

# From 'Promoter' To 'Person In Control: A Paradigm Shift In Concept Or a Mere Re-Conceptualisation Of The Term?

written by Abhilasha SG | April 18, 2022



The Securities and Exchange Board of India (SEBI) recently proposed four reforms that will have a significant impact on the business environment in India. They are as follows:

- a. Reduction of lock-in periods for minimum promoter's contribution
- b. Rationalization of the definition of the 'Promoter Group'
- c. Streamlining the disclosures of group companies, and
- d. Shifting from the concept of 'promoter' to the concept of 'person in control'

The scope of this article is only concerning the fourth reform.

## Context

India has taken various measures to boost business activities such as Startup India, production-linked incentive schemes, ease of doing business, etc., thereby fuelling the business environment. In furtherance of this goal, SEBI's reform is seen as a necessary and desirable step. SEBI seeks to amend the definition of "promoter" to "person in control" to make it comprehensive as well as appropriate to the transforming investor landscape in the post-Covid era. As time has progressed, the concept of promoters has taken on a different shape starting from conventional family-run promoters to the new age venture capitalists. The business trends show the prevalence of promoters by virtue of being classified as such, despite not having a proportionate financial stake. This may hamper the interests of the shareholders. There is a high probability of undue weightage given to promoters in corporate governance owing to the special privileges and preferential treatment granted to them under the legal regime.

## What's A Promoter?

A promoter is the most significant person in the growth of any business. Their role is to guide the company towards the peak of success. In all respects, a promoter can be considered the founding father of the relevant company.

Regulations 2(1)(za) and (zb) of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (hereinafter referred to as 'ICDR Regulations') defines 'promoter' and 'promoter group'.

## The Rationale For Reform

In the light of the aforementioned context, there is a need to revisit the

definition of the promoter to ascertain the persons with de facto control over business instead of those with de jure control. This means that SEBI endeavours to cause a paradigm shift of focus to those in control of the business rather than those who started the business.

Zomato is an excellent example of this. The red herring prospectus of Zomato states that the company is professionally managed without any identifiable promoter group. In this type of company, the concept of promoter itself is redundant as the board of directors are the ones who become accountable. Similarly, companies such as Larsen and Toubro also do not have any identifiable promoter group. Additionally, the recent past has seen many promoters of entities such as Yes Bank, Zee Enterprises and Mindtree losing a significant chunk of their shares in the company, causing a shadow of doubt to be cast on their ability to control the company -- though they are still labelled as promoters.<sup>[1]</sup>

The erstwhile concept of 'once a promoter, always a promoter' was identified and discussed by the Primary Markets Advisory Committee of SEBI in 2013 and 2014.<sup>[2]</sup> This was to be rectified by SEBI through Regulation 31A of the SEBI Listing Regulations for reclassifying promoters. However, this proved to be inadequate and did not yield the desired results. Regulation 31A states that the reclassification process can commence only if the promoter requests the listed company to do so. The procedure is entirely promoter-driven, and incapacitates the listed company, acting through its board, from initiating a reclassification of its promoters.<sup>[3]</sup> Therefore, this reform is much needed to address this long pending issue as well.

The shift would result in the removal of the reference to "promoters" and "promoter group" while introducing the concept of "person in control/controlling shareholders" and "persons acting in concert", respectively in various SEBI Regulations such as ICDR Regulations, LODR Regulations, Takeover Regulations, SEBI (Prohibition of Insider Trading) Regulations.<sup>[4]</sup>

SEBI is also mooted the change from "promoter group" to "persons acting in concert". Promoter Group means a relative of the promoter, persons whose shareholding is aggregated for the purpose of disclosing in the offer document the shareholding of the promoter group. By introducing the new concept, SEBI would like to include some of the major financial investors like private equity funds, pension funds and venture capitalists, who acquire an interest in the company and run it indirectly with the non-promoter as the person in control.<sup>[5]</sup>

There are situations where the promoter shareholder is minuscule whereas other dominant shareholders who are unable to be grouped are dominant. Additionally, there can also be shadow control exercised by the promoters despite not having adequate control. This means that promoters not in control might vote in favour of the majority and potentially harm the interests of minority shareholders. Further, with companies being professionally managed by persons in control, this reform seeks to abridge the asymmetry and bring them under the one and same umbrella of the person in control.

Pro And Cons Of The Reform

Pros:

- The compliance requirements of promoters can be reduced, giving them greater relief regarding disclosures and other obligations.
- Corporate governance can be professionally managed better by those in control

rather than being merely promoter-driven.

- It will encourage more private companies to come forward and get listed since compliances will be eased, thereby deepening the securities market. This will further attract foreign investments.

Cons:

- Concerns could arise regarding the period of transition which might affect business continuity along with stability.
- If the drafting of the law in terms of the definition and ambit of 'persons in control' is vague and ambiguous, this would cause disharmony, especially in the wake of the term "control" being interpreted differently by courts and the concept itself being layered, taking into account various situations. It ought also to be interpreted strictly while carefully carving out their rights bringing it in line with international best practices.

Key Concerns

If the proposed changes are to materialise, certain concerns must be adequately addressed. How would related party transactions work for persons in control? Whom to pin the liability on, whether it would be the entire board of directors or CEO or anyone else? What would be the accountability mechanism? How would the voting rights be divided?

There should be a clear separation of ownership and management for ascertaining the "person in control". If accountability is shifted from promoters to the board of directors or any other party as legislated, it should be ensured that adequate safeguards are in place to prevent its misuse.

Endnote

The definition should be flexible enough to incorporate the current investment climate while also being precise. There is a need to set out objective standards for defining "control" by taking its basis from the "Brightline Tests" in addition to the recent judicial precedents that encompass varied scenarios before legislating it. In 2016, SEBI had considered the "Brightline Tests for Acquisition of 'Control' under SEBI Takeover Regulations"<sup>[6]</sup> but it has not been legislated so far. Shifting from a promoter-centric approach to a control-centric approach would consolidate and standardise the concept of control for better governance.

The reform will have sectoral consequences entailing other regulations in India as the term 'promoter' has been used in various sectoral laws or by other regulatory bodies as well such as RBI, Companies Act 2013, IBC, IRDAI etc. There needs to be consensus among them, otherwise legal and regulatory gaps will cause counterintuitive results. The new definition has to be harmonised with all other existing laws of India. Promoters are currently a static group and this needs to be revamped to afford greater flexibility to the ground realities of today's markets. Thus, the discussion paper has been proposed by SEBI at an opportune time after recognising the recent market trends which are in line with new realities. It is more than just a change of nomenclature.

- 
- [1] <https://www.thehindu.com/business/markets/sebi-may-permit-promoter-reclassification/article30054068.ece>
  - [2] SEBI discussion paper on "Re-classification of Promoters as Public" dated December 30, 2014
  - [3]

<https://www.bloomberquint.com/opinion/promoter-reclassification-who-calls-the-shots>

• [4]

[https://www.sebi.gov.in/reports-and-statistics/reports/may-2021/consultation-paper-on-review-of-the-regulatory-framework-of-promoter-promoter-group-and-group-companies-as-per-securities-and-exchange-board-of-india-issue-of-capital-and-disclosure-requirements-re-\\_50099.html](https://www.sebi.gov.in/reports-and-statistics/reports/may-2021/consultation-paper-on-review-of-the-regulatory-framework-of-promoter-promoter-group-and-group-companies-as-per-securities-and-exchange-board-of-india-issue-of-capital-and-disclosure-requirements-re-_50099.html)

• [5]

<https://economictimes.indiatimes.com/markets/stocks/news/sebi-proposes-rationalising-promoter-group-definition-moots-person-in-control-concept/articleshow/82549988.cms?from=mdr>

• [6]

[https://www.sebi.gov.in/reports/reports/mar-2016/discussion-paper-on-brightline-tests-for-acquisition-of-control-under-sebi-takeover-regulations\\_31883.html](https://www.sebi.gov.in/reports/reports/mar-2016/discussion-paper-on-brightline-tests-for-acquisition-of-control-under-sebi-takeover-regulations_31883.html)

Contributed by Abhilasha SG, Associate

[King Stubb & Kasiva,](#)

Advocates & Attorneys

[Click Here to Get in Touch](#)

[New Delhi](#) | [Mumbai](#) | [Bangalore](#) | [Chennai](#) | [Hyderabad](#) | [Kochi](#) | [Kolkata](#) | [Pune](#)

Tel: [+91 11 41032969](tel:+911141032969) | Email: [info@ksandk.com](mailto:info@ksandk.com)