NEWSFLASH

The Gensol Case:

A Wake-Up Call for Promoter-Focused Startup Due Diligence

The unfolding situation at Gensol Engineering Limited (Gensol) goes beyond isolated misconduct—which signals systemic gaps in the startup ecosystem. Regulatory scrutiny of Gensol intensified following a SEBI complaint in June 2024 and credit rating downgrade in March 2025, leading to SEBI barring the promoters from the securities market in April 2025. The primary allegations centre on the fraudulent diversion of substantial loan funds, intended for electric vehicle procurement, towards the promoters' personal luxury expenses (like a high-end apartment) and routing money through a network of related or alleged shell entities. Additionally, Gensol is accused of misleading investors and regulators with inflated EV pre-order claims, misrepresenting manufacturing activity, and submitting forged documents to lenders. The situation has escalated further with the Enforcement Directorate conducting searches, detaining a co-promoter, and the Ministry of Corporate Affairs initiating its probe into the company's affairs.

While these industries are poised for transformative growth, the serious allegations against Gensol's promoters—ranging from significant fund diversion and fabricating lender documents to potential stock price manipulation—expose a critical vulnerability: the potential for catastrophic risk tied directly to the founders and leadership of startups.

In the early-stage startup ecosystem, valuations are frequently driven less by concrete financial metrics and more by the power of narrative and the founder's perceived charisma. Investors often buy into a compelling vision for future disruption or market creation. This focus on the story and the storyteller can create a vulnerability, sometimes leading to less rigorous due diligence specifically on the promoters themselves—their track record, integrity, and execution capabilities may be overshadowed by the compelling pitch, increasing downstream risks if fundamental promoter issues were overlooked.

This case highlights the need of rigorous, multi-faceted due diligence, with a targeted emphasis on promoters and their conduct and track record, is not just best practice, but an absolute necessity for survival, investor confidence, and sustainable growth.

From our perspective, the Gensol case underscores several critical truths, demanding deeper consideration:

1. Promoter Integrity: The Cornerstone of Startup Credibility:

Startups often embody the vision and drive of their founders. However, this reliance makes the company exceptionally vulnerable to the promoter's ethical compass. The allegations against Gensol's promoters serve as a potent reminder that assessing the character, historical conduct, financial transparency, and reputation of founders is often more consequential than evaluating the business model itself in the early stages.

Due diligence must go well beyond surface financials. It requires deep dives into promoter background: verifying credentials, scrutinizing past business ventures (both successes and failures), investigating any history of litigation or regulatory censure, identifying unexplained wealth or lifestyle inconsistencies, and mapping out potentially opaque corporate structures or related-party dealings that could conceal conflicts of interest. Ignoring red flags here is akin to building on unstable ground.

In today's interconnected world, a promoter's digital footprint and social media behavior are significant indicators of their character, professionalism, and potential risks. Thorough checks in these areas are essential for responsible and informed promoter assessments, safeguarding the organization's reputation and ensuring a good fit.

2. Governance Cannot Be an Afterthought – Building the Guardrails Early:

In the high-pressure environment of scaling a startup, establishing robust governance structures can seem like a secondary concern compared to product development and market capture. The Gensol situation, however, suggests how easily potential lapses in internal controls, inadequate board oversight, or unclear lines of responsibility can be exploited. Strong governance isn't merely corporate bureaucracy; it's the essential framework of checks and balances that safeguards asset, ensures accountability, protects minority shareholders, and builds long-term institutional trust. Robust due diligence must critically evaluate the substance of these controls, not just their existence on paper.

Founders must go beyond token compliance, proactively appointing independent directors, forming functioning audit and risk committees, and ensuring regular, third-party audits. Promoters themselves have a fiduciary duty to champion and embed a culture of strong governance from the very beginning, including independent board members where appropriate.

3. Surface-Level Checks Are Insufficient – The Need for Depth and Specialization OR Move Beyond Checklist Diligence: The Need for Deeper, Specialized Scrutiny:

The complexity and severity of the allegations in the Gensol case demonstrate that template-driven diligence approaches are often inadequate, especially in high-growth, high-valuation, or operationally complex environments. Assessing startups with intricate corporate structures, high-profile promoters, cross-border operations, or those operating in rapidly evolving, regulation-heavy sectors necessitates more sophisticated approaches. Enhanced Due Diligence (EDD), focusing on high-risk indicators, and potentially Investigative Due Diligence or forensic accounting become essential tools. This means meticulously verifying the source of funds and wealth (SoF/SoW), confirming ultimate beneficial ownership (UBO) through layers of entities, rigorously scrutinizing related-party transactions for fairness and legitimacy, and assessing compliance with all relevant regulations (like AML/KYC). Offshore structures and tax havens can be intentionally designed with complex, multi-layered ownership arrangements involving shell corporations, trusts, and nominee directors. These jurisdictions often have strict secrecy laws and a lack of transparency regarding company ownership, making it extremely difficult to identify the natural persons who ultimately own or control the assets and entities – the Ultimate Beneficial Owners (UBOs).

Red flags such as frequent intra-group transfer, excessive concentration of decision-mag authority, or opaque vendor structures should also prompt heightened scrutiny. Investors must be prepared to invest in these deeper levels of scrutiny when warranted. Investors should use external specialist like forensic accountants or investigators to trace ownership through potentially numerous entities registered in different countries with varying disclosure requirements. This often involves piecing together fragmented information from diverse sources and navigating legal complexities. Investors should also opt for Enhanced Due Diligence (EDD) to uncover the true ownership, including scrutinizing corporate registries, financial records, and engaging in international information requests.

4. The Ripple Effect is Real – Ecosystemic Risk:

The alleged fraud didn't just impact Gensol internally; it created tangible operational disruptions and significant reputational damage for key partners like BluSmart Mobility, which relied on Gensol's EV supply. This starkly illustrates that the failure of one entity due to inadequate diligence or internal misconduct can send shockwaves through its network. Investors, lenders, suppliers, and customers all share exposure. This underscores a collective responsibility within the ecosystem to uphold standards. Due diligence isn't just about protecting one's own investment; it's about contributing to the overall health and trustworthiness of the market.

5. Due Diligence is Mutual and Continuous:

While the focus is often on investors vetting startups, mature founders should also recognize the strategic importance of due diligence. This includes carefully vetting potential investors and funding sources to ensure alignment on ethics, long-term vision, and strategic value-add, avoiding "toxic" capital or partners with questionable reputations. Crucially, due diligence cannot be treated as a one-off event concluded at the point of investment. It must be an ongoing, dynamic process. This involves continuous monitoring of the startup's financial health, operational performance, governance practices, key personnel changes, and promoter activities throughout the lifecycle of the investment or partnership. Establishing clear covenants and regular reporting mechanisms is vital.

6. End use monitoring:

Investors or lenders need to monitor how startups use their investment/ funds to ensure accountability, track performance against goals, and maximize returns. This monitoring helps them identify and address potential problems early, keeping the startup aligned with the agreed-upon strategy and protecting their investment/ funds. It also provides the data needed for informed decisions, fulfills their responsibility, and ensures transparency. Ultimately, end-use monitoring is crucial for safeguarding capital and driving the success of both the startup and the investors/ lenders.

The role of post-investment monitoring—through MIS reviews, independent board oversight, and event-based re-evaluations—and the monitoring of investments is critical.

Our Stance:

The Gensol case must be more than a cautionary tale; it must serve as a catalyst for a fundamental shift in how due diligence is perceived and practiced within the startup ecosystem. We must move beyond viewing it as a procedural compliance hurdle and embrace it as an indispensable strategic tool for proactive risk mitigation, informed decision-making, and long-term value preservation.

Investors evaluating early-stage startups should focus on the individuals driving the venture using these five key areas:

- Founder Vision & Alignment: Assessing the clarity, passion, and investor alignment of the founder's vision.
- Founder Capabilities & Experience: Evaluating the founder's relevant skills, execution ability, and leadership potential.
- Integrity & Reputation: Examining the founder's background, references, digital footprint, and ethical conduct.
- Team Dynamics: (If applicable) Analyzing the co-founding team's skills, communication, and shared values.
- Skin in the Game & Incentives: Determining the founder's personal investment, equity structure, and commitment.
- End-use monitoring is crucial for safeguarding capital and driving the success of both the startup and the investors/ lenders.

This framework helps investors assess the crucial human element in early-stage ventures, recognizing that the team is often paramount to success.

For startups and their promoters, proactive transparency and the early adoption of robust internal governance are non-negotiable prerequisites for attracting quality capital and building sustainable enterprises. For investors, lenders, and strategic partners, a significantly deeper, more critical, and continuous examination of promoters, governance frameworks, and underlying financial realities is now imperative.

Ignoring these lessons invites not only direct financial loss but also contributes to systemic risk, erodes investor confidence, and damages the reputation of the entire innovation landscape. Rigorous, promoter-focused, and ongoing due diligence is the essential bedrock upon which trustworthy, scalable, and ultimately successful ventures are built.

Get in touch with our team-

Srinivasa Rao
Partner - Risk Advisory Services
srinivasa.rao@nangia-andersen.com

Mayank Garg
Director - Risk Advisory Services
mayank.garg@nangia-andersen.com

Our Locations

NOIDA
(Delhi NCR - Corporate Office) A-109, Sector - 136, Noida - 201304, India
T: +91 120 2598000

DELHI
(Registered Office) B-27, Soami Nagar, New Delhi - 110017, India
T: +91 120 2598000

MUMBAI
4th Floor, Iconic Tower, URMI Estate, Ganpat Rao Kadam Marg, Lower Parel,
Mumbai - 400013, India
T : +91 22 4474 3400

BENGALURU
Prestige Obelisk, Level 4, No 3 Kasturba Road, Bengaluru - 560 001, Karnataka, India
T: +91 80 2248 4555

GURUGRAM
001-005, Emaar Digital Greens Tower-A 10th Floor, Golf Course Extension Road, Sector 61, Gurgaon-122102
T: +91 0124 430 1551

CHENNAI
Prestige Palladium Bayan, Level 5, 129-140, Greams Road, Thousand Lights, Chennai - 600006
T: +91 44 46549201

PUNE
3rd Floor, IndiQube Park Plaza, CTS 1085, Ganeshkhind Road, Next to Reliance Centro Mall, Shivajinagar, Pune - 411005, India

DEHRADUN
1st Floor, "IDA" 46 E.C. Road, Dehradun - 248001, Uttarakhand, India
T: +91 135 271 6300

www.nangia-andersen.com | query@nangia-andersen.com