
PROMOTER RECLASSIFICATION – A SHIFT IN THE INDIAN CAPITAL MARKETS

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ABSTRACT

Promoters, as the entities exercising control over the company and its affairs, act as the soul and drivers of the company. However, with this level of authority, come immense responsibilities, liabilities and obligations, of which such promoter entities may not want to bear the burden. Therefore, in keeping with the market sentiment, the Securities and Exchange Board of India, through the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, has developed the regulatory framework for promoters to be reclassified as public shareholders or ordinary shareholders in public limited companies, which are listed or in the process of being listed on the stock exchanges. The market has been taking advantage of these provisions and hence, there has been a shift in the trend in Indian Capital Markets, wherein companies are shifting from promoter-driven entities to Professionally Managed Companies. This paper shall explore the concept of a promoter along with the responsibilities and liabilities associated therewith, with emphasis on promoter contribution requirements. It shall then move forward into dissecting the drivers behind this changing trend and analyse the impact on the companies, management, investors and market as a whole.

Keywords: ICDR Regulations, Initial Public Offering (IPO), LODR Regulations, Promoter, Promoter Contribution, Promoter Reclassification, SEBI

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1. INTRODUCTION

In a listed company, there are two broad classifications of shareholders, promoter along with promoter group and public shareholders. The term public shareholders encompasses all forms of non-promoter shareholders, including Retail Investors, Domestic Institutional Investors, Foreign Institutional Investors, Alternative Investment Funds etc. Therefore, as the key distinction is made between promoter and non-promoter, it is integral to understand the concept of a promoter. This paper shall walk through the conceptual and regulatory framework laid down in the Companies Act, 2013; the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 (“**SEBI ICDR Regulations, 2018**”) and the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“**SEBI LODR Regulations, 2015**”)

2. LEGISLATIVE DEFINITIVE FRAMEWORK

2.1. *Promoter*

Promoters are the entities who exercise control over the affairs of the company, either directly or indirectly or upon whose instructions the board of directors of the company are accustomed to act. Promoters are also entities identified as such in the annual returns of the company or the draft offer document for a proposed issuance.²

The generally accepted notion of being a promoter comes with atleast 20%-25% shareholding, as statutory definitions certify twenty-percent as promoter holding in promoter definitions³ and a substantial acquisition is deemed to be 25% or more under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeover) Regulations, 2011⁴ as that is the shareholding level which can block a special resolution in a company.⁵ These are not straight-arrow rules or strict guidelines for determining whether one is a promoter entity, they are general notions which are open to being interpreted differently. Control is the key element in identifying a promoter.

² The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Reg. 2(oo)

³ The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Reg. 14(1)

⁴ The SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011, Reg. 3(1)

⁵ The Companies Act, 2013, § 114(2)(c), No. 18, Acts of Parliament, India (2013)

However, persons acting in a purely professional capacity are excluded from the ambit of being a 'promoter'.⁶ The term promoter is often misconceived as referring to the person who has started the company, however in reality, a new investor or an acquirer of the company can also become its promoter.⁷

Simply put, the promoter is the person/entity in the driving seat of the company, directing its actions and movement, either through majority shareholding, explicit special rights, their position in the company hierarchy and by virtue of the operating management/board of directors usually acting as per their directions. A company without any identifiable promoter is called a Professionally Managed Company ("PMC").

2.2. Promoter Group

Another term that operates in sync with promoters is promoter group, which collectively refers to the entities so closely related to the promoter entity, so as to essentially form one group including the concerned promoter. Promoter group entities are generally immediate relatives of individual promoters, subsidiaries and holding companies of corporate promoters, companies in which the promoter or their immediate relatives hold twenty percent or companies which hold twenty percent of the shareholding of the corporate promoter.⁸ Essentially, any entity so closely related to the promoter that their actions are deemed to be interconnected, interdependent and concerted, would come under the ambit of the promoter group.

2.3. Control

An integral part of the promoter definition is 'control'. Control is a highly contentious topic in capital markets worldwide, including India, owing to its abstract and open-ended nature. Existing definitions of control include the right to influence management and policy decisions directly or indirectly and individually or with persons acting in concert and the right to appoint the majority of the directors on the board of directors.⁹ This is an inclusive and not exhaustive definition in law, and while attempts have been made to better define the concept, they have failed to take enforceable effect due to various reasons beyond the scope of this paper.

⁶ The Companies Act, 2013, § 2(69) Proviso, No. 18, Acts of Parliament, India (2013)

⁷ The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Reg. 31A(5)

⁸ The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Reg. 2(pp)

⁹ The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Reg. 2(i)

3. IMPLICATIONS OF PROMOTER CLASSIFICATION

In light of the explanation hereinabove, the implications of the definition of ‘promoter’ need to be examined. These implications are focussed upon promoters of public limited companies, listed on a stock exchange or in the process of listing, as it is in such companies that the stakes are the highest, the scrutiny is the most intense and responsibilities are the greatest. Such companies are subjected to regulation by the Securities and Exchange Board of India (“SEBI”).

3.1. *Disclosures in Offer Document*

In any public issuance, the central support is the offer document, be it a Red Herring Prospectus in an Initial Public Offering (“IPO”),¹⁰ a Placement Document in a qualified institutional placement¹¹ or a Letter of Offer in a rights issue¹². These are the main forms of issuances in capital markets and each of these issuances is built upon their corresponding offer documents. These offer documents include various disclosures aimed at eliminating the information asymmetry between the company insiders, including the promoters, and the public investors / potential investors, to whom the securities are proposed to be issued. These disclosures cover a wide array of information which in a Red Herring Prospectus includes, *inter alia*:

- a) Information regarding the Capital Structure of the company, which includes details of current shareholding as well as all past issuances along with the extent of promoter shareholding.¹³
- b) Information regarding the Business of the company, its products/services, markets, strategies, strengths etc., along with the extent of involvement of and dependency upon the promoter in the operations.¹⁴
- c) Information regarding Outstanding Litigations of the company, its subsidiaries if any, its directors and its promoters, comprising all criminal, regulatory and taxation matters as well as material civil matters.¹⁵

¹⁰ The Companies Act, 2013, § 2(70), No. 18, Acts of Parliament, India (2013)

¹¹ The Companies Act, 2013, § 175(2), No. 18, Acts of Parliament, India (2013)

¹² The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Reg. 70(1)

¹³ The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Sch.6 Part A Para. 8

¹⁴ The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Sch.6 Part A Para. 10

¹⁵ The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Sch.6 Part A Para. 12(A)

- d) Information regarding the management of the company, which includes complete and elaborate profiles of the promoter entities,
- i. For Individual Promoters: their educational history; professional history; personal address etc.
 - ii. For Corporate Promoters: History of the company; natural persons being beneficial owners; changes in control of the company¹⁶

It is evident that the extent of disclosures with regard to the promoter entity is fairly extensive, all information regarding the promoter is made publicly available in the interest of ensuring incoming investors are fully aware of where and with whom they are investing their money. The flipside is the extensive liability imposed upon promoter entities. Disclosures are not as simple as just putting up the required information in the document, it involves extensive due diligence and suitable supporting documents, analysed and verified by lawyers on behalf of the merchant bankers to the issue. Therefore, over and above having to lay down elaborate details about themselves, there is also a significant time and cost investment to the company in the form of legal fees etc.

3.2. Minimum Promoter Contribution Requirement

In a bid to ensure promoters remain committed to and invested with the company even post-issuance, SEBI enforces the Minimum Promoter Contribution requirement which is a mandatory minimum level of shareholding which the promoter must have and maintain post the issuance.¹⁷ Such shareholding is locked-in for a stipulated period and cannot be transferred or dealt with, in any manner for the duration of the lock-in, with the exceptions of inter-se transfers and certain pledges. Inter-se transfers are between other entities also holding such locked-in securities, provided that the transferred securities remain locked in for the remainder of the original tenure.¹⁸ Also, such securities can be given as collateral for borrowings for the same purpose as the concerned issuance with the stipulation that such securities shall remain locked in for the remainder of the lock-in duration.¹⁹

¹⁶ The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Sch.6 Part A Para. 12(G)

¹⁷ Supra Note 3

¹⁸ The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Reg. 22

¹⁹ The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Reg. 21

Promoters are mandated to hold atleast 20% of the post-issue capital²⁰ (or issue size in certain issuances)²¹ of the company as their minimum promoter contribution in an issuance. If the promoters do not have the requisite holding, alternative investment funds, mutual funds, commercial banks etc. can contribute up to 10%, in order to meet that requirement.²² This imposes an additional liability on the promoter as if they cannot meet the requirement on their own, they need to enter into agreements with such institutions and convince them to support the promoter. This requirement is to be met atleast one day prior to the opening of the issue.

Promoter contribution in an IPO or Further Public Offer is then locked in for a period of 18 months from the date of allotment in the issuance, and if the stated Object of the Issue is capital expenditure, such as the purchase of immovable property or fixed assets, the lock-in period extends to three years. If the promoter's shareholding is in excess of 20%, such additional holding shall be locked in for a period of six months.²³ However, there is no Minimum Promoter Contribution requirement and mandatory lock-in thereof in PMCs.²⁴

In contrast thereto, any shareholding by pre-issue shareholders is locked in for six months from the date of allotment in the issuance as a fixed rule, regardless of the Object of the Issue and with no mandatory minimum.²⁵ Therefore, it is evident that severe liabilities and restrictions with regard to shareholding are imposed upon promoter entities, whereas the restrictions on non-promoter pre-issue shareholders are far less stringent. All lock-in requirements are calculated excluding the number of shares successfully sold through the Offer for Sale by the Selling Shareholders and the Employee Stock Option Schemes if any.

3.3. Public Perception

Over and above statutory obligations imposed upon promoter entities, there also exists the public image of the promoter, which comes along with excessive expectations and scrutiny. The promoter of the company is widely perceived as the soul and mind of the company, which means investment and shareholder sentiments/expectations, are driven by and rest upon the promoter. Their actions are scrutinised and the market perception of the company is heavily intertwined with that of the promoter.

²⁰ Supra Note 3

²¹ The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Reg. 113(1)

²² Supra Note 3

²³ The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Reg. 16; The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Reg. 115

²⁴ Supra Note 3

²⁵ The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Reg. 17

Often, the personal matters of the promoter drive exceptional change in the market perception and ergo valuation of the company. A recent example is the controversial and contentious divorce of Raymond Ltd.'s promoter, Gautam Singhanian, depreciating the market valuation of Raymond Ltd.'s shares.²⁶ Raymond Ltd.'s shares have plummeted approximately 12.8%, since Singhanian's divorce announcement on November 13, 2023, as compared to marketing closing on November 24, 2023.²⁷ Furthermore, the promoter entity becomes the face of the company not just in public perception but also in regulatory and government perception, which in addition to weighing heavy on the promoter, can be detrimental to the company as well, as seen in the case of Raymond.

3.4. *Foreign Investor Perception*

Promoter-driven companies are prevalent in India, however, they are not as common in other, more developed countries with more sophisticated investors. These investors hold a substantial stake in the Indian Capital Markets. Foreign Institutional Investors, which are sophisticated institutional investors based in other countries, controlled over 20% of the entire equity market in India as of the end of the last financial year.²⁸ Foreign investors also act as anchor investors in public issuances. Anchor investors are those sophisticated investors who invest at least INR 10 Crores in an issuance²⁹ and their investment acts as a comfort factor for retail investors.

Therefore, the perception and preferences of foreign investors must be catered to in Indian Capital Markets. These investors tend to prefer Professionally Managed Companies, which are companies with no identifiable promoters, as compared to Promoter Driven Companies as they find comfort in the fact that PMCs are not controlled by one entity or group and are rather in the collective control of all shareholders by virtue of and in the ratio of their shareholding. This, in their opinion, reduces the chances of selfish interests, mismanagement, ignorance of minority shareholders or overall unfavourable direction. Hence, to meet the preferences of foreign investors, companies may opt to be PMCs instead of promoter-driven entities.

²⁶ Vikrant Chauhan, 'Billionaire Gautam Singhanian announces split after wife's 'Diwali party' charge', India Today, (Nov. 14, 2023, 15:21 PM IST), <https://www.indiatoday.in/india/story/raymond-group-chairman-gautam-singhanian-separation-wife-nawaz-modi-stopped-at-diwali-party-2462410-2023-11-13>

²⁷ Google Finance – NSE: Raymond Ltd., https://www.google.com/finance/quote/RAYMOND:NSE?sa=X&ved=2ahUKEwjexNjji-OGCAxX9TGwGHbpYC8sQ_AUoAXoECAIQAw&window=1M, (Nov. 26, 2023)

²⁸ Parimal Ade, 'Can India's stock market do well without FIIs?', Deccan Herald, (Jul. 13, 2023, 12:23 PM IST), <https://www.deccanherald.com/opinion/can-india-s-stock-market-do-well-without-fiis-1236199.html>

²⁹ The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Reg. 2(c)

3.5. Other Liabilities

- 3.5.1. Liability for exit offer to dissenting shareholder upon alteration of Memorandum of Association³⁰
- 3.5.2. Liability for exit offer to dissenting shareholders upon alteration of Objects of Issue³¹
- 3.5.3. Liability for misstatements in the prospectus for an issuance³²
- 3.5.4. Liability for contravention of The Companies Act, 2013 in private placements³³
- 3.5.5. Liability for disclosures in Explanatory Statement to Notice³⁴
- 3.5.6. Obligation to be involved in daily operations of the company

The drivers and intent behind promoter reclassification and becoming a PMC have been highlighted hereinabove. In light of the analysis of the obligations imposed upon promoter entities, in the form of disclosure requirements, minimum promoter contribution and lock-in requirements as well as public scrutiny and perception, the detriments of being classified as a promoter are clear, and that, coupled with the foreign investor angle, sets the stage for promoter reclassification.

4. PROCESS OF PROMOTER RECLASSIFICATION

This process is enumerated for listed entities, in the SEBI LODR Regulations, 2015, which prescribes certain criteria, all of which must be complied with by the promoter and their corresponding promoter group. If the promoter is reclassified as a public shareholder, the promoter group entities shall also be classified as public shareholders automatically, as their promoter group status is wholly dependent on the promoter entity being classified as such. The criteria with which the promoter and promoter group must comply are as follows:

- a) Their collective shareholding must not represent more than 10% of the total voting rights in the company.
- b) They should not exercise direct or indirect control over the affairs of the company, individually or collectively.
- c) They should not have any special rights with regard to the company, via any formal or informal agreement/arrangement.

³⁰ The Companies Act, 2013, § 13(8)(ii), No. 18, Acts of Parliament, India (2013)

³¹ The Companies Act, 2013, § 27(2), No. 18, Acts of Parliament, India (2013)

³² The Companies Act, 2013, § 35(1)(c), No. 18, Acts of Parliament, India (2013)

³³ The Companies Act, 2013, § 42(10), No. 18, Acts of Parliament, India (2013)

³⁴ The Companies Act, 2013, § 102, No. 18, Acts of Parliament, India (2013)

- d) They should not have any representation on the board of directors of the company (through a nominee director or otherwise), thereby ensuring they have no control over the management decisions.
- e) Neither the promoter nor their promoter group should hold a position of key managerial personnel of the company.
- f) They should not be classified as a wilful defaulter or a fugitive economic offender.³⁵

Pursuant to the above set of compliances, the promoter entity must make an application to the board of directors of the company, seeking reclassification with reasons therefor, which, upon analysis and approval by the board, is to be placed before the shareholders of the company at a general meeting. Such general meeting must be conducted within three months from the board approval but not earlier than one month from the board approval. The shareholders must then approve this application via an ordinary resolution, wherein the concerned promoter and promoter group shall not be entitled to a vote. The promoter entity would be considered reclassified as a public shareholder upon the passing of the ordinary resolution to that effect, by the shareholders of the company.³⁶

This process can be followed by all companies, be it private limited, unlisted public limited or listed public limited. Although, in private limited companies, as there are no public shareholders involved, the procedure is not as strictly regulated as it is in listed public limited companies. However, if the company is already listed, a few additional compliance requirements and disclosure mandates are invoked, in order to keep all shareholders and stakeholders apprised.

Firstly, the board of directors needs to disclose to the stock exchange where the securities of the company are listed about the receipt of an application from a promoter entity seeking reclassification as well as the minutes of the board meeting wherein this application was discussed and the decision thereupon. Within 30 days of the shareholder approval for the reclassification, the company must submit the application to the stock exchanges for their approval and must disclose the same through the stock exchanges as well as the decision of the stock exchange thereon.³⁷ The promoter is reclassified as a public shareholder only upon the approval of the stock exchanges, for a listed company.³⁸

³⁵ The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Reg. 31A(3)(b)

³⁶ The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Reg. 31A(3)(a)

³⁷ The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Reg. 31A(8)

³⁸ The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Reg. 31A(2)

In order to prevent malpractice or abuse of process, the framework herein, explicitly declares that if the reclassified entities, after being so reclassified, hold more than 10% of the voting rights or acquire control over the company or are bestowed with any special rights, they shall automatically be reclassified as promoter entities with immediate effect.³⁹ With regard to *Point d* and *Point e*, a cooling period of three years is prescribed, wherein, if these criteria are breached within three years of reclassification, such entities will be deemed promoters again, however, post the cooling period of three years, such reclassified entities may have representation on the board of directors or may hold a key managerial personnel position without being deemed promoter entities.⁴⁰

The regulatory framework also provides for public shareholders seeking to be reclassified as promoter entities, wherein, if approved by the board of directors and shareholders of the company, such entity would have to make an open offer to the existing shareholders of the company under the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011.⁴¹ An open offer is an invitation to offer made by an entity acquiring control or substantial voting rights (giving them power over 25% of the voting rights) in a company, wherein dissenting shareholders not willing to be invested under the new promoter entity, can tender their shares to such entity, who must purchase them at the predetermined price.⁴²

5. RECENT PROMOTER RECLASSIFICATIONS IN THE INDIAN CAPITAL MARKETS

5.1. *Protean eGov Technologies Limited*

The original promoter of technology services provider Protean eGov Technologies Limited, Suresh Sethi was reclassified as a public shareholder and currently holds the positions and titles of Managing Director and Chief Executive Officer of the company which was successfully listed on November 13, 2023.⁴³

5.2. *PayTM – One97 Communications Limited*

³⁹ The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Reg. 31A(4)(a)

⁴⁰ The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Reg. 31A(4)(b)

⁴¹ Supra Note 7

⁴² The SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011, Reg. 3

⁴³ Business Today - Protean eGov Technologies Ltd Share Price, <https://www.businesstoday.in/stocks/protean-egov-technologies-ltd-share-price-404911#:~:text=The%20promotor%2Fpromoters%20of%20Protean,Krishnamurthy%20Rao%2C%20Maulesh%20Jagatkumar%20Kantharia>, (Nov. 26, 2023)

The original promoter of the financial services platform PayTM, Vijay Shekhar Sharma, was reclassified from a promoter entity to a public shareholder prior to the company's IPO in 2021. He retained the titles of Chairman, Chief Executive Officer and Managing Director of the company.⁴⁴

5.3. Zomato Limited

The original promoter of delivery services platform Zomato, Deepinder Goyal, was also reclassified from a promoter entity to a public shareholder prior to the company's IPO in 2021. He holds the positions and titles of Founder, Managing Director and Chief Executive Officer of the company.⁴⁵

Note: As these companies converted to PMCs and reclassified their promoters prior to their listing on stock exchanges, the bar on being a KMP does not apply to them, and hence the original promoters are holding positions as KMPs in the companies.

6. ANALYSIS AND CONCLUSION

Based on the discussions hereinabove, the concept of a promoter and their liabilities in the capital markets are clear. Being a promoter can be a very daunting and burdensome role, however, it does come with its benefits, such as continuing to be in control of the company founded, publicity for the growth of the company as the brainchild of the promoter and ofcourse financial benefits from listing gains as well as through sale via the Offer for Sale component in an IPO. While this paper focussed on the detrimental repercussions of being a promoter, the benefits can far outweigh the drawbacks. That coupled with the Indian market sentiment encouraging promoter-driven companies, is the reason behind the fact that most companies in the Indian Capital Markets are promoter-driven. However, this is changing. As India is catching up to the more developed and sophisticated capital markets around the globe, and as the size of the market has been growing exponentially, there is a shift towards PMCs. The market and companies therein are realising the benefits of being professionally managed as discussed herein. Other benefits of being a PMC are better skills in management, potential for better

⁴⁴ Business Today, 'Vijay Shekhar Sharma-led Paytm receives shareholders' nod to raise Rs 12,000 crore', Business Today, (Jul. 12, 2021, 19:20 PM IST), <https://www.businesstoday.in/latest/corporate/story/vijay-shekhar-sharma-led-paytm-receives-shareholders-nod-to-raise-rs-12000-crore-301095-2021-07-12>

⁴⁵ Mugdha Variyar, 'No-promoter IPO: Zomato may only be 10th in 15 years; may guide more Indian unicorns', CNBC TV18, (Apr. 29, 2021, 19:04 PM IST), <https://www.cnbc18.com/market/no-promoter-ipo-zomato-may-only-be-10th-in-15-years-may-guide-more-indian-unicorns-9111601.htm>

shareholder returns and growth as well as pure focus on the company and its benefits as compared to focus on the promoter's vision of the company.

SEBI as the market regulator, has taken notice of the changing trends and improved the regulatory framework facilitating promoter reclassification in 2018. However, the trend is picking up momentum in the realm, not under the control of SEBI, i.e., unlisted companies. Companies intending to go for an IPO have been reclassifying their promoters by applying SEBI's requirement, but as this is done at an earlier stage, it is not regulated by SEBI. That being said, SEBI has to be satisfied that the entities purported to have been reclassified have actually complied with the conditions laid down in that regard, in order to approve the issuance as a PMC.

In conclusion, promoter reclassification is a vital tool offering promoters a necessary option with regard to their position in the company, in light of the extensive liabilities associated therewith. Companies have been taking advantage of this option, albeit gradually. The prevalent market sentiment in favour of and comfort in promoter-driven companies will take time to change, but PMCs are likely to be the bulk of public issuers in the future.

