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# Reviewing the Traditional Concept of Promoter and Promoter Group

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## ABSTRACT

*According to the data released by the National Stock Exchange (NSE), from January 2020-December 2021 i.e, amidst the global Covid-19 Pandemic, 78 companies have taken the Initial Public Offering (IPO) route to get listed on domestic stock markets. To put things into perspective, 63 companies have already taken the IPO route in 2021 and 15 companies in 2020, the calendar year of 2020 and 2021 is already seeing an increase percentage of IPO's by 47.04% when compared to 2018 and 2019<sup>2</sup>, all of this at a time when the pandemic is disrupting economic activities, companies are forced to shut their business voluntarily<sup>3</sup> which continues to wreak havoc on India's economy. The objective of this research paper is to comprehend how the watchdog of Indian capital market, Security Exchange Board of India (SEBI) is bringing about systematic changes, to balance out the shift taking place in the market, and to develop an environment where increasing number of companies are motivated to pursue the IPO route to get listed on domestic stock markets.*

**Keywords:** National Stock Exchange, Covid-19, Initial Public Offering, Listed.

## I. INTRODUCTION

Historically, Indian companies and enterprises has been managed and owned by families. Due to this, identification of promoter and subsequent regulations of promoter was highly important. In the last two decades, only handful number of companies such as ICICI, HDFC, Larsen & Toubro, ITC etc were professionally managed, in other words had no identifiable promoters. Now, with the opening of the economy and the entry of institutional players in the market, Indian companies are progressively becoming professionally managed companies. With this evolution in the shareholding pattern of companies there is a shift taking place in the market, and Indian markets progressively will no longer be called promoter controlled but there will be companies that will be widely held or institutionally owned and professionally managed. The watchdog of India's capital markets, SEBI has played an active role and several reforms have been framed with the goal of increasing transparency, and effectiveness of the

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<sup>2</sup> Past Issue IPO, NSE India, [https://www1.nseindia.com/products/content/equities/ipos/hist\\_ipo.htm](https://www1.nseindia.com/products/content/equities/ipos/hist_ipo.htm)

<sup>3</sup> Sec. 248(2), Companies Act, 2013

market.

### **(A) Research Methodology**

Sources of data (Includes but not limited to)

Secondary Statistical Data: 1) Websites of National Stock Exchange, Bombay Stock Exchange, Security Exchange Board of India

### **(B) Literature Review**

1) Security Exchange Board of India consultation paper, “Review of regulatory framework of promoter, promoter group and group companies as per SEBI (Issue of Capital and Disclosure Requirement) Regulations 2018, dated May 11, 2021: Recognising the evolution in the Indian market, and changing landscape of shareholding pattern in companies, there is a shift from companies that are backed by promoters to companies being widely held, institutionally owned and professionally managed. Due to this paradigm shift subsequent changes in the regulation are required to incentivise the market participants. The consultation paper proposes amendments to the framework governing 'Promoter', 'Promoter Group' and 'Group Companies' under the SEBI (Issue of Capital and Disclosure Requirements) Regulation. Further it seeks to move from promoters to controlling shareholders

## **II. EXISTING BURDEN OF COMPLIANCE AND RELAXATION PROPOSED**

An issuer making an initial public offer has to satisfy the conditions given in Chapter II of SEBI (Issue of Capital and Disclosure Requirement) Regulations, which was implemented in 2009. Since then, numerous modifications have taken place in the regulations with the objective to make public issues straightforward for Indian Companies and to have a regulation with minimal ambiguity. The SEBI ICDR regulations carves out a list of detailed set of obligation for being a promoter and includes inter alia, disclosure obligations, lock in restrictions, ensuring compliance with the applicable law. The promoters, historically even before the pre-SEBI era had the requirement of maintaining a minimum stake in those companies which are proposed to be listed, it was a condition mentioned in the Capital Issues Control Act, 1947. Keeping in mind the protection of the investors, in 1992 when SEBI was established, the regulatory body introduced condition requiring the minimum promoter equity contribution be locked with the issuer company after an Initial Public Offer. The same condition is present in the SEBI ICDR regulations, it restricts promoter from having an exit from the companies after an IPO. The promoter shall hold at least 20% of the post issue Capital, if it is less than 20%, a maximum of 10% of the post issue capital can be contributed by certain regulated entities such

as foreign venture capital investors, alternative investment funds, scheduled commercial banks, public financial institution, registered insurance companies, to make for the shortfall without being identified as promoters<sup>4</sup>. The SEBI ICDR regulation, imposes a lock in period for Minimum promoter contribution, during the IPO process, which is 3 years from A) date of commencement of commercial production or B) date of allotment in IPO offer, whichever is later. Further the promoters which are holding in excess of minimum promoter contribution, the excess amount shall be locked in for a period of one year from the date of allotment in the initial public offer<sup>5</sup>. Now, the SEBI consultation paper released on May 11, 2021<sup>6</sup> seeks to make reduction in the lock in period. Inter alia, it proposes, IPOs undertaken for financing, other than capital expenditure for a project or offer for sale, the minimum lock in period will be for 1 year from the date of allotment, as opposed to the present requirement of 3 years. Further promoters holding in excess of minimum contribution will be locked in for a period of 6 months, as opposed to the present requirement of 1 year. Such proposals will provide further flexibility to promoters with respect to their post issue holdings consequently will act as stimulus for the promoters to undertake IPOs of companies. Further as more and more companies are being institutionally held and professionally managed, the institutional investors such as the venture capitalist and private equity firms, who are usually not acquiescent with longer lock in periods will welcome such a move.

The SEBI ICDR regulations makes certain disclosure quintessential in the offer documents of any company which is going public through undertaking IPO of its equity securities, likewise the promoter group and group companies have to make a list of disclosures. The ICDR regulation, sets out different category of promoter group and the members that will be identified as promoters from different categories are based on certain criteria of each promoter i.e the members of the promoter group changes based upon whether a promoter is identified as an individual or body corporate. Inter alia, when a body corporate<sup>7</sup> (A) is defined as a promoter of a company (S), members of the promoter group will include i) a subsidiary or holding company of (A) ii) any company in which (A) holds 20% or more equity share capital and any company that holds 20% or more of the equity share capital in (A). iii) if a group of Companies or individuals or combination of both are acting in concert and holds 20% or more of the equity capital in (S) and also in another company (C), then Company (C) is a member of promoter

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<sup>4</sup> Sec. 14(1), SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009

<sup>5</sup> Sec. 16, SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009

<sup>6</sup> SEBI, Review of the regulatory framework of promoter, promoter group and group companies as per SEBI (Issue of Capital and Disclosure Requirement) Regulation, 2009

<sup>7</sup> Sec 2(1) (pp), SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009

group being a common investee. All these members of the promoter group are required to make plethora of disclosures. The consultation paper released by SEBI seeks to remove common investee from the definition of promoter group, as such entities are likely to be unrelated and the financial objectives of such entities can also be different. This will reduce the compliance burden for the investors and the issuer company will be relieved from a reduction in compliance.

The definition of group companies is given in Regulation 2(1)(t) of the ICDR regulation, it includes the companies with which the issuer has entered into a related party transaction (other than promoters and subsidiary of the issuer) during the period wherein the financial information is disclosed in the offer document and other companies as considered material by the board. In the offer document the group companies have to make disclosures inter alia, equity capital, nature of activities, date of incorporation, details pertaining to outstanding litigation, in case of more than 5 listed group companies then financial information of top 5 listed, in case of less than 5 or no listed group companies then financials for all listed company and largest unlisted group company or financials of 5 largest unlisted group companies based on turnover<sup>8</sup>. The consultation paper seeks to reduce the disclosure. It proposes to disclose only the names and registered office addresses of the group companies. Other information will be omitted from the offer document. Such a change when implemented, will reduce the disclosure burden of the companies at the time of undertaking an IPO. A change in the definition of promoter group and group companies is a progressive step taken by SEBI keeping in mind the shift in marketplace from promoter backed companies to professionally managed companies. The institutional investors will be benefited who will be spared from the possibility of their other investor companies becoming part of the promoter group of any issuer company. The proposed change in the consultation paper will reduce the disclosure requirements from group companies consequently the offer document will have no additional information which are not relevant for an investor's due diligence while investing in an IPO.

Lastly, keeping in mind the shift of the market, the regulator seeks to move from promoter/promoter group to person in control/ controlling shareholder. Under the existing guidelines, even though there has been a change in the promoter of the issuer company over a period of time, the person indicated as a promoter in the offer document will be liable. This was also emphasized in the standing committee on finance<sup>9</sup>. Consequently, there is an issue of

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<sup>8</sup> Schedule VI, SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009

<sup>9</sup> 21<sup>st</sup> Report, Standing Committee on Finance (2009-2010) on the Companies Bill, 2009

once a promotor always a promoter<sup>10</sup>. Being a promoter of a company subjects the person or body corporate to a plethora of obligation ensuring compliance with applicable law and continuous obligation even after ceasing to be control. Having a promoter tag even after a person ceases to be in control acts as a deterrent to institutional investors from making investments in controlling Indian companies. The proposed changes reflect the changing landscape in the Indian market, and the increased shareholding held by institutional investors in both listed as well as unlisted company. It will induce further investments from institutional investors as they will be less burdened with post exit obligation.

### **III. CONCLUSION**

According to the data released by SEBI, the period between April 2020 and January 2021 i.e, amidst the global Coronavirus Pandemic, the retail investors rushed to the stock markets, consequently during this period new dematerialised account rose to an all-time high of 10.7 million. This growth in the number of retail investors in the country is a reflection of systematic changes taken by the regulatory body to ensure smooth and easy access of the common public to stock markets. Technology is at the cornerstone reason behind the growth, E- KYC (Electronic Know Your Customer) and Aadhar e-signing are few examples that helped the retail investor community grow. The watchdog of India's capital market has proposed certain changes to balance the changing landscape of Indian market wherein the concept of promoter and promoter group is evolving and shifting towards the idea of person in control. With the ongoing initial public offering rush mostly from the startup universe, the regulatory gaps need to be revised to keep with the changing landscape of the market and to align with global standards. Keeping in mind the pandemic scenario, the consultation paper released by SEBI is a progressive step and is crucial for the growth and development of the Indian securities market.

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<sup>10</sup> SEBI Primary Market Advisory Committee, Re-Classification of Promoter as Public, 2014