to manageat this time, the interests of investors will be affected leading to conflicts. Therefore, a startup needs a good financial strategy and an effective financial strategy. “Master yourself, master the enemy”. Startups must know the legality of the assets they are prepared to own, how much they are owned, how much they hold, the rules stored in the shareholder register or legal documents, licenses and rules. Startup must regulate and understand its internal, this is the best way to protect before participating in the game with investors. One of the fastest ways to develop resources is to receive investment capital from organizations and individuals. The founders should be clear from the beginning about the terms of cooperation, modes of cooperation. That way, it can solve the problems that arise in the business process or when the company grows in the future. Currently, there are many founders who do business without establishing businesses, especially in the field of technology, until investors pour capital to pay attention to forming legal entities. From a legal perspective, simple agreements in the form of civil agreements between founders can easily lead to subsequent disputes. Disputes between the founder and the investor usually appear when the project has stabilized, bringing high revenue, because the parties did not control the problem in the first place. To avoid this situation, founding members need to have clear shareholder agreements or membership agreements right after establishing a business and incorporation into the company’s charter. In addition, tax obligations are based on three principles: accurate, complete and timely. Receiving large amounts of investment capital but failing to comply with the process of declaration, reporting and paying taxes may put the startup at unnecessary risks, causing damage and being handled by state agencies. Concerning intellectual property rights, unique and different ideas about products and services need to be registered for intellectual property protection right at the start of the project or right after its establishment enterprise. Regarding the roadmap for receiving investment capital, it is necessary to plan and negotiate from the beginning, clearly stipulating the rights and obligations of investors and founding members of Startup. It is also important to know your investors to know that the investment is legal, to avoid becoming money laundering for illegal financial sources. Current Vietnamese startup projects are usually smaller in scale than the region and the world. They generally approve the funding mechanisms proposed by investors. In case the startup is only a group of individuals or individuals (not establishing an enterprise), the investment is made according to the capital contribution and benefit distribution mechanism in accordance with the Civil Code. If following the mechanism of enterprise formation, the investor will buy the capital contribution or shares under the Enterprise Law, if the investment capital from abroad is according to the mechanism of the Investment Law. To prevent risks, the general principle is that what is unknown should hire a consultant. The experts here are not necessarily lawyers but can be capital strategic advisors who have experience. Advisors, lawyers, experts are all good sources of support, helping startups achieve sustainable development and establish a fairer game with investors.

3.2 Method of Crowd-funding

Crowd-funding is a term that is no stranger to the international startup community. To put it simply, crowd-funding is a form of crowd-funding, in particular online community contributing capital to realize an idea or a new product. To encourage donations, the project owner gives souvenirs or favors when buying products. The pledge is actually considered to be a pre-order product. Because of the prior purchase and the risk of not receiving the product, the purchase price is usually 30%-50% lower than the market price.

The first benefit when calling community capital to mention for businesses is capital. This is the reason why this form attracts so many start-up projects, especially those companies that do not have enough access to diverse capital sources, business experience or ability to raise capital from investors or banks. With crowd-funding, callers only need to convince the network community to open their wallets. Gradually, the number of supporters increased, the business earned an unexpectedly large amount of money, enough to develop and produce the product they promised.

The second advantage of crowd-funding is the market survey. Start-up product ideas are often ones that have never appeared on the market or have unique features. So how to know this product, the other feature will be welcomed by the market? It is very costly and wasteful to invest a large amount of money to develop products without being sure that the market will accept them or not. With crowd-funding, the results and market reaction are the most accurate base of product potential. Consumers may incorrectly answer market surveys, but when they can boldly spend money to buy an unreleased product, that product must be appealing to a certain extent and ensure guarantee the success level when it's born. In addition to the advantages, the form of public funding also faces obstacles and risks such as: there is no guarantee that after calling for capital, the project owner will release the product and bring it to the community as promised. The form of crowd-funding so far remains spontaneous, the state has not had any form of management or control for businesses and projects calling for capital in this form. So far, the United States is the place to call for the most thriving community capital due to open-mindedness, high levels of risk-taking, and the liking for new ideas network companion.

In Vietnam, a company can fully participate in raising capital equally as other companies in the world due to the openness of the world community calling network (such as Indie Go Go, Kick Starter). New products, not only in the field of technology, but also in the fields of arts, handicrafts, even agricultural products, food ... can access not only domestic community capital. But it is also possible to apply a more generous way of calling investment to consumers around the world for their appearance.

3.3 Vietnam Laws and Regulations Regarding the Investors' Capital Contribution to Startup Enterprises

Start-up businesses in addition to complying with the provisions of the law on investment, law on enterprises, they will enjoy more incentives and advantages as well as support from the state and society in accordance with the Law on Support small and medium enterprise 2017 and its guiding documents. Decree 38/2018/ND-CP of the Government guiding the implementation of the Law on Supporting Small and Medium Enterprises has specified the investment and support model for current start-ups, initially forming and completing the legal framework for startups' operating model as well as the relationship between the founders of Startup and investors, limiting risks for investors as well as protecting rights and Benefits of the founders of Startup. Accordingly, the Creative Start-up Fund is formed from the capital contributed by private investors to invest in small and medium-sized start-up businesses according to the following principles:

- Investing in small and medium-sized innovative start-ups not exceeding 50% of the charter capital of the enterprise after receiving the investment;

- Private investors who contribute capital to the fund must have financial conditions and take responsibility for their contributed capital.

Investors of small and medium-sized start-up businesses are exempted from, or limited to, corporate income tax for a limited period of time for incomes from investments in small and medium-sized start-up businesses under the provisions of law on Corporates income tax. Based on local budget conditions, provincial-level People's Committees shall propose People's Councils of the same level to decide on assignment of local state financial institutions to invest in innovative small and medium-sized enterprises. Guidelines as following:

a) To select creative start-up investment funds eligible to jointly invest in small and medium-sized start-up businesses;

b) The investment capital from the local budget must not exceed 30% of the total investment capital mobilized by creative start-ups from the selected creative startup investment funds;

c) Transferring the investment capital to the private investor within 5 years from the time of capital contribution. The transfer of investment capital complies with the law on management and use of state capital invested in production and business activities in enterprises.

Decree 38/2018/ND-CP provides quite detailed instructions on the operation and operation of funds. The portfolio and investment activities of the innovative start-up investment fund include: Depositing at commercial banks according to the provisions of law; invest no more than 50% of the charter capital of small and medium-sized businesses starting their businesses after receiving the investment. All contributed capital and assets of investors at the fund must be accounted separately from the fund management company; Investors contributing capital to establish a fund shall reach agreement on their competence to decide on investment portfolios and this content must be provided for in the fund charter and contracts with the fund management company (if any).

The creative start-up fund is organized and managed by one of the following models: The General Meeting of Investors, the company that manages the creative startup investment fund; General Meeting of Investors, Board of Fund Representatives or Director of Funds, companies that manage creative startup investment funds; General Meeting of Investors, Board of Fund Representatives and Director of the Fund, the company implements the management of an innovative start-up fund. Investors of the fund may establish or hire companies to manage creative startup funds. The fund management company shall carry out procedures for establishment of a fund and notify the supplementation of lines of management of an innovative start-up investment fund in accordance with the law on enterprise registration when performing management investment fund creative startup.

The management of creative start-up fund as stipulated in this Decree shall comply with the fund’s charter, contracts signed with the fund (if any) and not governed by the securities law. The transfer of shares of founding shareholders at the company that manages the creative startup investment fund shall comply with the Law on Enterprises.

The increase or decrease of contributed capital of an innovative start-up investment fund complies with the following provisions: the charter of the fund stipulates the increase or decrease of the contributed capital of the fund; the increase and decrease of the fund’s capital contribution were approved by the Fund’s General Meeting.

The fund liquidation and dissolution is conducted in the following cases: the operation duration stated in the fund charter has expired; The general meeting of investors decides to dissolve the fund before the expiry of the operation term stated in the fund charter; the fund management company is dissolved, bankrupted, or its certificate of enterprise registration is revoked but the fund management board fails to establish a fund management company within 2 months from the date of arising event.

The mechanism of using local budgets to invest in small and medium-sized innovative start-ups is prescribed as follows:

Based on local budget conditions, provincial-level People's Committees shall propose People’s Councils of the same level to assign local state financial institutions with financial investment function to make investment in small enterprises and just started his creative career.

In cases where local state financial institutions organize and operate under the model of off-budget state financial fund, the assignment of tasks and support of charter capital to off-budget state financial funds must meet specified in Clause 11, Article 8 of the State Budget Law. In cases where local state financial institutions organize and operate according to the enterprise model, the addition of charter capital must comply with the provisions of

Articles 4, 13, 14 and 15 of the Law on Management and using state capital to invest in production and business in enterprises. Principles of innovative start-up investment by local state financial institutions comply with Clause 4, Article 18 of the Law on Support for Small and Medium Enterprises; Local state financial institutions exercise the rights and responsibilities of the owner representative when investing in innovative start-up small and medium enterprises.

Information about innovative start-up activities funded by local budgets must be publicized on the web portal of the People's Committee of the province where the application is made. Local government of financial institutions select creative start-up investment funds with the following minimum investment requirements: Commitment with local state financial institutions to invest in small businesses and have just started a creative business; at least 1 year of experience in investing in startup activities; be able to cover expenses when participating in making investment; Other conditions (if any).

Every year, local state of financial institutions assesses, adjust and publish the list of selected innovative investment funds on the websites portal of the local state financial institutions and of the provincial People’s Committee.

4. Conclusion and Recommendation

Starting a business is a new trend of the era all over the world, suitable for many subjects, especially young people. As a start-up business, capital is always needed from investors. Therefore, building a legal framework to regulate the relationship between investors and startups is essential in the current period. In general, the current Vietnamese legal system on investment and business is quite complete, just need additional separate regulations to guide investors in more detail when investing capital in startup businesses.

For a start-up business, before deciding to receive investment capital from investors need to conduct careful investor evaluation. Investigation needs to be done very carefully in terms of financial capacity, prestige ... including civil investigations about investors, representatives and showing the investors’ commitments in writing. When signing an investment cooperation agreement, there must be clear and detailed provisions on investment cooperation on each contractual term when negotiating. In the investment agreement, it is necessary to specify the limit of ownership, management of investors and founding members of Startup. In which it is necessary to anticipate ownership and administration after receiving capital for each stage of development, establishing intellectual property rights for intellectual property assets formed in the early stages of the Startup business. These agreements are signed in writing before receiving the capital and clearly agreeing on this property right after receiving capital. Startup also needs to be careful in publishing information. Widely disclosing information to the media to avoid problems with taxes, competitors, creditors ... In the investment cooperation agreement, it is also necessary to specify the costs, a clear agreement on the amount of capital received, that is the amount of capital the founders receive or the capital for doing business; expenses such as taxes, brokerage fees, attorneys ... party to bear or deduct from the investment. The parties need to know clearly the regulations on corporate finance, the transfer of money into and out of the account, paying taxes, the capital of the investors ... should comply with the provisions of law.

In addition, the parties also need to have regulations on divestment of investors from Startup enterprises. The parties should agree on a divestment right at the negotiation stage, the case unilaterally terminate the contract. The parties should have clear rules about their obligations if there is a risk of divestment. To avoid risks or disputes, the parties need to agree on agreement from the stage of negotiation until conflict or divestment, including the termination of investment and the termination of cooperation to protect the prestige of together. In the process of investment cooperation between Investors and Start-ups need to standardize legal documents and records.

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