

SEBI consultation on Lock-in – one step closer, one step away

Yesterday, SEBI issued a consultation paper to review the regulatory framework of promoter and promoter group. It is indeed remarkable that the regulator in these tough times is not just focused on business-as-usual, but also exhibiting resilience by working on progressive issues with a long-term impact. In my view, the consultation paper covered two very significant issues – first, the proposed reduction in lock-in periods for minimum promoters' contribution and other shareholders for public issue; second, shifting from the concept of 'promoter' to the concept of 'person in control'.

Promoter shareholding Lock-in conditions

At present, SEBI prescribes a minimum promoters' contribution of 20% to be locked-in for a period of three years from listing. Additionally, any other pre-IPO capital is required to be locked-in for one year, except some exempt categories.

The logic behind the lock-in requirement was to restrict the controlling shareholders from disposing of their holding after listing of the company, to ensure they have a 'skin in the game', and to make them take responsibility to deliver on the promises made in the offering circular. In fact, in my view, the origin of this thought goes back to the control environment pre-1991 when industries were being set up based on special permissions. In those days, the license conditions used to prescribe a minimum equity contribution by the promoter which was locked up until the lender's money was paid off. A similar thought found resonance in the capital markets regulations and a minimum of 20% equity contribution from promoters was made compulsory with a lock-in period.

SEBI has now proposed to reduce lock-in period on the 20% minimum promoter shareholding to 1 year and on other pre-IPO shares to six months, except in situations of project financing. This reduced lock-in period is a welcome first step. This regulation certainly required a rethink, and I am glad that the regulator has put this out for public consultation. However, I do think we need to take the final step of letting market forces determine the lock-in period instead of prescribing a uniform fixed lock-in period. As SEBI in its consultation paper has noted, the Indian capital markets have not only matured over the years, but it has also adopted best international practices.

When we look at the international benchmarks, in the global capital markets a number of these provisions are determined by the market forces. It is left to the market forces to decide and the equilibrium between the number of shares required in the market to create proper liquidity and the promoter lock-in period immediately after a transaction. The question of promoter lock-in is left to the underwriters to make a call on the lock-in period based on market feedback. These underwriters are regulated entities with deep understanding and wide experience of markets. If the market is willing to accept a shorter lock-in because of the liquidity in the stock, then we should have that flexibility. Similarly, if the market feedback suggests that a longer lock-in is required for a certain type of issuer, then that needs to be built in so that the transaction goes through smoothly. We should not underestimate the power of market as a decision maker.

Shift from 'Promoter' to 'Person in control'

The concept of 'Promoter' and the argument for Promoter having a skin in the game, as I have already mentioned earlier, is more historical. Given the pace at which the nature of businesses and business ownership in India are changing, regulations must match the stride. Recognizing the evolved business scenarios, SEBI is proposing just that – to remove reference to promoter from various SEBI regulations and instead introduce the concept of person in control over a transition period of three years.

Our Views

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Today, the concept of a promoter is blurred. Several Indian companies are now owned by financial investors rather than by a controlling family. Some businesses are owned by a group of professional investors. In such circumstances, there is no identifiable promoter, and the company is largely board controlled. Most banks, some other large financial institutions and several corporates are examples of board-controlled companies. Though the proposed simplification will necessitate reorientation of enforcement strategies and will have implications on other laws, it will facilitate more board control companies to tap Indian capital markets. This will eventually add further depth to the market and bring it at par with the global markets.

Both these steps are in the right direction and would take us closer to the global standards. However, we need to walk one more step of letting market forces determine the lock-in period instead of prescribing a uniform fixed lock-in period!

<https://economictimes.indiatimes.com/markets/stocks/news/one-step-closer-one-step-away-sebi-moves-to-bury-two-licence-raj-legacies/articleshow/82598036.cms>

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