

# [Initial public offering and differential voting rights essay sample](https://assignbuster.com/initial-public-offering-and-differential-voting-rights-essay-sample/)

SEBI has constituted a standing committee, chaired by Shri M S Verma, Chairman, TRAI. This committee comprises representatives from ICAI, ICSI, investor associations, merchant bankers, Industry associations, Ministry of Finance etc. The terms of reference of this committee are as follows : 1. To advise SEBI on matters relating to regulation of intermediaries for ensuring investor protection in the primary market. 2. To advise SEBI on issues related to development of primary market in ndia. 3. To advise SEBI on matters required to be taken by for changes in legal framework to introduce simplification and transparency in the primary market. This committee meets at regular intervals and makes recommendations to SEBI. The committee had received several representations from merchant bankers and other participants in the primary market regarding the various changes required in the SEBI (Disclosure and investor Protection) Guidelines, 2000, in order to make it more market/investor friendly. The committee discussed these suggestions and has made the following recommendations to SEBI : (I) Provisions relating to Book Building I (1) Requirement to mention floor price in the Red Herring Present Position The company is required to disclose the floor price in the Red Herring Prospectus to be submitted to RoC, at least 3 days prior to the bid opening date, as per Clause No. 11. 3. 1(vii)(a) of SEBI (DIP) Guidelines, 2000. Recommendation

The company may be allowed to disclose the floor price, just prior to the bid opening date, instead of in the Red herring Prospectus. This may be done by any means like a public advertisement in newspapers etc. Rationale As per provisions of section 60B (2) of Companies Act, 1956 Red Herring prospectus is to be filed with ROC at least 3 days prior to the bid opening date. That means issuer company has to disclose the floor price prior to atleast 3 days of the bid opening date. In a dynamic market scenario, the companies do not like to indicate a floor price too much in advance to the bid opening period, as the market conditions may change, requiring the company to revise its floor price downwards, which may not be possible in case the floor price has been frozen in advance. I (2) Moving price band Present position

As per Clause No. 11. 3. 1(vii)(a) of SEBI (DIP) Guidelines, 2000, Red Herring prospectus has to disclose the floor price (i. e. the price below which the issuer is not willing to ‘ .) Disclosure of “ price band” is not allowed. sell’ Recommendation SEBI may consider providing flexibility to the issuer company by permitting them to indicate a 20% price band ( Flexibility of moving the price up and down). Issuer may be given the flexibility to revise the price band during the bidding period. Rationale The committee felt that indicating a floor price defeats the very purpose of book building, as the investors tend to bid at or around the floor price. The price band may be allowed to be moved upwards or downwards, depending on the direction in which the book is being built. The moving price band coupled with a closed book building will help in real price discovery.

I (3) Closed Book building Present position As per clause 11. 3. 1, the issuer/merchant banker(s) are required to ensure online, real time graphical display of demand and bid prices at the bidding terminals, during the bidding period. The book running lead manager is also required to ensure the availability of adequate infrastructure for data entry of the bids on a real time basis. Recommendation The issuers may be allowed to have a closed book book-building i. e. the book will not be made public and the applicants will have to take a call on the price at which they should make the bid, without having any access to information regarding the bids made by other applicants. Rationale The committee was of the view that revealing details of “ bids” received in not in consonance with the concept of “ price discovery” as a discovery is possible only when the applicants make independent bids. Revealing the book also leads to cartelization of the process and makes it meaningless.

I (4) Re-look at 3rd condition of Rule 192b for 10% issue Present position As per Rule 19(2)(b) of the SC(R)R, 1957, a company make an IPO of less than 25% of its post issue paid up capital subject to 3 conditions, one of which was “ Issue should be made through book building mechanism, with minimum 60% allocation to QIBs” (else the issue fails). Recommendation SEBI may examine this requirement and if approved, request Government of India to delete this requirement. Rationale The committee pointed out that there is an anomaly in view of the following : A company offering at 25% of its post issue paid up capital, having the necessary track record is allowed to come out with either a fixed price issue or a book built issue. However, the same company, if it is offering 24. 99% of its post issue paid up capital, is required to make the issue through book building with compulsory allotment of 60% to QIBs, failing which the issue is deemed to have failed. As per Clause 2. 2. 1 of the guidelines, this requirement of 60% allocation to QIBs is required only in case a company is not having the necessary track record.

Hence, there is an element of inconsistency in the provisions of the SCRR vis a vis SEBI (DIP) Guidelines, as SC(R)R equates companies with track record, but offering less than 25% with companies without track record. In order to ensure harmonious provisions in the SC(R)R, the committee felt that a company otherwise satisfying the eligibility criteria laid down by SEBI may be allowed to offer less than 25% subject to compliance with the first two conditions. I (5) Research report Present position Clause 9. 3. 1(iii), regarding research report, states the following : “ no report or information, other than the contents of the draft offer document shall be circulated by the issuer or any member of the issue management team/ syndicate or their associates, after the date of receipt of observations from SEBI.” Recommendation It has been recommended that black out period for research should be re-stated as “ from 40 days before issue opening till 40 days after issue closing”.

Rationale The committee noted that the current requirements are very restrictive in nature. SEBI’ observations are valid for a period of 1 year. In such cases, the members of the s issue management team cannot issue any research reports from the date of the observations, which, in extreme case means a blackout for almost a year. It was also submitted that the international practice is to have blackout for 30-45 days prior to launch of issue till the same period after issue closing. (II) Other provisions II (1) Hosting of Draft and final prospectus on the company/Lead Manager’s site till listing. Present position The draft offer document is hosted on SEBI’ website for a period of 21 days from s filing of the document and the final prospectus is hosted from issue opening till closure of the issue. Red herring prospectus is available on SEBI’ website till bid s closing. Recommendation The draft and final offer document may be made available on the lead manager’ and s company’ website till listing. s Rationale

The committee felt that to have wide dissemination of information in the prospectus/draft offer document and to provide easy and wider access to investors, the draft and final prospectus of issuer companies may be hosted on the company and lead manager’ websites. s II (2) Definition of Retail Investors Present position Retail investor, in case of a book built issue is defined as any applicant who applies for not more than 1000 shares. Even in fixed price portion at least 50% of the issue is made available for investors who have applied for not more than 1000 shares. Recommendation “ Retail investor” may be re-defined in terms of the amount applied for, instead of the number of shares applied for, as at present. Rationale The committee was of the view that current definition does not differentiate between a “ retail investor” who has applied for 1000 shares of Rs. 530 each and a “ retail investor” applying for 1000 shares of Rs. 10 each, even though the profile of these investors differs vastly.

II (3) Requirement regarding minimum subscription in an issue Present position A company is required to refund the entire subscription received in the issue in case it has not been able to collect at least 90% of the issue size. Recommendation SEBI should consider not having a mandatory requirement of 90% subscription and allowing the companies to disclose in the prospectus, the amount of minimum subscription they require and the sources for meeting the shortfall. Rationale The committee was of the view that there may be cases where the company has multiple projects in hand and seeks to raise resources for them through the public issue. Even if the company does not get 90% amount, it may still be able to take up some of the projects and not taking up the rest may not have any impact on the other projects. Moreover, increasingly companies, especially those in the services sector, are raising resources for expansion of facilities. Even in these cases, less than 90% subscription may mean a reduction in the expansion plans, not a complete failure. However, his may require amendments to the Companies Act provisions.

II (4) Green shoe option One of the reasons attributed for the dull sentiment in the IPO market is that of the perceived overpricing of the issues and trading of shares at a price below the issue price immediately after listing. SEBI has been following a policy of “ free pricing” for issues and allows a company to freely price its shares, subject to the justification for the price being disclosed in the document. However, the committee felt that SEBI, in its developmental role, needs to break the vicious circle of “ dull market-lack of trading interest-depressed prices-dull market” and recommended that SEBI may examine the practice of “ green shoe option” available in other markets abroad. Green shoe option is an “ over allotment” option granted by the issuer to the underwriter in a public offering. This enables the syndicate member to over allocate the shares to the extent of option available and to subsequently purchase additional shares from the issuer at the original offering price in order to cover the over-allotments (if required).

Typically this option is to the extent of 15% of the issue size. In the Indian context, if the issuer company opts for Green Shoe option, the mechanism would work as follows : i. If a company is issuing 100 shares, the company will grant an over-allotment option to one of the members of Issue management team to the extent of say 15 shares. ii. Simultaneously, the promoters would lend 15 shares to the syndicate member for a limited period of 30 days from the date of listing. (To this extent, exemption would be required from SEBI(DIP) Guidelines regarding lock in of pre-IPO shares for one year from allotment. The provision may be added to allow Syndicate Member to borrow shares for this purpose ) Allotment would be made to the extent of 115 shares.(100 shares issued by the company and 15 borrowed from the promoters) Listing permission is taken for 100-115 shares ( To this extent, Stock Exchanges would be required to give listing approval for shares, which may or may not be issued, depending upon the scenario) . In case, on listing the price falls below the issue price, the Syndicate Member may buy shares from the market to the extent of 15 shares. This may counter the selling pressure. The shares bought by the Syndicate member are then returned to the promoters. Thus, only 100 shares remain listed on the exchange after 30 days. In case the share price rises rapidly, the Syndicate member does not enter the market and at the end of the 30 day period (or before) invokes the overallotment option, asks the company to allot 15 more shares. These shares are then returned to the promoters. Thus 115 shares remain listed on the exchange.

B. Equity Shares with Differential Voting Rights

The extant SEBI (DIP) Guidelines, 2000 specifies norms for Public Issue/Rights Issue/Offer for Sale of any security. Section 86 of the Companies Act, 1956 has been amended w. e. f 13/12/2000 providing for issuance of equity share capital with different rights as to dividend, voting or otherwise. The amended section reads as under : “ The share capital of a company limited by shares shall be of two kinds only, namely: (a) equity share capital – (i) with voting rights; or, (ii) with differential rights as to dividend, voting or otherwise in accordance with such rules and subject to such conditions as may be prescribed; (b) preference share capital.” As, SEBI (DIP) Guidelines is applicable for Public Issue/Rights Issue/Offer for Sale of any security, Equity Shares with Differential Rights also comes under its purview.

In light of this amendment in the Companies Act, SEBI(DIP) Guidelines 2000 has been reviewed internally. It was found that SEBI(DIP) Guidelines, 2000 in general, is applicable for Equity Shares with differential voting rights. However, the following issues have been specifically examined and addressed Public Issue requirements in DIP Guidelines As SEBI (DIP) Guidelines, 2000 is applicable for Public Issue/Rights Issue/Offer for Sale of any instrument, it will be applicable for Public Issue/Rights Issue/Offer for Sale of Equity Shares with differential voting rights. In the same logic, the limits of promoters contribution, post-issue capital etc. would have to be calculated in the line of the same applicable for Equity Shares with normal voting rights.

Under the existing law, there appears to be no prohibition against composite issue of Equity shares with normal voting rights and Equity shares with Differential voting rights. Therefore composite issue of Equity shares with normal voting rights and Equity shares with Differential voting rights may be allowed. At the same time, it can be fairly assumed that Equity shares with Differential voting rights will be having less voting power compared to Equity shares with normal voting rights. Therefore, holders of Equity shares with normal voting rights will influence the decision of the company in most of the cases. It has therefore been felt that a company should not be allowed to make an initial public offering of Equity shares with Differential voting rights (ESDVR) prior to making an initial public offering of Equity shares with normal voting rights (ESNVR) to ensure public participation in the decision making process of a listed company. Rule 19(2)(b) of SCRR This rule provides for minimum public offering of 25% or 10% as a pre-condition for listing. The rule starts with the words: “ At least 10% of each class or kind of securities issued by a company was offered to the public… ”.

In view of the underlined words, the normal construction would be that 10% or 25%, as the case may of, the differential rights shares would also have to be separately offered to the public in the manner provided. This is because though section 86 speaks only of two kinds of capital, differential rights shares constitutes a separate class of instrument within the equity shares category . Listing requirement Compliance with rule 19(2)(b) as explained above is necessary for obtaining listing.. Therefore atleast 25% or 10% of the Equity shares with Differential voting rights are required to be offered to public for being eligible for listing. The conditions of continued listing shall be applicable for each instrument separately. Moreover, in case of a further issue of differential rights shares to promoters, the provisions of clause 40A(iii) of the Listing Agreement would be applicable and would have to be complied with.

All provisions of the Listing Agreement would be applicable to differential rights shares also since they are also a class of equity shares, provided no absurdity arises on such application. Preferential Allotment Clause 13. 0 of the DIP Guidelines says that the preferential allotment guidelines apply to all preferential allotments of equity shares. As per section 86 of Companies Act, 1956, Equity shares with Differential voting rights is also a type of equity share. Therefore provisions of SEBI (DIP) Guidelines, 2000 regarding preferential allotment will be applicable for preferential allotment of Equity shares with Differential voting rights. Bonus shares entitlement Regulation 96 of Table A (Model Articles of Association to be adopted) of Schedule I of the Companies Act lays down the provisions relating to bonus issue. Sub-clause

(1)(b) thereof says that the reserves etc. may be capitalised inter alia for the purpose of issuing fully paid bonus shares “ amongst the members who would have been entitled thereto, if distributed by way of dividend and in the same proportions.” Therefore, if a company has the same articles as Table A, the bonus shares have to be issued in the same proportion in which dividend would be distributed. Therefore in the case of shares having differential rights as to dividend, would have to be treated differently and the entitlement of holders of such class will be scaled up or down to the same extent as their dividend would have been. If the articles contain some other proportion, that has to be followed. Rights entitlement Section 81(1) of the Companies Act, specifies the mode of making a rights issue. Clause (a) says that the further rights shares “ shall be offered to the persons who, at the date of the offer, are holders of equity shares of the company, in proportion, as nearly as circumstances admit, to the capital paid-up on those shares at that date.” Thus for deciding the rights entitlement, only the capital paid up on each share is relevant.

The rights to dividend, voting etc. are not. As per rule 3(9)(e) of the said Rules, the company has to state in its explanatory statement that a member of the company holding differential rights shares shall be entitled to bonus shares and right shares of the same class. This does not speak of the proportion of their entitlement vis-à-vis holders of ordinary equity shares. Thus the interpretation given above in calculation of rights and bonus entitlement has to be taken. In view of the above-mentioned consideration, the following proposals are being made: ? ? ? All provisions relating to ordinary Equity Shares will be equally applicable to the ‘ Shares with differential voting rights’ also. SEBI (DIP) Guidelines, 2000 needs to be amended prohibiting IPO of ‘ Shares with differential voting rights’ prior to IPO of ordinary of Equity Shares. Composite issue of both ordinary equity shares and shares with differential voting rights can be done.

However, all provisions of SEBI (DIP) Guidelines, 2000, applicable for issue of Equity Shares are to be complied with in case of issue of shares with differential voting rights on a stand alone basis. Provisions of Section 73 of Companies Act, 1956 are required to be complied with if ‘ Shares with differential voting rights’ are intended to be offered to public. Both ordinary Equity Shares and ‘ Shares with differential voting rights’ have to be of same denomination. ‘ Shares with differential voting rights’ are required to be offered to the public in the manner specified in Rule 19(2)(b) of SCR(R), 1957. ‘ Shares with differential voting rights’ are to be listed compulsorily subject to compliance with Rule 19(2)(b) of SCR(R), 1957. All provisions of the Listing Agreement would be applicable to ‘ Shares with differential voting rights’.

Provisions of SEBI (DIP) Guidelines, 2000, applicable for preferential allotment of ordinary Equity Shares will be applicable to the preferential allotment of ‘ Shares with differential voting rights’. ? It is permissible to issue 100% ‘ Shares with differential voting rights’ to the promoters. However, in that case provisions of Section 81(1A) of Companies Act, 1956 will be applicable. In case of a listed company, provision of Provisions of SEBI (DIP) Guidelines, 2000, applicable for preferential allotment of ordinary Equity Shares will be applicable. In case of Bonus Issue, Rights Issue, holder of ‘ Shares with differential voting rights’ shall be entitled to the shares of same class in the same proportion at which holders of the Equity Shares with normal right are getting the benefits.