COMMITTING ON EASE OF DOING (LISTED COMPANY) BUSINESS AND FUND RAISE

1. INTRODUCTION

In a move towards fulfilling the objective announced at Union Budget for financial year 2023-24, i.e., to simplify, ease, and reduce cost of compliance, the Securities and Exchange Board of India ("**SEBI**") on January 11, 2024, released interim recommendations and invited comments from the public ("**Consultation Paper**"). These recommendations, outlined in the Consultation Paper, address certain aspects of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("**SEBI LODR Regulations**") and Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 ("**SEBI ICDR Regulations**").

Given India's status as a developing economy and the need to attract substantial foreign investments, the recommendations in the Consultation Paper are a welcome move which could ease the fund raising activity while upholding the governance and regulatory standards.

2. RECOMMENDATIONS IN RELATION TO SEBI ICDR REGULATIONS

2.1 *Inclusion of compulsory convertible securities ("**CCS**") towards minimum promoters' contribution ("**MPC**")*

Currently, the SEBI ICDR Regulations does not consider the holding period for CCS towards holding period of shares required for MPC. However, the SEBI ICDR Regulations in other places (e.g. eligibility of offer for sale shares or OFS) do consider the period of CCS held towards holding period of shares to be offered in the OFS. Inclusion of CCS towards MPC is always a challenge which promoters have been dealing with in past only to resolve it through an exemption application to SEBI. Some recent examples where such exemption was granted include *Entero Healthcare Limited, Oravel Stays Private Limited, Bajaj Energy Limited, Happiest Minds Technologies Limited* and *Spandana Spoorthy Financial Limited*.

Further, the CCS come with certain benefits to the holder and once such security is converted it loses the advantage attached with the CCS in its original form (be it in terms of liquidation or dividend preference). In a situation where a company does not proceed with an Initial Public Offer ("**IPO**") it becomes difficult to restore the MPC shares back to their original form of a convertible security. The ability of a shareholder to convert the securities should be closer to the launch of an IPO and flexibility in its hands in case an IPO (due to market or other considerations) is not pursued further. Therefore, by way of the Consultation Paper, allowing convertible instruments towards MPC would also help in aligning the policy on calculating the holding period of such instruments for both MPC and OFS in an equitable manner.

2.2 *Expansion of entities eligible to contribute towards MPC*

Under the current regulatory framework, a promoter is required to contribute 20% of post-IPO share capital towards MPC. However, in certain situations it has been observed that the promoters do not hold the minimum 20% post-IPO share capital and hence are unable to fulfil this requirement. This requirement acts as a deal breaker for new age entrepreneurs, who often

hold lower teen (or single digit) percentage in their ventures and are unable to satisfy this requirement and in turn undertake an IPO.

By way of the Consultation Paper, it is suggested that non-individual shareholders should be permitted to contribute towards MPC without being identified as a promoter, subject to them holding at least 5% of post-IPO share capital. The intent of having the requirement of MPC has always been understood to make sure promoters maintain a substantial stake post IPO, i.e. to have "skin in the game".

The Consultation Paper, however, is missing the intent of MPC by allowing contributions from other non-individual investors and therefore, appears to deviate from the regulatory intent. The approach suggested in the Consultation Paper unfortunately focuses on managing liquidity by overlooking the regulatory intent. If that being the ultimate objective, there already exists a pre-IPO shareholding lock-up under SEBI ICDR Regulations to address concerns related to liquidity[1] which could have been revised in the Consultation Paper. Hence, the proposal to require non-promoter shareholders to contribute equity shares for MPC seems to be missing the point.

Alternatively, locking in shares of promoter group (in addition to the promoters') could have achieved the regulatory intent to some extent without unfairly burdening non-promoter shareholders, and promoting ease of doing business and plugging any structuring innovation promoters would engage into prior to an IPO to escape MPC.

However, in the event SEBI intends to implement the proposal captured in the Consultation Paper *as is*, SEBI should keep the following points in mind:

(a) trusts and partnership firms held by trustees or partners (who may be individuals) contributing towards MPC for achieving the shortfall without being identified as promoters; and

(b) the requirement of at least 5% shareholding for contributing towards the MPC should be dispensed with on account of widespread shareholding of certain issuers due to regulatory reasons or otherwise and situations where shareholders holding more than 5% are not willing to contribute towards the shortfall.

2.3 *Thresholds for refiling of the DRHP*

In accordance with the SEBI ICDR Regulations, fresh issue size cannot change beyond 20% between Draft Red Herring Prospectus ("**DRHP**") and Red Herring Prospectus ("**RHP**") stage and offer for sale issue size cannot change beyond 50% between DRHP and RHP stage. Prior to the Consultation Paper, there was a constant debate around which matrix to be followed for identifying whether the thresholds for refiling of the DRHP have been breached – accordingly, both the parameters were tested by the issuers prior to filing of the RHP.

The recommendation in the Consultation Paper provides clarity on the matrix (namely, the estimated issue size calculated in rupee value or as per the number of shares) to be followed in case of change in the "estimated issue size" in case of a fresh issue and offer for sale. Further, it has now been clarified that for fresh issue the matrix to be relied upon is issue size in Rupee

[1] Please refer Part IV: Lock-In and Restrictions on Transferability of Chapter II - Initial Public Offer on Main Board of SEBI ICDR Regulations.

terms (irrespective of such size disclosed in the DRHP or in the cover letter) and for offer for sale the matrix to be relied upon is the one disclosed in the DRHP only.

An important clarification by SEBI to further provide clarity and towards pushing its objective of ease of doing business.

However, there is still room for further easing the regulations by SEBI particularly in relation to 'use of IPO proceeds'. For example, the criteria triggering refiling of the DRHP also includes increase in estimated deployment in any of the objects of the issue by more than 20%. The focus should shift from 'changes in estimated deployment in any of the objects of the fresh issue' to 'the aim of maintaining the 20% threshold at aggregate level'. Any modifications to the objects of the fresh issue should not raise concerns for investors or regulators. Such consideration would strike a balance between ensuring transparency and safeguarding investor interests while accommodating practical considerations in the dynamic landscape of fund raising via IPO route.

By allowing a reasonable degree of flexibility in deploying individual objects within the specified threshold, issuers can navigate changes effectively without compromising regulatory standards or causing unnecessary disruptions in the filing process. As the market evolves, these refined thresholds can contribute to a more adaptable and investor-friendly regulatory framework, meeting the objective of the SEBI's consultation paper i.e., ease of doing business.

3. KEY RECOMMENDATION IN RELATION TO SEBI LODR REGULATIONS

The journey of dealing with heavy compliances does not end at the listing stage for an issuer. As soon as an issuer gets listed the SEBI LODR Regulations takes the front seat. Requirements like - timely disclosures, limit on memberships, corporate governance etc always add to the compliance burden of a newly listed company.

The existing provisions of the SEBI LODR Regulations trigger many compliances on the basis of market capitalization. These include the need to have one independent woman director on the board of directors, risk management committee, size of the board of directors, etc. Such compliances get triggered on the basis of calculation of market capitalization as on March 31st and remain applicable forever. To ease market capitalisation linked compliance for companies experiencing temporary fluctuations on account of internal or external factors, the Consultation Paper has recommended to increase the period for determining the market capitalisation of the listed entity to be the average of six months period (i.e. from July 1 to December 31).

While the proposal is beneficial for the listed companies, perhaps six-month may be a smaller window for a listed company to start undertaking host of obligations (in addition to the regular compliances), a better way could be to increase the period for determining market capitalisations of an entity to one year. This would ensure that the stock exchanges and investors factor in four quarterly results, including one annual result, of the listed company versus basing it on two very good quarterly result (which may be on account of various external factors) leading to short lived breach of market capitalisation. This particularly becomes important since the long term compliance requirements stick to the listed entity despite fall in its market capitalisation which may not be in line with the objective of ease of doing business and rationalising the compliance requirements of listed companies.

Further, if the listed entity ceases to maintain the required threshold (based on market capitalisation), the committee has recommended introducing a sunset clause of three years for such compliance, which could again be restricted to two years.

4. CONCLUSION

Through the Consultation Paper, SEBI has taken a positive step towards enhancing the ease of doing business in India. The proposed interim recommendations in SEBI ICDR Regulations and SEBI LODR Regulations reflect a balance between regulatory oversight and the need to foster a more business-friendly environment. Overall, SEBI's efforts to streamline regulations and enhance the business environment is a welcoming move.

If the regulator keeps an open mind to the public comments, it can have the potential to create a much more adaptable and investor-friendly regulatory framework, which would encourage the growth of companies in India. It remains crucial for SEBI to find a balance between regulatory oversight and the evolving needs of businesses to achieve the ultimate objective of easing the doing of business in the country.

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