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# Venture Capital Ecosystem in Iraq: **Identifying the Gaps and Overcoming the Reluctance of the Laws and Regulations**

With the fourth largest population among Arab countries with over 41 million people, Iraq is a market that is difficult to neglect. Nevertheless, over the past thirty years, with the sanctions, wars, security, and social and political unrest, Iraq has unfortunately missed on the economic growth that neighboring countries with smaller populations and lesser resources have been able to benefit from. The startups and venture capital ecosystem has been facing a similar destiny as well.

Over the past three years, the venture capital ecosystem in Iraq has been more and more active. Accelerators and incubators are shaping up. They are organizing mentorship programs and other activities to support the development of startups in Iraq. However, venture capital funding has remained minimal in comparison to other countries in the MENA region.

There are numerous challenges that have kept venture capitalists from investing in Iraq. As a result, most of the investments taking place in the Iraqi startup scene have been coming from local angel investors.

## The Challenges

The Iraqi lawmakers have neglected the importance of foreign direct investments in small and medium enterprises (SMEs) and have failed to develop an ecosystem that attracts new business ventures.

VC funds, along with startups, face numerous challenges in Iraq. While some of those challenges relate to the political instability of the country, many others are more associated with the legal system, laws, and regulations.

- **Foreign Ownership Restrictions**
  Companies and foreign investments have been evolving in Iraq under the rules and regulations set out by Companies Law No. 21 of 1997 as amended in 2004. Other than the foreign ownership restriction that has been introduced in 2017, the Iraqi Companies Law has witnessed limited updates and has failed to address foreign direct investments requirements and venture capital needs.

  It is unfortunate that the Iraqi lawmakers have decided to introduce provisions in 2017 limiting foreign ownership in Iraqi companies to forty-nine percent (49%) while other Arab countries have been relaxing similar restrictive measures and promoting full foreign ownership to encourage foreign direct investments.

- **Underdeveloped Commercial Law Provisions**
  It is a common market practice in most countries that whenever a startup wishes to raise funds through various rounds, it opts for a joint-stock company structure with multiple classes of shares. While the Iraqi Companies Law has introduced several types of companies, including limited liability companies and private joint-stock companies, the practice has shown over the years that the incorporation of a private joint-stock company in Iraq is rather complex and requires a lengthy and costly process that startups cannot afford. Therefore, the most commonly used structure in Iraq has been the limited liability company.

Joint-stock company structures have been used over the past years in Iraq by companies aiming to get listed on the stock exchange or required by the applicable laws. For example, telecom operators were operating for years under a limited liability structure until they were compelled to convert into joint-stock companies. In addition, companies in Iraq cannot have various classes of shares with different benefits and privileges.

As part of the development of a more favorable ecosystem, Iraqi lawmakers should introduce a simplified private joint-stock company structure similar to the one that has been introduced in France a few years ago, which has become the most popular company structure in France.

Such a simplified structure would ease proceedings as well as the governance of private joint-stock companies. In addition, lawmakers should introduce the possibility of having various classes of shares with voting or non-voting rights, prioritizing the distribution of dividends or liquidation.

- **Lack of Judicial Ruling Stability**

In addition to the aforementioned, there is a lot of judicial ruling instability in Iraq when it comes to the enforcement of convertible notes as well as the enforcement of shareholders' agreements and other partnerships' arrangements.

## The Solution

In light of the previously mentioned obstacles, there are several structures that allow to mitigate those challenges and facilitate foreign venture capital investments in Iraq. We hereinafter take the opportunity to develop what we believe to be the most efficient structure from a cost, time, and investor-friendly perspective.

- First and foremost, investors should incorporate a special purpose vehicle outside Iraq to permit having a joint-stock company with multiple classes of shares with voting and non-voting rights in a jurisdiction with flexible and stable legislation.

- The selection of the jurisdiction is by itself a challenge and should be based on several criteria. Such criteria include mainly the speed of execution, the regulatory requirements, and the cost of implementation.

- Any special purpose vehicle that aims to invest in Iraq will have to be regulated in its jurisdiction of incorporation. It is essential to highlight that the size of the fund constitutes an important factor in the selection of the jurisdiction since several regulated jurisdictions can be very costly (e.g., the Cayman Islands). In addition, the regulator will have to closely assess the identity of limited partners and the portfolio companies, their bookkeeping, tax declarations, and audited financial statements.

- For investments to be undertaken in Iraq, it is recommended to establish the special purpose vehicle in the Abu Dhabi Global Market (ADGM). ADGM has, over the past years, proven to be a reliable platform with a reputable regulator while remaining cost and time-efficient. In addition, the applicable laws and regulations in the ADGM remain inspired by English laws. With an ADGM special purpose vehicle in place, Middle Eastern limited partners should not face any compliance issues so long as they are reputable.

  In addition, they can implement a general partner with a limited partner structure alongside a limited partnership agreement governing the relationship of the investors. This ADGM special purpose vehicle would then acquire minority participation in portfolio companies in Iraq.

- The previous solution partially addresses the challenges highlighted hereinabove. However, many challenges remain unresolved with the portfolio company being still based in Iraq. Therefore, any venture capital should bind its capital injection to the establishment by the portfolio company of a legal entity outside Iraq. Such a legal entity would have the same shareholding structure as the Iraqi portfolio company.

  Gradually the Iraqi entity will have to transfer its intangible assets to the newly incorporated foreign entity and capitalize on any newly developed intellectual property in the newly formed legal entity. This way, the Iraqi entity will steadily become a service provider to the foreign entity that will become the owner of any goodwill, intellectual property, and any other assets. Hence, the investment of any venture capital firm will become subject to a jurisdiction that is more stable and has efficient enforcement mechanisms.

- The choice of the jurisdiction where the Iraqi portfolio company should relocate is also challenging and will vary depending on numerous parameters. Nevertheless, the most important parameter will remain the growth plan of the portfolio company and the target territories where it aims to develop its operations and the investors it seeks to solicit.

While various structures can be put in place to circumvent the challenges and incentivize venture capital investment in Iraq, the key remains to find attractive opportunities led by founders who have the capabilities to take their startup to the next level.