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DOWN ROUNDS IN INDIA

Surviving the Valuation Cut: Law, Contracts, and Commercial Reality

1. What is a 'Down Round'?

A down round is a funding event where a company raises fresh capital by issuing new shares at a price and a valuation that is lower than what investors paid in the preceding rounds. In other words, the company's valuation is lower than what earlier investors anticipated when they committed their funds.

For example: The Series A investors had initially valued the startup at INR 1000 million. However, the incoming Series B round is being raised at a reduced valuation of INR 600 million. This downward adjustment means that, atleast on paper, the Series A investors are facing a notional loss, since the company's valuation has depreciated since their entry.

Illustration: Basic Mechanics

(a) Series A: 100 shares issued at INR 10 per share
(b) Series B (down round): 50 new shares issued at INR 6 per share
(c) Series A investor: paid INR 10 per share, now effectively worth INR 6 per share

For Series A investor, ownership diluted AND price per share fallen - a double hit.

2. The Hall of Fallen Unicorns: Real Indian Cases

Down rounds are no longer exceptional in India. The 2022–2024 funding winter has grounded several marquee names. As reported, Indian startups raised approximately ~71% less capital in 2023 than at the 2021 peak, a direct casualty of rising U.S interest rates and a sudden evaporation of global VC appetite (*for more information - click here*). Notably, several high-profile Indian companies, as enumerated below, have faced down rounds in recent years, underscoring the severity of the correction:

(a) **Byju's**, once India's most valuable startup at a peak of approximately USD 22 billion saw its valuation collapse to under USD 3 billion by early 2024, as reported in press articles in late 2023 and early 2024 (*for more information, click here*). Investors including Prosus, Blackrock, and Silver Lake watched their stakes erode as the company descended into governance controversies, revenue restatements, and ultimately NCLT insolvency proceedings.

(b) **Oyo**, backed by SoftBank, Sequoia, and Lightspeed, saw its valuation compress from USD 10 billion to approximately USD 2.7 billion (*for more information, click here*). It survived by restructuring aggressively, tightening its hotel portfolio, and re-filing for an IPO at substantially reduced ambitions.

(c) **Meesho** raised a down round in 2023 at approximately USD 3.5 billion, down from its USD 4.9 billion peak (for *more information, click here).* With SoftBank, Sequoia, and Meta on the cap table, Meesho used the reset intelligently, focusing on unit economics, cutting burn, and turning EBITDA positive by 2024.

(d) **Dunzo**, backed by Reliance Retail and Google, received a down round at a significantly lower valuation following severe cash-flow stress (*for more information, click here*). Unlike Meesho and Oyo, Dunzo has not recovered with its operations being severely curtailed by late 2024, a reminder that capital without a credible path to profitability is merely deferred pain. In 2025, Dunzo was admitted into insolvency by the NCLT.

It is pertinent to note that companies backed by patient, large-balance-sheet investors such as Reliance, SoftBank, Temasek tend to survive down rounds because the lead investor stays the course. However, where the investor conviction has completely evaporated, as was the case with Byju's, a down round is merely the opening act of a longer decline.

3. The Reality Behind Down Rounds in India

Down rounds are not accidents. In India, they cluster predictably around three key triggers:

3.1 Macro and Market Conditions

- **Global funding winters:** Rising U.S interest rates from 2022 triggered a global VC pullback. Indian startups raised approximately ~71% less in 2023 than in 2021 (*for more information, click here*).
- **The exuberance correction:** The 2020 – 21 era produced exuberant valuations due to cheap availability of capital. When the cost of capital normalised, investors demanded grounded multiples, and a wave of write-downs followed.

3.2 Company-Specific Issues

- **Fraud and financial misreporting:** BharatPe's board ousted co-founder Ashneer Grover in early 2022 over allegations of financial misappropriation, as reported by CNBC TV18 in March 2022, leading to a renegotiated investor framework (*for more information, click here*). Zilingo faced a similar fate - a down round and board breakdown leading to initiation of liquidation proceedings in 2023 (*for more information, click here*). Both cases demonstrate how quickly governance failures are reflected in the next valuation.
- **Revenue shortfalls:** When a Series B company grows only at 20% against a projected 80%, new investors do not simply adjust their models, they slash the price sharply.
- **Governance breakdown:** Founder exits, board deadlocks, and ongoing litigation inevitably add a risk premium that any rational investor cannot ignore. In contrast, a company with an intact, stable and motivated founding team tends to command a significantly higher valuation than those stuck in leadership uncertainty.
- **Realistic projections and expectations:** Gauging the market demand, current market outlook, global scenarios, board plans, quantum of money chasing expected return of investment, revised investment horizon and other similar parameters, it may be relevant to reassess the current valuation of the business as a whole viewed over a period of time in order to ascribe a reasonable valuation matching the (a) current situation; and (b) current expectation of future.

3.3 Structural and Sectoral Issues

- In hyper-competitive sectors such as quick commerce, edtech and fintech, customer acquisition costs soared, switching costs were low, and unit economics failed to achieve sustainability in the post-pandemic period.
- **Regulatory shifts**: The actions of Reserve Bank of India ("**RBI**") on fintech lending and the scrutiny of Securities Exchange Board of India's ("**SEBI**") on crypto-linked business models abruptly impaired previously high-valued ventures.
- **IPO pipeline failures**: When the exit route that justified a lofty valuation disappears, as it did between 2022 and 2024, the valuation itself becomes indefensible.

4. Why founders fear and yet sometimes accept a Down Round?

A down round delivers a reputational blow for any founder. In the startup ecosystem, valuation is not merely a financial metric, it is a social currency, leveraged to attract talent, customers, and gain media attention. A visible step-down signals distress, even when the underlying business may fundamentally be sound.

Yet, the maths is often unavoidable, and dilution is preferable to dissolution**.** The strongest founders treat a down round as a reset for trimming costs, re-setting culture, and re-focusing on the core business.

Why Founders Accept Down Rounds	Why Founders Resist Down Rounds
Cash runway is critical - survive to fight another day	Anti-dilution clauses crush founder ownership
Avoids winding up or insolvency	Reputational signal to customers and employees
Preserves employee jobs and morale	ESOPs go underwater leading to an immediate talent retention crisis
Buys time to hit a profitability milestone	Heightened investor scrutiny and governance friction

5. Anti-Dilution Protection: The Shield in the Agreement

Anti-dilution provisions are the primary contractual weapon that investors deploy against down rounds. The market standard in India is the broad-based weighted average ("**BBWA**") formula. "Full ratchet" anti-dilution, which resets the conversion price to the new lower price regardless of the size of the round, is theoretically available but virtually absent in well-negotiated Indian deals.

5.1 Two Types of Anti- Dilution

(a) Full Ratchet - The Nuclear Option

The investor's conversion price resets to exactly the price of the down round, no matter how small that round is. Even a single share issued at a lower price triggers a full adjustment. The mechanism is highly punitive, effectively penalising founders for any down round, however minor.

(b) BBWA - The Market Standard

The conversion price adjusts proportionally, taking into account all shares on a fully diluted basis. A large down round produces a meaningful correction; a small down round barely moves the needle. This is fair, commercially balanced, and the near-universal Indian standard.

5.2 BBWA Formula

NCP = OCP × (OS + NM) ÷ (OS + NS)

NCP = New Conversion Price (adjusted)
OCP = Old Conversion Price (original)
OS = Old shares outstanding (fully diluted, pre-new issue)
NM = Money received in down round ÷ OCP
NS = Number of new shares issued in down round

5.3 Worked Example of BBWA Formula and Full Ratchet

Illustration: BBWA Anti-Dilution Calculation

Facts:

Series A investor paid INR 100 per share. Total shares on a fully diluted basis: 100,000. OCP = INR 100.
Down Round (Series B): Company issues 200,000 new shares at INR 60 per share.

Step 1: Money received = 200,000 × INR 60 per share = INR 12,000,000

Step 2: NM = INR 12,000,000 ÷ INR 100 (OCP) = 120,000
Step 3: NCP = INR 100 × (1,000,000 + 120,000) ÷ (1,000,000 + 200,000)
= INR 100 × 1,120,000 ÷ 1,200,000
= INR 100 × 0.9333 = INR 93.33
Result: Series A's conversion price drops from INR 100 to INR 93.33. On conversion, the investor receives more equity shares for the same CCPS held, with no additional payment.

In case of Full Ratchet, the conversion price would snap to INR 60 that would be far more punitive for the founders.

5.4 How Anti-Dilution Actually Plays Out

Scenario 1 - Adjust the CCPS Conversion Ratio (The Clean Route)

In case of foreign investors holding Compulsorily Convertible Preference Shares ("**CCPS**"), the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 ("**NDI Rules**") provide that in case of convertible instruments, the price / conversion formula should be determined upfront, at the time of issuance of the instruments. Accordingly, in case of any down round, the Shareholder Agreement ("**SHA**") should contain a flexible conversion mechanism for the investors holding CCPS, facilitating conversion of the CCPS to equity shares taking into account the current scenario.

Where the investor holds CCPS and there is any down-round event, the conversion mechanism, mentioned at the time of issuance of CCPS, should be flexible enough to accommodate variables (such as change in projections, infusions at premium or down rounds, other relevant valuation variables/components, etc.) at the time of conversion so that the investor holding CCPS receives additional equity shares upon conversion without any fresh payment but only after considering the impact of down rounds on the overall valuation of the company**.** The existing CCPS simply converts into more equity shares. There is no immediate cash outflow from the investee company.

Scenario 2 - Where No Convertible Security is Available

Where the investor holds equity shares rather than CCPS, the SHA must backstop the anti-dilution obligation through alternative means: (i) issue additional shares at nil or nominal cost; (ii) share buy-back; (iii) bonus shares or rights issue; or (iv) any other measure achieving an equivalent economic result. This backstop matters precisely because the pricing restrictions under Foreign Exchange Management Act, 1999 ("**FEMA**") may block a nil-cost share issuance to a foreign investor. The alternatives preserve the economic intent where the primary route is regulatorily unavailable. Further, buy-back as an anti-dilution alternative would also be subject to taxation in the hands of persons tendering their shares for buy-back.

6. Regulatory Compliances

A down round in India does not happen in a legal vacuum. It activates a series of regulatory requirements each of which, if ignored, can unravel an otherwise well-negotiated transaction.

6.1. FEMA

(a) Floor Pricing Issue

Rule 21 of the NDI Rules mandates that equity instruments issued to non-resident investors must not be priced below their fair market value ("**FMV**"). The FMV must be certified by a SEBI-registered Category I Merchant Banker, using internationally accepted methodologies, typically Discounted Cash Flow ("**DCF**") or comparable transaction analysis.

This creates a direct and structural conflict with the stringent commercial mechanics of a down round. For instance: if a company intends to issue shares at INR 60 but the certified FMV still remains at INR 80, issuance at INR 60 to a foreign investor would directly contravene the pricing norms under NDI Rules. The consequence

is serious, as under Section 13 of FEMA, the entire transaction may be treated as a contravention of FEMA, attracting penalties of up to three times the amount involved and compounding proceedings before the RBI.

Further, immediately successive valuation reports certifying FMV at vastly different amounts within a short span of time, say less than 12 months, may lead to questioning by the RBI around the basis of the valuation mechanism itself, which could pose issues on pricing under FEMA.

Practical workarounds used in India:

1. **Rights issue structure:** Structuring the down round as a rights issue allows existing investors, including the foreign ones, to participate pro-rata at a price determined by the company, without triggering the general pricing floor under NDI Rules, since Rule 7 of the NDI Rules expressly carves out a rights issue pricing from the FMV requirement.
2. **Domestic and foreign tranching:** Separating the round into a domestic-investor tranche (no pricing constraint under FEMA) and a foreign-investor tranche (priced at a freshly certified FMV) allows the economics to diverge where necessary.
3. **Fresh merchant banker valuation:** Commissioning a new merchant banker valuation after a reasonable time lapse from previous valuation that certifies the reduced FMV as at the date of the down round. If the merchant banker concludes that the company is now worth INR 60 per share, the pricing conflict (under NDI Rules) dissolves entirely. This is both the simplest and most commonly used route.

(b) Nil-Cost Anti-Dilution Shares and the FEMA Problem

Issuing shares at ‘nil- cost’ to a foreign investor violates pricing norms under NDI Rules. As per the NDI Rules, an Indian Company cannot issue equity to a non-resident below FMV, save and except in cases of a rights issue. Since the CCPS was valued at the time of its original subscription, and conversion is governed by those original terms the same does not constitute a fresh issuance below the FMV, it is just a re-expression of the existing contractual framework.

(c) Reporting Obligations - Form FC-GPR

Every fresh allotment of equity instruments to a non-resident must be reported to the RBI via Form FC-GPR within 30 days of allotment, filed through the FIRMS portal. Anti-dilution share allotments are not exempt from such filing. Non-filing attracts proceedings under FEMA. This is a procedural requirement that might be overlooked in the pressure of closing a down round.

6.2 Income Tax Related Issues

(a) Angel Tax - Section 56(2)(viib) of the Income-Tax Act, 1961 (“IT Act 1961”): Abolished

Section 56(2)(viib) of IT Act 1961 dealt with infusion of monies into Indian companies at a premium in excess of the FMV determined in prescribed manner and tax on such excess premium in the hands of recipient Indian company - basically, a tax on capital. This was commonly referred to as ‘Angel Tax’ as such practice was observed during primary infusion rounds by initial investors referred to as ‘Angel Investors’. For down rounds, this was never an issue because the infusion may not be at a premium but instead, at a discount. On the contrary, the tax authorities may argue that the previous round was made at a higher value by taking reference of the valuation of the current round and hence may allege that the said Section 56(2)(viib) was applicable for the previous round.

However, with effect from 1 April 2025, Section 56(2)(viib) of the IT Act is repealed and hence, simply no longer a consideration. For infusion rounds completed before that date, historical angel tax exposure may remain live for pending assessments, but one must note that the provision no longer carries prospective risk.

(b) Section 92(2)(m) of Income-Tax Act, 2025 (“IT Act 2025”) - Tax in the Investor's Hands: Very Much Alive

While Angel Tax has been abolished, Section 92 (2)(m) of the IT Act 2025 (erstwhile Section 56(2)(x) of the IT Act 1961) continues to remain in full force. Under this provision, if any property is received for a consideration

that is lower than its calculated FMV by an amount exceeding INR 50,000, the entire difference between such FMV and the actual consideration paid (i.e., the Shortfall) is taxed as "Income from Other Sources" in the hands of the recipient of the property. The term property is defined to include shares and securities. For the purpose of this Section, the relevant FMV is determined under Rule 57 of the Income-tax Rules, 2026 ("**IT Rules 2026**") [erstwhile Rule 11UA of the Income-tax Rules, 1962].

Accordingly, where shares are received for inadequate consideration, most relevantly, nil-cost/relatively low anti-dilution shares acquired from another shareholder or even the down rounds made at a discount (where the argument could arise if the FMV as per IT Rules 2026 is higher than the issue price), the difference between the FMV of those shares and the NIL/inadequate consideration paid is taxable as income from other sources in the investor's hands. This may potentially create a painful trap that many deal teams overlook.

Further, an issue under Section 79 of the IT Act, 2025 (erstwhile Section 50CA of the IT Act, 1961) may also arise in relation to shares acquired from another shareholder at NIL / inadequate consideration pursuant to down-round arrangements. Section 79 provides that where unquoted shares are transferred for a consideration lower than their FMV, the FMV determined in the prescribed manner shall be deemed to be the full value of consideration for the purposes of computing capital gains in the hands of the transferor. Accordingly, in cases involving transfer of existing shares at a steep discount or for NIL consideration, the tax authorities may seek to substitute the prescribed FMV as the deemed sale consideration in the hands of the transferring shareholder, thereby triggering capital gains tax exposure notwithstanding the commercially agreed transaction price.

Therefore, in a situation where shares acquired from another shareholder at NIL / inadequate consideration pursuant to down-round arrangements, it could potentially trigger taxation in the hands of transferor as well as transferee.

Illustration: Section 92(2)(m) of IT Act 2025 - Tax Trap

FMV of anti-dilution shares acquired from another investor: INR 5,000,000.
Consideration paid by investor: INR 1,000,000.
INR 4,000,000 shall be taxable in investor's hands as income from other sources @ 30% = INR 1,200,000

Well-drafted SHAs indemnify the investor against this tax liability. But the indemnity payment is itself taxable income to the investor thereby, creating a gross-up loop that compounds rapidly depending upon the relevant tax slab as may be applicable to the investor.

(c) Capital Losses - Sections 67, 72, 108, and 111 of the of the IT Act 2025 [erstwhile Sections 45, 48, 70 and 74 of the IT Act 1961]

Existing investors who exit at or around the time of a down round will crystallise capital losses. In such cases, the treatment of set- off becomes critical:

1. **Short-term capital loss** (unlisted shares held under 24 months): Short-term capital losses can be set off against any capital gains either short or long-term. Further, if the loss cannot be wholly so set off in that tax year, then the amount of loss not so set off shall be carried forward for eight tax years immediately succeeding the tax year for which the loss was first computed and shall be available for set off against short-term or long-term capital gains.

2. **Long-term capital loss** (held over 24 months): Long-term capital losses can only be set off against long-term capital gains. This asymmetry is significant and often misunderstood. An investor sitting on a long-term capital loss from a down round exit cannot shelter it against short term capital gains. Further, if the loss cannot be wholly so set off in that tax year, then the amount of loss not so set off shall be carried forward for eight tax years immediately succeeding the tax year for which the loss was first computed and shall be available for set off only against long-term capital gains.

(d) ESOP Repricing - Section 17(1)(d) of the IT Act 2025 [erstwhile Section 17(2)(vi) of the IT Act 1961]

Exercise of ESOPs would generally trigger a perquisite tax in the hands of such employee exercising ESOPs with perquisite value being the difference between FMV of the company on date of exercise and the exercise price.

Employee ESOPs granted at an exercise price above the down round price is technically out of the money - a talent retention crisis waiting to happen. If the exercise price itself is higher than the repriced down round price i.e., the FMV, while the same may not lead to any perquisite tax – as it would be a higher price paid by such employee upon exercise - such higher exercise price due to repriced (lower) FMV itself may be a disincentive for such employees to exercise ESOPs to acquire shares in the company at a price more than the repriced FMV. In practice, companies going through a down round often face difficult ESOP conversations with senior employees, and the higher capital cost of repricing is frequently overlooked until it surfaces at exercise.

(e) Restriction on carry forward of accumulated losses of a company in case of change in the beneficial ownership of shares - Section 119 of the IT Act 2025 [erstwhile Section 79 of the IT Act 1961]

Section 119 of the IT Act 2025 [erstwhile Section 79 of the IT Act 1961] restricts the carry forward and set off of losses of a closely held company where there has been a change in the beneficial ownership of shares during the relevant tax year. Specifically, no loss incurred in any prior year may be carried forward unless, on the last day of the tax year, shares carrying not less than 51 percent of the voting power are beneficially held by the same persons who held that threshold on the last day of the year in which the loss was incurred. This restriction does not apply to eligible start-ups, subject to fulfilment of the prescribed conditions under Section 119(3)(b) of the IT Act 2025.

In a down round, if the issuance of fresh equity to incoming investors results in a change in the beneficial ownership of shares carrying not less than 51 percent of the voting power, then the company's eligibility to carry forward its accumulated losses of prior years may be impacted.

6.3 Companies Act, 2013

(a) Preferential Allotment

Fresh issue of shares in a down round, other than through a rights issue, constitute a preferential allotment under Section 62(1)(c) of the Companies Act, 2013 ("**Companies Act**") read with Rule 13 of the Companies (Share Capital and Debentures) Rules, 2014. The mandatory requirements are that (i) a special resolution is passed by at least 75% of shareholders; (ii) an independent valuation report by a Registered Valuer; and (iii) completion of the allotment within 12 months of passing the resolution.

The valuation report must justify the lower price, which is the source of risk. Anti-dilution and drag-along clauses that require share issuances at prices or on terms inconsistent with the Companies Act must be carefully drafted to ensure that they are enforceable.

In addition, under Section 42 of the Companies Act, a preferential allotment is treated as a private placement, thereby requiring compliances with the private placement framework including the issueance of an offer letter, adherenace to the cap on offerees, receipt of application money only through banking channels into a separate account, and timely filings with the Registrar of Companies.

(b) Bonus Shares

Under Section 63 of the Companies Act, bonus shares must be issued to all shareholders of the same class on a pro-rata basis. Selective bonus share issuances for instance granting bonus shares to a single investor as anti-dilution compensation are expressly prohibited. This restriction makes the bonus share route of very limited practical utility in down round investments. Unless all shareholders in that class consent, which is rarely achievable in practice, bonus shares cannot be used as a targeted anti-dilution mechanism.

(c) Buy-Back of Promoter Shares

Where the SHA provides for the company buying back promoter shares to fund anti-dilution adjustments, such a transaction triggers Sections 68 and 70 of the Companies Act along with their attendant constraints. The statutory requirements include: (i) the maximum buy-back in any financial year is limited to 25% of paid-up

capital and free reserves; (ii) an independent report from a Registered Valuer is required; (iii) post buy - back, the debt-equity ratio cannot exceed 2:1; and (iv) a minimum gap of 12 months must elapse between two separate buy-back exercises. These are hard statutory caps and no contractual provision in a SHA can override them.

7. Conclusion

The most complex aspect of a down round is not the procedural mechanics, which are well-defined and manageable. The real challenge lies in strategic assessment *viz* determining whether the company has the potential for revival and long-term value creation, or whether it is fundamentally unsustainable and likely to continue consuming capital without return. To guide this assessment, the following indicators merit close consideration:

When a Down Round Works	When a Down Round Hurts
Business model is sound but capital-starved	Only existing investors are participating — no fresh validation
A credible new investor leads the round	Core business model disrupted with no viable pivot
Proceeds fund a clear, time-bound path to positive cash flows	Fraud, litigation or regulatory issues remain unresolved
Founder and management team remain intact and motivated	Revenue and EBITDA trajectory is structurally negative
Pricing reflects realistic FMV, not distressed desperation	Founders disengaged, demotivated or have already exited
Enables an IPO or M&A exit within 3 to 5 years	Capital buys months of survival, not a runway to profitability

Some examples as quoted above, illustrate that companies can traverse down rounds and emerge stronger, more focused, and ultimately more valuable. Their success, however, rests on at least the following three conditions being met simultaneously: the underlying business warrants continued investment, a credible new plan exists, and the key people remained committed in the business. Down rounds succeed only when all these conditions are met simultaneously.

When these conditions are absent, i.e., when the round is being led only by existing investors because no new capital is forthcoming, when the business model is broken rather than merely underfunded, or when founders are disengaged or preparing to exit, a down round ceases to be a rescue. It becomes in effect, capital deployed without conviction or as the saying goes, good money after bad.

Down rounds demand honesty from all the parties involved. Investors must acknowledge that their original valuation was flawed. Founders must accept dilution with grace and without ego. Both must commit to a realistic plan that would withstand scrutiny from a dispassionate outsider. When those conditions exist, a down round is not a failure, but a recalibration toward resilience and eventual success.

The gravest risk is neither the down round itself nor the dilution it entails. It is the denial and the refusal to reset valuation until the company has become truly unsalvageable.

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