
ECONOMIC OWNERSHIP WITHOUT CONTROL: THE CONTRACTUAL SEPARATION OF POWER IN INDIAN STARTUPS

Pratham Ahuja, School of Law, UPES

ABSTRACT

In the Indian startup ecosystem, the governance structure is perceived to be equity-centric, but the actual decision-making power is embedded in contract-based mechanisms, specifically Shareholders' Agreements (SHAs). The existing literature is predominantly concerned with valuation, exit, and funding patterns, and the governance implications of SHAs remain understudied. SHAs enable the separation of ownership and control, enabling minority shareholders to exercise disproportionate influence over the governance structure, which can then be used to transform the strategic and operational framework. This paper uses a doctrinal approach to SHAs with a contractual governance perspective, using the Indian startup ecosystem to demonstrate how contract-based provisions, and not legal provisions, form the core constitutional structure of startups. By reframing the understanding of SHAs as the constitutional documents of Indian startups, this paper proposes that there is a need for greater contractual literacy among founders and investors, suggesting that the solution to governance problems lies not in the realm of regulation but in understanding private contracts.

Key Words: - Shareholders' Agreements, Contractual Governance, Indian Startup Ecosystem, Ownership–Control Separation, Founder–Investor Dynamics.

I. INTRODUCTION

The illusion of power associated with majority equity, where the founders own the majority of the organisations stock, therefore masquerades as power within the startup's operation. Notably, it is imperative to point out that owning the majority of the company's stocks equates to power within the organisation's operation. The domination of the organisation's operation by the founder of the company results in nominal control within the company's operation, yet it becomes apparent that neither the founder nor the majority owners has the power to govern the company.¹The separation of the ownership stakes within the organisation, therefore, signifies the cash-flow rights, where the contractual layer of the shareholders' agreement serves to allocate the power within the company to the minor authority structures of the company's operation. The formal ownership associated with the so-called ownership of the startup's operation, therefore, signifies the contractual layer of the shareholders' agreement within the company's operation. However, the rapid development of the startup ecosystem within the country exposes the founder to increased risks of conflict.² It is with such risks of conflict within the startup's operation that the article maps the power reallocation within the company to the operational aspects of the company.

II. ECONOMIC OWNERSHIP AND THE ILLUSION OF EQUITY-BASED CONTROL IN STARTUPS

Economic ownership within Indian startups incorporates the right to collect dividends, share assets realised from the venture's liquidation, or maximise exit value via a series of-preferred stock stacks within the right of first refusal element of the contract , each specifying the individual bearing the upside or downside of the venture as stipulated in the contract³⁴. Therefore, the share-holding size of the founder can be maximised while the founder receives

¹Adv. Narayani Modi, *Mitigating Startup Conflicts: The Importance of Co-Founder Agreements in Structuring Roles, Shares, Equities and Exit*, 6 *Indian Journal of Law and Legal Research* 5, *Mitigating Startup Conflicts: The Importance Of Co-Founder Agreements In Structuring Roles, Shares, Equities And Exit*.

² Anamika Baid, *Corporate Governance in Startups: Legal Challenges and Frameworks in India*, 8 *International Journal of Law Management & Humanities* 2 (2025), *Corporate-Governance-in-Startups.pdf*.

³ *Promoters Agreement: The Legal Backbone for Early-Stage Startups in India*, White & Brief Advocates & Solicitors (9 September 2025), *Promoters Agreement: The Legal Backbone For Early-Stage Startups In India - Corporate Governance - India*

⁴ *Equity Finance 2025*, Chambers & Partners (21 October 2025), *Equity Finance 2025 - India | Global Practice Guides | Chambers and Partners*.

little in cash value from the startup upon the realisation of a liquidity event⁵. Similarly, the issuance of preference shares constructions such as OCPS and CCPS can significantly reduce the founder's equity while maintaining rights over cash flow.

III. STATUTORY CORPORATE GOVERNANCE UNDER THE COMPANIES ACT AND THE SPACE FOR PRIVATE ORDERING

The Companies Act in India provides a default corporate governance framework in which control is presumed to be vested in the majority shareholder, and board powers are derived directly from shareholding patterns. Under the statutory regime, the board's fiduciary obligations and powers are correlated with equity stakes, establishing a direct and transparent relationship between ownership and control. However, in many Indian startups, the corporate structure is typically a closely held VC-funded company with a highly concentrated equity structure among a few founders and venture capitalists. This leads to an asymmetry in bargaining power, where venture capitalists typically negotiate for special rights, and founders retain control over operations, and the Companies Act is largely agnostic about how internal power is distributed in such a tightly networked capital structure. The freedom of contract provided to private companies allows shareholders to negotiate Shareholders' Agreements (SHAs) that specifically supersede the statutory defaults.

IV. SHAREHOLDERS' AGREEMENTS AS CONSTITUTIONAL DOCUMENTS OF INDIAN STARTUPS

Courts have been receptive to enforcing such private ordering arrangements and have held SHAs to be enforceable governance documents that can alter board composition, voting percentages, and veto powers. As a result, the control in the real world, as it applies to startups, shifts from the statutory framework to the contractual framework, where SHAs become the de facto constitutional documents. Although the companies comply with the Act, the actual control is redistributed through contractual agreements, thus emphasising the importance of considering SHAs as the main source of control in the Indian startup scenario.

⁵ G. Sabarinathan, *Zomato Ltd.: Understanding the Cap Table from a Governance Perspective (IIM Bangalore Working Paper No. 675, March 2023)*, *Microsoft Word - Understanding Zomato's Cap Table Working Paper Sabari Mar 2023.*

V. CONTRACTUAL DECOUPLING OF OWNERSHIP AND CONTROL IN VENTURE CAPITAL TRANSACTION

Control rights, by contrast, are vested in voting interests, board composition, consent, and veto rights that define strategic direction, timing, and risk profile⁶⁷. A shareholder agreement typically includes shareholder-agreement (SHA) clauses that accord investors board seats, reserved matters, or a supermajority voting threshold to guide critical decision-making despite the percentage of shares they own⁸. There are also veto rights over capex spending, transactions involving related parties, or the hiring of top executives to immunise the investing minority from the strategic choices of the operating leadership⁹.

The contractual decoupling thesis maintains that a venture contract of today treats ownership as a separable bundle of rights, and thus it creates on purpose the division between economic and control components between different parties. Indian startup SHA-operationalises private ordering to redistribute power beyond statutory defaults, embedding bespoke consent rights, drag-along/tag-along clauses, and staggered vesting schedules that reconfigure governance away from the naïve equity-equals-control model. It is within this private-order framework that founders' consent to the surrender of strategic authority, even as they retain headline equity, and it forms the analytical basis for assessing how contractual design reshapes power in the Indian entrepreneurial ecosystem.

VI. GOVERNANCE MECHANISM EMBEDDED IN SHAREHOLDERS' AGREEMENT

The shareholder agreements (SHA) drawn up for investors specify a list of so-called reserved matters, such as the issuance of new stocks, major acquisition transactions, and capital structure modifications. The use of a contract stipulates that these override majority voting and instead

⁶ *Investor Control Rights: What It Means for Start-Ups and Their Founders*, Shardul Amarchand & Co. (25 July 2022), [INVESTOR CONTROL RIGHTS: WHAT IT MEANS FOR START-UPS AND THEIR FOUNDERS - Shareholders - India](#).

⁷ *Balancing Founders and Investors Rights in Startup Shareholders Agreement, The Recitals (Startup Fundraising Series, Part VIII)*, Synergia Legal (26 November 2025), [Balancing Founders and Investors Rights in Startup Shareholders Agreement \(Startup Fundraising Series, Part VIII\) – Synergia Legal](#).

⁸ *Tamanna Bahety & Srijan Kumar, Between Control and Contribution: A Welcome Reform or Regulatory Grey Area for Startup Founders?* (8 July 2025), [Between Control and Contribution: A Welcome Reform or Regulatory Grey Area For Startup Founders? | GNLU Centre for Business and Public Policy](#).

⁹ *Abhishek Bansal & Pavish Singhla, Investor Protection Rights vis-à-vis Founders Rights – Investment Agreements* (7 April 2021), [Investor Protection Rights vis-à-vis Founders Rights
-Investment Agreements](#).

specify these decisions to certain investors in opposition to the majority, circumventing corporate law with a private rule set, granting power to a veto minority bloc. It utilises contract-theoretic concepts with separation between ownership bundles to solve hold-up and information asymmetry difficulties.

SHAs frequently mandate board composition, which grants investors a disproportionately high level of control in terms of both nominee directorships and observer directorships, whereby they can influence management via a director's fiduciary duties to both management and shareholders, assisted by quorum-setting provisions to accentuate control.

Real-time governance no longer resides in shareholders but in a directorate whose only loyalty lies in a contractual relationship to investors on behalf of shareholders. The reverse vesting clause ties up the shares of founders for a specified period of time. It considers the contribution of labour as a separate asset from the capital. Although it has been introduced as an aligning clause, it imposes a responsibility on the founders of the firm to stay on post-investment. It subjects the founders as an accountability agent of capital to the asymmetric exit risks. The founders have no power over their shares, and the capital is represented by the investors.

The inclusion of drag-along provisions gives the minority investor group the power to enforce the sale of the shares when the predetermined liquidity level is reached, thus mandating the exit. Founder autonomy is reduced as the agreement now forces the founders to exit through the investor-led exit mechanism, which is the juncture when economic interest is mirrored by control, ultimately to the detriment of the founders¹⁰.

VII. BARGAINING ASYMMETRIES AND THE VENTURE CAPITAL CONTRACTING ENVIRONMENT IN INDIA

Venture capital founders frequently enter shareholder agreements wherein control is transferred in entirety, even as control in name is transferred. At the outset, the venture capital market in India has highly standardised term sheet formats widely circulated among players in the industry. This VC playbook format includes complex provisions in the case of reserved matters and drag-

¹⁰ *Alvaro Pereira, The Law of Contingent Control in Venture Capital, 2023 Columbia Business Law Review, The Law of Contingent Control in Venture Capital / Columbia Business Law Review.*

along provisions, as well as the schedule of reverse vesting itself; hence, the despair of founders in dictating the same. Further, the factor of time adds weight to the negotiation dilemma.

Startup ventures in the early stages face significant cash flow issues; hence, the fear of the partnership being broken off in the name of the deadlock arising due to the draw-out process forces founders to opt for ill-fruitful arrangements in the name of sending the right signal to obtain attractive valuations. Finally, legal advice is sought only after the term sheet itself is executed; hence, the legal player enters the game too late in the day to be concerned with the architecture of the contract being altered in favour of the founders.

VIII. BOARDS FUNCTIONALITY, FOUNDER DISENFRANCHISEMENT AND GOVERNANCE CONSEQUENCES

The disconnection between ownership and control has a profound effect on boards of directors. Boards essentially become rubber-stamp organisations where investor-appointed members dictate risk-averse practices, and founders become detached from operational management despite no longer retaining strategic veto power. Founders are thus coerced to enact operational execution without any buffers from investor pressure to ensure returns on investment, ostensibly creating a principal-agent problem that diminishes risk-tolerance in entrepreneurship-related endeavours.

Eventually, a model of undue investor pressure results in a value-creating distortion, where premature investor exit is preferred to patient product development, stifling entrepreneurship by driving innovation exhaustion as founders and lead engineers become increasingly disenchanted from a sense of autonomous control to push a desired product to market. From an empirical analysis of boards in the Indian startup environment, organisations highly susceptible to investor control weigh less in terms of valuation growth after funding and face a higher propensity of turnover in terms of founding teams.

IX. CONTRACTUAL AND INSTITUTIONAL DESIGN INTERVENTION

Contractual Design Interventions require sunset clauses in veto rights to set a time limit for founder control, gradually requiring renegotiation to ensure such power does not become

irrevocably entrenched with time¹¹. The use of super-majority voting structures to pass critical decisions for independent directors mitigates unilateral power and increases fluidity¹². Establishing time-based transitions within corporate structures (such as requiring a new board structure after certain fundraising rounds) reduces the need for manual regulatory intervention¹³.

X. GOVERNANCE LITERACY AND THE ROLE OF PROFESSIONAL INTERMEDIARIES

Governance Literacy for Founders accelerators can include a series of obligatory workshops to demystify board-founder dynamics and enable founders to understand how to balance power and duty¹⁴. Pre-Term counselling, provided by experienced corporate-law practitioners, can also enable founders to become aware, through plain-English disclosures concerning voting thresholds, drag-along provisions, and lock-ups for founder shareholdings¹⁵.

In the case of Indian companies, the role of a Company Secretary (CS), as a statutorily prescribed, obligatorily running board committee, is to assist the board in decision-making regarding compliance, corporate standards, and the drawing of minutes, but the mandate extends to the role of a governance engineer. Participation by the board in the initial design of the structure is a measure taken to promote board neutrality through a conducive composition of committees and the enforcement of minority shareholder protection regulations, factors that create a protective edge for the board as a preventive measure to guard pioneers from an overregulated scenario while capturing the strategic foresight dimension that is particular to the Indian scenario.

Having ownership of the equity itself is not enough for power to be bestowed on the individual, as the contracts created to govern the decision-making processes are well before the actual

¹¹ Shyam Agrawal, *Company Secretaries: An Important Pillar of Corporate Governance*, C:\Documents and Settings\Admin.

¹² *Consultative Paper on Review of Corporate Governance Norms in India*, Securities and Exchange Board of India, Microsoft Word - CONCEPT%20PAPER%20ON%20CORPORATE%20GOVERNANCE-final[1]

¹³ Pragma Richa Tiwary, *Corporate Governance and Minority Protection: Dissecting SEBI's New LODR Framework for HVDLEs (4 November 2025)*, Corporate Governance and Minority Protection: Dissecting SEBI's New LODR Framework for HVDLEs - NLS Forum

¹⁴ Afra Afsharipour & Manali Paranjpe, *Handbook on Corporate Governance in India (14 July 2021)*, Handbook on Corporate Governance in India.

¹⁵ *Improving Corporate Governance in India: Related Party Transactions and Minority Shareholder Protection*, Organisation for Economic Co-operation and Development (OECD), Improving Corporate Governance in India (EN).

culture of the startup even begins. The importance of creating and establishing transparent contracts on voting power, the makeup of the board of directors, and the way to safeguard the minority ownership becomes the foundation of creating the startup culture where the power itself is embedded within the very foundation of the organisation. In the case of successful and enduring startups, the power of these organisations comes not from the hostile and tiered structure of the organisation, but within the actual contracts created to govern the organisation itself.

XI. CONCLUSION

Analysis shows that, in Indian startups, equity alone is no longer a determinant of governance control, and control is carefully crafted through contractual arrangements in Shareholders' Agreements. Through board rights allocation, reserved matters definition, vesting schedule design, and exit control design, these agreements consolidate decision-making authority in the hands of investors while reducing the status of founders to insignificance. The governance structure that emerges often results in founder disenfranchisement, reduced entrepreneurial risk-taking, and a disequilibrium that can be innovation-stifling. Although the legal framework of the Companies Act is a rule book for the default setting, it is not adequate to deal with the complexities of power play in contemporary venture-capital-backed ventures. Regulatory intervention, therefore, is not likely to cure the underlying contractual imbalances. The solution actually lies in improving contractual literacy among founders and investors, with the help of informed advisors and corporate secretarial experts who can negotiate and draft balanced SHAs.