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Mr. Abhishek Rozatkar, Assistant General Manager  
Smt. Yogita Jadhav, Deputy General Manager  
Corporation Finance Department  
Securities and Exchange Board of India  
SEBI Bhavan Plot No. C4-A "G" Block, Bandra-Kurla Complex,  
Bandra (East), Mumbai - 400051, Maharashtra, India  
Via email: [abhishek@sebi.gov.in](mailto:abhishek@sebi.gov.in)

**Re: Public Comment on the Issuance of Equity Shares with Differential Voting Rights**

Glass, Lewis & Co. ("Glass Lewis") appreciates the opportunity to comment on the Report submitted by the Primary Market Advisory Committee ("PMAC") of the Securities and Exchange Board of India ("SEBI") and the DVR Group, which was formed to evaluate the issuances of equity shares with differential voting rights in India.

Founded in 2003, Glass Lewis is a leading, independent governance services firm that provides proxy research and vote management services to more than 1,200 clients throughout the world. While, for the most part, institutional investor clients use Glass Lewis research to help them make proxy voting decisions, they also use Glass Lewis research when engaging with companies before and after shareholder meetings.

Through Glass Lewis' Web-based vote management system, ViewPoint, Glass Lewis also provides investor clients with the means to receive, reconcile and vote ballots according to custom voting guidelines and record-keep, audit, report and disclose their proxy votes.

From its offices in North America, Europe, and Australia, Glass Lewis' 300+ person team provides research and voting services to institutional investors globally that collectively manage more than US\$35 trillion, while Glass Lewis covers over 900 shareholder meetings in India on a yearly basis. Glass Lewis is a portfolio company of the Ontario Teachers' Pension Plan Board ("OTPP") and Alberta Investment Management Corp. ("AIMCo"). Glass Lewis operates as an independent company separate from OTPP and AIMCo. Neither OTPP nor AIMCO is involved in the day-to-day management of Glass Lewis' business. Moreover, Glass Lewis excludes OTPP and AIMCo from any involvement in the formulation and implementation of its proxy voting policies and guidelines, and in the

determination of voting recommendations for specific shareholder meetings.

The responses provided below are not meant to be exhaustive but are designed to address what Glass Lewis sees as the main issues and concerns raised in the Consultation Paper. Thank you in advance for your consideration and please do not hesitate to contact us if you would like to discuss any aspect of our submission in more detail.

Respectfully submitted,

/s/

Daniel J Smith, General Manager, CGI Glass Lewis

[dsmith@glasslewis.com](mailto:dsmith@glasslewis.com)

/s/

Jeffrey Jackson, Manager, Asia Research, CGI Glass Lewis

[jjackson@glasslewis.com](mailto:jjackson@glasslewis.com)

Enclosure

## **Overview**

The Consultation Paper views the creation of and ability for Indian companies to adopt differential voting rights share classes (“DVRs”) not as an isolated case, but rather as a continuation of other global markets adopting similar market rules. Indeed, the experiences of other markets are referenced, including the United States, Canada, and recent adoptees of multiple-class shares, [Hong Kong](#) and [Singapore](#). In this context DVRs are viewed by the PMAC and DVR Group as being beneficial for the Indian market, based on global experiences. The Consultation Paper’s premise behind DVR is to ostensibly encourage the growth of India’s high-tech sector, but it also seems to insulate founders/promoters and promoter groups from other investors.

The key rationale for adopting DVRs in India are:

- To allow companies to fundraise without dilution of control to protect against hostile bids, which reduces the need to engage in debt financing. For Indian companies, this route of fundraising is seen as advantageous as technology firms often have smaller amounts of tangible assets, which may make debt financing challenging.
- To allow investors to participate in equity investing at more efficiently priced shares. This is as DVR shares can be priced lower for shares with lesser voting rights, without any dilution of their rights to dividend distributions.<sup>1</sup>

The Consultation Paper examines a series of advantages and disadvantages of DVRs, which have been debated in many markets. For India, this issuance of DVRs is currently limited based on the Companies Act, 2013 (the “Act”), as well as by Securities and Exchange Board of India (“SEBI”) regulations. Notably, companies have been allowed to have DVR equity structures, although the issuance of a different share class must still have voting rights albeit they may be inferior to ordinary shares. Additionally, such inferior-voting shares may not exceed 26% of a company’s “total post-issue share capital, including equity shares with differential rights issued at any point in time<sup>2</sup>”.

The Consultation Paper notes that of the publicly-traded companies in India, there are only five companies with DVR equity structures including: Tata Motors Limited, Future Enterprises Limited, Gujarat NRE Coke Limited, Jain Irrigation Systems Limited, and Stampede Capital. Of the five

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<sup>1</sup> PMAC DVR Group Report. *Issuance of Equity Shares with Differential Voting Rights*. February 2019. Page 2.

<sup>2</sup> PMAC DVR Group Report. Page 5.

companies with DVR, the current share class structures were adopted between 2008 and 2011. The voting rights for three DVR companies allow fractional voting at 1/10<sup>th</sup> of an ordinary share, while Gujarat NRE Coke Limited's DVR has fractional voting rights at 1/100<sup>th</sup> of an ordinary share. However, the Consultation Paper does not indicate the differential voting rights for the fifth company, Stampede Capital.

The Primary Market Advisory Committee ("PMAC") of SEBI and the DVR Group, which produced the Consultation Paper, ultimately believes that companies which are already listed and those which may seek to list in the future should be allowed to adopt DVR equity structures provided:

- A company's articles of association must provide for such DVR shares; and
- The issue of DVR shares must be authorized by the special resolution passed at general meeting of shareholders. Companies would need to disclose details of the DVRs include: issuance size, ratio of difference in voting rights, rights to differential dividends, sunset clause (if any), coat-tailing provisions" or other disclosure as required by SEBI.<sup>3</sup>

As envisioned by the PMAC and DVR Group, there would be two types of share DVR classes. The first being "fractional voting rights shares" ("FR Shares"). FR Shares could be issued by companies already listed on a stock exchange for at least one year, while the shares would have a ratio of not less than 1 vote for every 10 shares held (1:10). FR Shares could be issued one of three ways: (i) rights issue; (ii) bonus issue pro rata to all equity shareholders; or (iii) a follow-on Public Offer, which would be open to subscription by existing shareholders and other third parties.

The other type of DVR share class is "superior votes rights shares" ("SR Shares"), would be reserved for companies seeking to IPO on a stock exchange. The primary requirement for SR Shares is that while companies would need to maintain such class of shares for more than a year prior to the filing of a draft offer document with SEBI, while only a company's promoters or promoter group can hold such shares. The SR Shares would have a voting rights ratio of up to 10 votes for each share held (10:1). SR Shares would have an initial five-year period following an IPO, before reverting to ordinary shares, but could be extended at least for an additional five-years. Companies with SR Shares would be allowed to issue FR Shares one year following their IPO.

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<sup>3</sup> PMAC DVR Group Report. Page 14.

### ***Glass Lewis' Views***

Glass Lewis strongly favours a “one-share-one-vote” principle. We believe shareholders should have a say in decisions that will affect them. We believe that allowing one vote per share generally operates as a safeguard for common shareholders by ensuring that those who hold a significant minority of shares can still weigh in on issues set forth by the board, especially regarding the election of director process. We believe that the voting power of each shareholder should match their economic stake such that no small group of shareholders, by virtue of their founder status or otherwise, should have voting rights different from those of other shareholders.

In our view, shareholders do and should take a limited role in the operation of the Company. Management, at the direction of the board, is there to operate the business. However, for matters relating to governance and shareholder rights, we believe shareholders should have the power to speak, the opportunity to be heard and effect change if necessary. That power should not be disproportionately concentrated in the hands of certain shareholders, including a company’s promoter or promoter group, for reasons other than economic stake.

With this starting point in mind, Glass Lewis believes DVR structures are typically not in the best interests for shareholders outside of the major and/or controlling shareholders. Accordingly, we are opposed to the proposed introduction of DVR structures in India. We see allowing DVR structures to lack clear benefits to the Indian economy and may have greater negative effects on shareholder rights in India, particularly as India is working to improve its image and reputation for attracting increased global investment. In fact, the introduction of DVR may instead harm India’s attempts to improve its image in corporate governance, much like Hong Kong and Singapore’s reputation was diminished following the introduction of multiple share class structures in 2018<sup>4</sup>. Additionally, investors may not be as supportive of multiple class share structures, as seen by S&P’s decision to exclude the high-profile, high-tech company, Snap, Inc., from the S&P 500 due to its multiple share class structure.<sup>5</sup>

We generally agree with the “Downside for Investors” portion of the Consultation Paper, while the “Downside for the Issuer” portion, we

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<sup>4</sup>Asian Corporate Governance Association and CLSA Limited. *CG Watch 2018. Hard Decisions: Asia Faces Tough Choices in CG Reform*. December 5, 2018. Pages 11-14.

<sup>5</sup> Trevor Hunnicutt. [“S&P 500 to exclude Snap after voting rights debate.”](#) Reuters. August 1, 2017.

believe, highlights important consideration as investors may not want to be marginalized on voting when they are making investments into a publicly-traded company. Further, we will selectively respond to the Consultation Paper sections “Companies Whose Equity Shares are Already Listed - Issuance of FR Shares” and “Companies Whose Equity Shares are Proposed to be Listed – Issuance of SR Shares” in the remainder of this submission.

### *Supporting Innovation*

We acknowledge that a DVR structure, particularly SR Shares, may afford managers control while raising equity capital during an incubation period. Yet, there is ample “patient capital” in India and across the world, such as in the form of pension funds with long-term investment horizons that seek to invest in companies that focus on sustainable growth instead of short-term profits. These types of investors may otherwise eliminate the need to have DVR structures. Furthermore, companies with DVR share structures and entrenched promoters/promoter groups are not guaranteed to perform better than companies with a single share class.

In relation to FR Shares, such shares would only be issued after a company’s IPO. As such, most companies that would be eligible to issue FR Shares would be beyond incubation stage. As a result, the claim that the introduction of FR Shares would promote innovation is tenuous, at best.

### *Eligibility Testing for Admittance with SR Shares*

To prove that the SR Shares are truly for high-tech companies, the rules should include eligibility testing. Indeed, as provided in Hong Kong’s rules for weighted voting rights shares, “Applicants are expected to demonstrate the necessary characteristics of innovation and growth and demonstrate the contribution of their proposed beneficiaries of weighted voting rights to be eligible and suitable for listing with [weighted voting rights] structure as set out in guidance published on the Exchange website and amended from time-to-time.”<sup>6</sup> Under the proposed rules, there is no such discussion, which makes the argument surrounding the need for SR Shares to support the high-tech sector questionable.

Likewise, rules for FR Shares should be developed to determine eligibility based on, for example, a company’s financial need as a driving force for FR

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<sup>6</sup> Chapter 8A. “Equity Securities - Weighted Voting Rights.” Hong Kong Exchange Limited. Page 8A-1. It is noted that in Hong Kong, the term “weighted voting rights” or “WVR” is used to denote class structures that have different voting rights, which would be similar to the term DVR.

Shares. Before such share classes are considered, equity issuances should be offered to existing shareholders on a rights basis.

#### *In Who's Interest? An Over-Reliance on Promoters*

Glass Lewis draws attention to the argument in favour of DVR structures which states:

*“One way to let Indian entrepreneurs have some autonomous space for managing and growing their business without the suppliers of their capital over-supervising them and offering advice they cannot afford is to allow them to issue shares with differential voting rights to the founders/promoters. If the business model and execution capability on offer are compelling, they would, attracted by the financial return promised by the venture. Research shows that firms with an exciting story to tell issue dual-class shares. Market will be willing to give up control to an insider who has proven to be successful.”<sup>7</sup>*

Despite the argument's premise, we see significant concerns where founders/promoters are afforded a controlling voting stake, when they may not have a majority economic stake. Additionally, we note the risk that owner managers who have a majority of their personal wealth tied up in shares of the issuer might have different incentives (e.g. to support higher dividend payouts to fund other personal financial commitments) and/or lower risk tolerances than portfolio investors.

#### **FR and SR Shares**

As previously mentioned, Glass Lewis does not support the introduction of DVR structures in India. We further believe the proposed criteria for issuing FR Share and SH Share structures would not result in significant mitigation of our concerns.

#### *Leveling the Playing Field for all Companies?*

Should the SR Shares be made available only to newly listed issuers, this could lead to a race to the bottom amongst existing listed companies. Notably, the proposed rules do not provide for limitations on corporate engineering (e.g. de-list then re-list, conduct a reverse takeover of a listed entity with a DVR structure) in order to secure a DVR structure, let alone being able to have both SR Shares and FR Shares following an IPO.

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<sup>7</sup> PMAC DVR Group Report. Page 2.

Additionally, it is possible that companies may seek to lobby SEBI for further changes to allow for SR Shares when competing for management talent and control. Therefore, we fail to see how such developments would benefit the Indian market overall.

We are also concerned about the prospect of a company ultimately having three classes of shares. Specifically, were a company to IPO, they would have SR Shares, with a 10:1 voting ratio compared to ordinary shares. When FR shares are added a year after and IPO with a 1:10 voting ratio, the holder of SR Shares would ultimately have voting power that is 100 times the voting power of an FR Shareholder. This drastic disparity of voting power with a concentration of voting power within the promoter group indicates that SR Shares are less about economic opportunity than relative immunity from other voting shareholders.

#### *Casting a Shadow on the Sunset Clause?*

As proposed, the SR Shares would have an initial period of five years from a company's IPO, which can then be extended for a further five years. However, there is no indication that a further extension may not be possible. We believe the sunset clauses should be specific and not be open to further extensions. Unfortunately, the proposed rules are vague about the prospect of future extensions. Likewise, for SR Shares companies, there should be a limitation on the ability to issue FR Shares until after the SR Shares are converted into ordinary shares.

In contrast to SR Shares, the FR Shares carry no sunset clause. Instead, the FR Shares would be valid in perpetuity, while conversion to ordinary shares can only take place through schemes of arrangement, share buy-back or by capital reduction. Also, as SR Share companies could issue FR Shares, such share classes could enable promoter groups to eclipse minority shareholders (or even majority shareholders where such shareholdings carry diminished voting rights) by keeping their interests in the shadows, while the power of promoters would be further entrenched.

#### *Limitations on Coat-Tail Provisions*

Shareholder rights and voting are central to owning shares in a company. As proposed, there are some coat-tail provisions for SR Shares, which result in SR Shares having only the voting power of ordinary shares for certain types of shareholder proposals. These proposals include: appointing/removing independent directors and/or auditor; change of control; material transactions; voluntary winding up; material changes to

articles or memoranda of association; debt resolution plans; and extending the validity of SR Shares from an initial five years. Yet, for FR Shares, there are no such provisions. As the aforementioned proposals are viewed as being important to all equity participants, holders of FR Shares should have non-diluted voting rights on such matters.

#### *Zero Sum Gains for Promoters at the Expense of Minority Shareholders*

While India has made strides in improving its corporate governance practices, the proposed DVR regime does not continue that trend. Rather, as promoters stand to benefit from increased power, there is little in improvements to corporate governance practices. Therefore, should promoters be provided with the ability to have SR Shares and issue FR Shares to outsiders, promoters should give up their presence on board committees. This could result in the audit, nomination and remuneration and other committees comprising solely of independent directors to avoid conflicts of interest with the promoters and executives alike. Likewise, promoters who are interested in proposals such as executive or non-executive director remuneration should be forced to abstain from voting as their self-interest and entrenched voting power could result in self-enriching pay packages. Lastly, no promoter should be exempt from not having to retire by rotation as every director should be subject to periodic retirement by rotation.

#### *The Holding of and Recording the Outcome of General Meetings*

As companies are required to disclose the voting results of general meetings, there is no discussion within the proposed rules of how SR Shares, let alone FR Shares will be counted or displayed in the meeting outcome. To ensure that FR shareholders are adequately represented in the meeting results and can participate in voting, all general meetings should be conducted by poll, while voting by show of hands should be abolished. To that end, the quorum rules in the Companies Act, 2013, would likely need to be amended to reflect such other share classes, while quorums should not be lowered.

#### *Conclusion*

We believe that the one-share-one-vote principle should remain intact to preserve the rights afforded to all types of shareholders. Based on the proposed rules, we view the introduction of DVR as potentially problematic for shareholder rights and participation. Overall, we view the proposed introduction of DVR as a step backward for India, especially considering the

advances India has made in the recent years in the realm of corporate governance.