10. DUALITY IN CORPORATE CONTROL: RECALIBRATING INDIA'S DIFFERENTIAL VOTING RIGHTS FRAMEWORK

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Abstract

The principle of "one share, one vote" has been central to corporate governance in India. However, this model faces scrutiny in promoter-led companies seeking to retain control while attracting capital. Differential Voting Rights (DVRs) offer a solution by allowing founders to issue shares with unequal voting power. This paper critically examines India's regulatory framework for DVRs, highlighting the complex interplay between the Companies Act 2013 and SEBI regulations. It assesses the limited adoption of DVRs in India, examining key issues such as corporate control, shareholder rights, and regulatory ambiguities between listed and unlisted companies.

Through a comparative analysis with jurisdictions like the U.S., Canada, Hong Kong, and Singapore, the paper identifies the rigidities in India's approach, particularly SEBI's conditions on the issuance and conversion of DVR shares. The analysis underscores the challenges Indian companies face in balancing growth aspirations with robust governance structures. The study proposes reforms, including the introduction of flexible sunset clauses, consistent regulatory guidelines, and economic incentives to align the interests of DVR and ordinary shareholders.

The paper argues that India's DVR framework requires refinement to foster innovation while protecting investor interests. Enhancing transparency, simplifying compliance, and adopting best practices from global counterparts are vital for DVRs to become a viable instrument for corporate growth in India. This nuanced approach is crucial to navigating the differences between founder control and shareholder democracy in a dynamic corporate environment.

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SHARES WITH DIFFERENTIAL VOTING RIGHTS IN INDIA

The principle of "one share, one vote" has long been the cornerstone of corporate governance. This structure, where each shareholder holds an equal say proportional to their economic interest, is seen as a fair and democratic way to manage companies, ensuring that decision-making reflects the collective interests of all shareholders. However, the rise of fast-growing, promoter-led companies has sparked debate on whether this model remains ideal. Promoters, founders, and even some institutional investors argue that retaining control over the company is essential to safeguard its long-term vision and growth strategy, particularly in the early stages of development. This has led to increased interest in shares with Differential Voting Rights (DVRs), which allow founders to raise capital without diluting their decision-making power.[1]

In the global context, the issuance of dual-class shares (DCS) has become more common in countries like the United States, China, and Hong Kong, where high-growth companies, especially in the technology sector, utilize these structures to maintain control while raising substantial amounts of capital through public.[2] In India, the use of DVRs has seen a slow but growing acceptance, with regulatory changes aimed at promoting their adoption by companies, particularly in light of the country's ambitions to foster innovation and entrepreneurship. However, the adoption of DVRs remains a matter of debate, raising important questions about shareholder rights, corporate control, and the potential for abuse.

DVRs refer to equity shares that carry unequal voting rights in comparison to ordinary shares. Typically, they are issued in two forms: Superior Voting Rights (SVRs), which grant shareholders more votes per share than ordinary shareholders, and Inferior Voting

[1] Jay R. Ritter, 'Initial Public Offerings: Technology Stock IPOs' (2024) 352.846-2837 <https://site.warrington.ufl.edu/ritter/files/IPOs-Tech.pdf> assessed 10 September 2024.

[2] Sharad Moudgal and Thomas George, 'Framework for issuance of differential Voting Rights Shares' (*Khaitan & Co.*, 5 July 2019) <https://www.khaitanco.com/thought-leadership/framework-for-issuance-of-differential-voting-rights-shares> accessed 10 September 2024.

Rights (IVRs), where the number of votes per share is less than that of ordinary shares.[3] DVRs allow founders and promoters to raise capital while retaining significant control over the company, thus avoiding the dilution that typically occurs with additional equity issuance. This can be particularly attractive to founders who believe in their long-term vision for the company and wish to avoid external interference that could disrupt strategic objectives. For public investors, DVR shares with inferior voting rights are often compensated by offering higher dividends or being priced lower than ordinary shares, providing a financial incentive to offset their reduced voting power.

The first notable experiment with DVRs in India occurred in 2008 when Tata Motors issued shares with DVRs.[4] The shares offered higher dividends, appealing to retail investors more interested in financial returns than exercising control over company decisions. However, the regulatory landscape at the time was restrictive, particularly concerning SVR shares. In 2009, the Securities and Exchange Board of India (SEBI) imposed a ban on issuing shares with superior voting rights for listed companies, driven by concerns over the potential for abuse by promoters to the detriment of public shareholders.[5] SEBI's apprehensions were rooted in the fear that SVR shares could enable promoters to entrench their control disproportionately to their economic interest, potentially leading to corporate governance issues and minority shareholder oppression.

Despite SEBI's cautious approach, global trends especially in tech-focused economies, pushed India to reconsider its stance on DVRs. Promoters of technology companies, which are often asset-light but capital-hungry, argued that raising funds through DVR structures was crucial for their growth. Recognising this, in 2019, SEBI allowed companies in the technology sector to issue shares with superior voting rights, subject to

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[3] Akila Agrawal, 'Shares with Differential Voting Rights – SEBI's Sequel Trumps the Original' (*India Corporate Law*, 14 May 2019) <https://corporate.cyrilamarchandblogs.com/2019/05/shares-with-differential-voting-rights-sebi/> accessed 10 September 2024.

[4] Tata Motors, *Details of Issue of Equity Shares with Differential Rights completed during the Fiscal 2016* (Statutory Report, 71st Annual Report 2015-16) annexure 1.

[5] Aishwarya H. and Harshita Srivastava, 'Another step forward by India Inc : DVR shares' (*Corpsec Hotline*, 13 September, 2019) <https://www.nishithdesai.com/generateHTML/4549/4> accessed 8 September 2024.

stringent conditions.[6] These companies could list with DVRs, provided promoters met criteria such as a net worth cap, a sunset clause to limit DVR duration, and a requirement that promoters actively participate in the company's management.

This shift by SEBI marked an important step towards creating a more enabling environment for high-growth startups in India. However, the acceptance of DVRs remains limited with many companies hesitant due to concerns over investor perception, regulatory hurdles, and potential for misuse. Even globally, the dual-class structure has sparked considerable debate.[7] Proponents believe these shares help companies focus on long-term goals without the pressure of short-term performance, especially in innovation-driven industries. Critics, however, highlight the risks associated with entrenching control in a small group of insiders, potentially to the detriment of broader shareholder interests. This concern is particularly relevant in India, where a significant number of companies are still family-owned or promoter-controlled.

This paper highlights that while the adoption of DVRs provides a powerful tool for founders to retain control, it must be accompanied by strong safeguards to prevent misuse. For instance, sunset clauses, which limit the duration of superior voting rights, help ensure promoters do not hold disproportionate power indefinitely. Additionally, ensuring transparency in the issuance and governance of DVRs will be critical to gaining the trust of both domestic and foreign investors.

REGULATORY FRAMEWORK FOR DIFFERENTIAL VOTING RIGHTS IN INDIA

The dual regulatory framework governing DVR in India highlights a significant deviation between rules applicable to listed and unlisted companies. The Companies Act, 2013 and its amendments form the foundation for both listed and unlisted entities, while SEBI's regulations specifically target listed companies. This distinction creates a gap, particularly

[6] SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Regulation 6(3).
[7] Sidhartha, 'Easier rules for differential voting rights shares likely' *Times of India* (Delhi, 24 April 2019).

in the treatment of 'inferior voting rights' shares. SEBI's 2019 prohibition on such shares in listed companies contrasts with the permissibility for unlisted companies to issue them indefinitely.

In comparison, jurisdictions like the United States allow more flexibility in DVR structures. For instance, Berkshire Hathaway Inc. offers Class A shares with full voting rights, which can be converted into Class B shares with inferior voting rights.[8] However, Indian law restricts such flexibility by prohibiting the conversion of equity shares with voting rights into shares with differential voting rights and vice versa, preserving the original structure of the shareholding class.

COMPLIANCE UNDER THE COMPANIES ACT, 2013

Under Section 47 of the Companies Act, 2013,[9] every equity shareholder possesses a voting right proportional to his share in the paid-up equity share capital on every resolution placed before the company. However, this right is limited by Section 43(a)(ii),[10] which allows companies to issue equity shares with differential rights concerning voting power, dividends, or otherwise. This flexibility is often used by founders to retain control of their companies while still offering outside investors the opportunity to share in long-term profits. By offering such shares, companies can maintain strategic direction without the risk of outside shareholders swaying company policy towards short-term profits. This system aligns with international practices, such as in the US, where DVR shares help founders balance control and investment.[11]

Rule 4 of the Companies (Share Capital & Debenture) Rules, 2014,[12] outlines the detailed conditions that companies must satisfy to issue DVR shares. *Firstly*, the Articles of

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[8] U.S. Securities and Exchange Commission, 'Berkshire Hathaway Inc., 2023 Form 10-K, Part II' (SEC, 2023)

[9] Companies Act 2013, s 47

[10] Companies Act 2013, s 43(a)(ii)

[11] Rick Fleming, 'Dual-Class Shares: A Recipe for Disaster' (ICGN Miami Conference, Florida, 15 October 2019) <https://www.sec.gov/newsroom/speeches-statements/fleming-dual-class-shares-recipe-disaster> accessed 5 September 2024

[12] Companies (Share Capital & Debenture) Rules, 2014, r 4

Association must permit DVR shares, and shareholder approval is required via an ordinary resolution at a general meeting. *Secondly,* DVR shares are also capped at 26% of the total post-issue paid-up equity share capital, ensuring that the balance of power does not overly favor those with superior voting rights. *Thirdly*, companies issuing DVR shares must meet stringent financial and compliance requirements, such as filing financial statements and annual returns consistently over three years and avoiding defaults on dividend payments or term loans. *Fourthly,* the company must not have been penalized by any Court or Tribunal during the last three years of any offense.

However, the regulatory landscape for DVR shares in India includes some limitations, particularly concerning start-ups and newer companies. The earlier requirement for companies to show consistent profits over three years restricted the issuance of DVR shares by start-ups that, by their nature, often face losses in the initial years.[13] Recognising this, amendments to the rules have relaxed some of these conditions, encouraging more dynamic and innovative companies to explore DVR issuance as a means of capital growth. This flexibility aligns with the broader intention of supporting mature start-ups and promoting long-term strategic thinking.

In contrast to Indian law, U.S. regulations permit a more flexible approach to the conversion of equity shares into DVR shares and vice versa. In the United States, companies can convert existing voting shares into shares with differential voting rights, which is not allowed under Indian law, as per Rule 4(3) of the Companies (Share Capital & Debenture) Rules. This divergence represents a key difference in how DVR frameworks operate across jurisdictions, with Indian law prioritizing the maintenance of shareholder rights and stability in shareholding structures over flexibility.

An interesting case that tests the validity of DVR shares in India is the case of Anand Jaiswal v. Jagatjit Industries,[14] where the Company Law Board upheld the validity of DVR shares. In this case, the issuance of SVR shares gave a shareholder, Mr. Karanjit

[13] Lok Sabha Unstarred Question-Problems Being Faced By Indian Startups, 4 March 2020, 2115, annexure-A.
[14] *Anand Pershad Jaiswal v Jagatjit Industries Limited* C.P. No. 60 of 2007.

disproportionate control with 64 percent voting rights to his shareholding of 32 percent. The decision led SEBI in 2009 to prohibit listed companies from issuing shares with superior voting rights, but this prohibition was not extended to unlisted companies.[15] As a result, unlisted companies can still issue DVR shares, provided they comply with the provisions of Section 43 of the Companies Act, thereby maintaining the ability to structure control within the company's founding members or key shareholders.

The regulatory framework governing DVR shares in India strikes a delicate balance between enabling founders to retain control and protecting shareholders' rights. The interplay of the Companies Act, 2013, and SEBI regulations creates a structure that, while sometimes rigid, aims to maintain corporate integrity while encouraging long-term strategic growth. However, as India's business environment evolves, particularly with the rise of start-ups and new forms of capital raising, there may be a need for further refinement of these regulations to ensure they remain fit for purpose. The experiences of jurisdictions like the United States may offer valuable insights in this regard, particularly concerning flexibility in share conversions and balancing founder control with shareholder rights.

SEBI REGULATIONS: A FOCUS ON LISTED COMPANIES

In 2009, SEBI prohibited the issuance of shares with superior voting rights by listed companies, fearing misuse by those in control. The primary concern was to prevent promoters from consolidating voting power through shares that granted disproportionate voting power without a corresponding economic investment. This restriction was introduced to safeguard minority shareholders from the potential exploitation that SVR shares could create by allowing those in control to maintain dominance without adequate financial commitment.

[15] SEBI Amendments to the Equity Listing Agreement (21 July 2009) Circular No.: SEBI/CFD/DIL/LA/2/2009/21/7.

However, SEBI's prohibition was selective. While shares with superior voting rights were restricted, those with inferior voting rights remained permissible under the regulatory framework. The distinction between the two is important. DVR is a broader concept that encompasses both superior and inferior voting rights. Superior voting rights refer to shares that confer more than one vote per share, while inferior voting rights provide voting rights below the standard 'one-share-one-vote' rule. The rationale for this differentiation lies in ensuring that while voting power can be structured differently, it should not allow promoters to unfairly entrench control.

A relevant case that highlights SEBI's interpretation of such rights is Ashwin K Doshi v. SEBI.[16] In this matter, the issue was whether the transaction in question amounted to consolidation of control, which would require a public offer. The judgment made a significant reference to the Companies Act (Amendment) 2000[17], which allowed for the issuance of DVRs or non-voting shares. The court emphasized that any such transfer of control must ensure equal treatment and opportunity to the investor and protection of the interests of shareholders, as prescribed under SEBI regulations. This case also reaffirmed that DVRs, while permissible, must adhere to stringent regulatory standards to maintain fairness in the market.

Further reinforcing this position was the decision in Zycus Infotech, where the Bombay High Court ruled on the applicability of shares with no voting rights.[18] In this case, the original owners sought to regain control using DVR shares. As per the Companies Act, 2000 (Amendment), companies were allowed to issue equity and preferential shares, with further classification based on voting and dividend rights. At that time, the current Companies Act, 2013, had not yet come into effect, but these precedents laid the groundwork for how DVR frameworks would be structured under the new regulatory environment.

[16] *Ashwin K. Doshi v Securities and Exchange Board of India*, SAT Appeal No. 44/2001

[17] Companies Act (Amendment) 2000.

[18] *M/s Zycus Infotech Pvt. Ltd v The Commissioner of Income Tax*, Income Tax Appeal No.1356 OF 2007.

These judicial interpretations, combined with SEBI's regulatory stance, reveal a nuanced approach to DVRs in India. While DVR shares allow flexibility in capital structuring, they are subject to checks to prevent their misuse, ensuring that the balance between control and shareholder protection is maintained.

In 2019, SEBI introduced key guidelines for companies looking to issue shares with superior voting rights, while prohibiting the issuance of inferior voting rights shares.[19] This move primarily targeted tech companies, allowing founders or promoters to maintain control while offering ordinary shares through an Initial Public Offering (IPO). It is mandatory for promoters or founders receiving shares with SVRs to hold an executive position within the company. A significant limitation, however, is that these provisions apply only to listed companies, leaving unlisted entities outside the scope of these regulatory advancements.

The Securities Contracts (Regulation) Rules[20] set minimum thresholds for public offerings of each share class. At present, companies with different share classes must comply with these thresholds for an IPO. However, SEBI recently allowed tech companies to offer only ordinary shares in public issues while requiring that SVR shares also be listed. This creates ambiguity between the two regulations, necessitating clearer guidance.

For a company to issue SVR shares under SEBI's framework, it must meet the eligibility requirements of the SEBI (Issue of Capital and Disclosure Requirements) Regulations,[21] and several other conditions. *First*ly, the issuer company should qualify as a tech company under SEBI regulations.[22] *Secondly*, the promoters or founders holding the SVR shares must hold executive positions and their collective net worth should not exceed ₹500 crores. In 2021, this restriction was eased to allow the promoter group to have a net

[19] SEBI Board Meeting PR No.: 16/2019 (27 June 2019).
[20] SEBI Securities Contracts (Regulation) Rules, 1957.
[21] Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018.
[22] Framework for the process of accreditation of investors for the purpose of Innovators Growth Platform (29 May 2019) 20190529-14.

worth of up to ₹1,000 crores while issuing SVR shares.[23] *Thirdly,* these shares must be authorized through a special resolution passed at a general meeting and held for a minimum of six months before the company files its Red Herring Prospectus. Again in 2021, SEBI relaxed the regulation, requiring that SVR shares must be held for at least three months before the submission of the Red Herring Prospectus.

The voting ratio between SVR shares and ordinary shares can range from 2:1 to 10:1. However, SEBI restricts the total voting power of SVR shareholders to 74%, even when combined with their ordinary shares. Importantly, while SVR shares are listed alongside ordinary shares, they cannot be transferred, pledged, or subjected to a lien until converted to ordinary shares. Despite these restrictions, SVR shares are treated similarly to ordinary shares in most respects.

To mitigate the potential misuse of SVR shares, SEBI has introduced stringent corporate governance norms. One key requirement is that at least half of the Board of Directors and two-thirds of the committees prescribed under the SEBI (Listing Obligations and Disclosure Requirements) Regulations must be composed of independent directors.[24] Moreover, the Audit Committee in companies issuing SVR shares must consist solely of independent directors. These measures aim to safeguard the interests of ordinary shareholders, balancing the power held by SVR shareholders. Regulation 41(3) of SEBI LODR Regulations further prohibits listed companies from issuing shares with superior voting or dividend rights compared to existing equity shares. While DVR shares are allowed, they cannot include superior voting rights that would diminish the voting power of current shareholders.

Under the ‘coat-tail provisions’, after the IPO, SVR shares will be treated as ordinary shares with one vote per share in specific situations. These include appointing or removing independent directors/auditors, transferring control, related party transactions, voluntary winding up, changes to company documents, initiating a

[23] SEBI Board Meeting PR No.: 28/2021 (28 September 2021).
[24] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.

resolution under the IBC, misusing company funds, substantial value transactions, and decisions on delisting or buy-back of shares. These provisions ensure balanced governance despite the existence of SVR shares.

Another notable regulatory tool is the 'sunset clause,' which mandates the conversion of SVR shares to ordinary shares in specific situations. There are two primary triggers for conversion. First, in a time-based situation, SVR shares are converted after five years from listing. An extension for an additional five years is possible through a resolution, but notably, SVR shareholders are prohibited from voting on this extension. Therefore, ordinary shareholders retain ultimate control over the extension decision. Second, in a contingent situation, SVR shares are automatically converted when the holder of such shares dies, resigns, or otherwise ceases their role.

The framework is not without its contradictions. While SEBI has permitted the issuance of SVR shares, it has simultaneously prohibited fractional voting rights shares, as evidenced by the 2008 issuance by Tata Motors.[25] These shares remain listed but cannot be replicated by other companies. The subsequent chapters of this paper will offer a comparative analysis of the DVR frameworks in other jurisdictions, such as the USA, Canada, Hong Kong, Singapore, and provide recommendations to rejuvenate India's somewhat stagnant DVR landscape.

COMPARATIVE STUDY OF DUAL-CLASS SHARES: A CROSS-JURISDICTIONAL ANALYSIS

While several countries allow the listing of companies with Dual-Class Shares (DCS), others, such as the UK, Australia, Spain, Germany, and China, do not permit such structures for listing.[26] The UK initially permitted DCS for Standard Listings but later

[25] Anubha Gupta and Swati Sharma, 'Case Study on Is DVR a Better Option for Shareholders – Case of Tata Motors' (2013) 2(2) *International Journal in Multidisciplinary and Academic Research*
[26] CFA Institute, Dual-Class Shares: The Good, The Bad, And The Ugly (2018).

prohibited it. In contrast, Singapore and Hong Kong have recently accepted DCS structures, implementing detailed regulations to ensure proper governance.

United States of America

The regulatory landscape for DVRs in India can be contextualised by examining global frameworks, particularly the practices observed in the United States. In the U.S., issuers with DCS structures can list their shares on major exchanges like the NYSE and NASDAQ. According to Rule 313A of the NYSE Listing Manual,[27] these shares must adhere to enhanced disclosure and safeguarding policies. However, it's crucial to note that the DCS structure is only permitted for issuers that have established it prior to listing.[28] Once a company opts for a 'one-share-one-vote' structure, it cannot transition to a DCS framework that would potentially diminish the interests of existing shareholders.

A prominent facet of DCS structures in the U.S. is the voluntary adoption of a sunset clause by some companies. While not mandated, a sunset period—typically five years—is occasionally applied, after which shares with multiple voting rights automatically convert into ordinary shares with one vote each. This approach aims to ensure that control does not remain indefinitely concentrated in the hands of founders or promoters. In India, SEBI mandates a five-year sunset clause, offering less flexibility and ensuring that control does not remain indefinitely with promoters.

Prominent examples highlight the dynamics of DCS structures.[29] Google's founders established a capital structure featuring three classes of shares: Class A shares with one voting right, Class B shares with ten votes (held privately by Sergey Brin and Larry Page

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[27] New York Stock Exchange Listed Company Manual, Rule 313A.

[28] Zacks, 'Facebook (FB) Decides Against the Creation of Class C Shares' (*Nasdaq*, 25 September 2017) <https://www.nasdaq.com/articles/facebook-fb-decides-against-the-creation-of-class-c-shares-2017-09-25> accessed 12 September 2024.

[29] Aurelio Gurrea Martínez, 'Should securities regulators allow companies going public with dual class shares?' (*Oxford Business Law Blog*, 16 January 2018) <https://blogs.law.ox.ac.uk/business-law-blog/blog/2018/01/should-securities-regulators-allow-companies-going-public-dual-class> accessed 9 September 2024.

and subject to a sunset clause), and Class C shares with no voting rights.[30] This arrangement allows founders to maintain significant control over the company while providing public investors with the opportunity to participate. The market prices of Class A and Class C shares have converged over time, explaining investor acceptance of non-voting shares.

Similarly, Facebook issued Class A shares with one voting right and Class B shares with ten votes each held by Mark Zuckerberg and affiliates with no sunset clause. While Class C shares were initially proposed as a non-voting option for dividend distribution, this proposal was withdrawn due to investor resistance, highlighting the critical role of shareholder sentiment in these decisions.[31]

In contrast, companies like Snapchat adopted more radical approaches by issuing non-voting Class A shares at their IPO, thus setting a precedent in the market. The Class C common stock, owned by the founders, accounts for approximately 90% of the voting power in the company's outstanding capital stock.[32] Additionally, there is no sunset clause for the founders, ensuring their voting rights remain indefinitely. This trend underscores the ongoing debate around shareholder rights and corporate governance.

Companies such as Nike and Viacom have also employed dual-class structures, allowing controlling shareholders to wield substantial power while still engaging public investors. Nike has issued Class A shares, which allow the holders to elect 75% of the Board of Directors. These shares are unlisted and owned by Philip Knight, Travis Knight, Mark Parker, and Trevor Edwards. In contrast, Class B shares are listed and held by public shareholders, granting them the power to elect the remaining 25% of the Board.[33]

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[30] Titiaan Adam Keijzer, 'Vote and Value' [2020] Wolters Kluwer.
[31] Colin Stretch, 'Preserving Founder-Led Structure to Focus on the Long Term' SEC Exhibit 99.2.
[32] Snap Inc., *Form S-1 Registration Statement*, United States Securities And Exchange Commission (2 February 2017) <https://www.sec.gov/Archives/edgar/data/1564408/000119312517029199/d270216ds1.htm> accessed 5 September 2024.
[33] Nike Inc, *Schedule 14A Information*, United States Securities and Exchange Commission (24 July 2018) https://www.sec.gov/Archives/edgar/data/320187/000032018718000144/nke-2018xdef14a.htm accessed 5 September 2024

Similarly, Viacom is listed on NASDAQ, trading as "VIA" for Class A common stock (with 1:1 voting rights) and "VIAB" for Class B common stock (non-voting).[34] Class A shares are primarily held by Sumner M. Redstone, while Class B shares are owned by public shareholders. Class A stock can be converted to Class B on a one-for-one basis, but not vice versa. Shareholders are concerned about the CEO's over 80% control through approximately 10% shareholding.

Canada

In Canada, DVRs are recognised under federal corporate law and the regulations of the Toronto Stock Exchange (TSX).[35] Companies introducing a multiple voting class of shares must secure the approval of a majority of votes cast by shareholders at a meeting, excluding insiders, directors, and promoters. Like India, the TSX implements a 'coat-tail' provision designed to protect minority shareholders in companies with DCS structures. This is similar to India's attempt to prevent shareholder exploitation, but Canada enforces this with stricter corporate governance standards. This provision mandates that minority shareholders maintain a level of voting power in alignment with their economic interests, thereby preventing the potential exploitation of voting discrepancies by majority shareholders.

Furthermore, the Canadian Coalition of Good Governance has established best practices principles for companies operating under DCS structures. These principles advocate that holders of multiple voting (MV) shares should have the right to nominate directors proportional to their voting rights. This ensures that their influence within the company reflects their ownership stake.[36] A meaningful equity ownership stake, typically requires that the voting rights ratio does not exceed 4:1, unlike India, where DVRs can offer up to 10 times the voting power of ordinary shares. This guideline aims to strike a balance between empowering founders while safeguarding the interests of other shareholders.

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[34] Snap Inc., *Form S-4 Registration Statement*, United States Securities And Exchange Commission (October 1999) <https://ir.paramount.com/node/57011/html> accessed 5 September 2024.
[35] Canada Business Corporations Act 1985, S. 24.
[36] Daniel P Cipollone, 'Risky Business: A Review of Dual Class Share Structures in Canada and a Proposal for Reform' [2012] Dalhousie Journal of Legal Studies, 64.

The DCS structure should include provisions for its eventual collapse. The board may determine a suitable timeline for this collapse, ideally documented in the company's articles. Upon collapse, a one-for-one conversion of MV shares to ordinary voting (OV) shares occurs, unless a majority of OV shareholders choose to continue the DCS structure for a maximum of five years.[37] This framework not only promotes stability but also incentivises good governance, ensuring that the interests of all shareholders are protected.

Hong Kong

In Hong Kong, the regulatory landscape for DVRs was reformed in April 2018, allowing companies to list with DCS or Weighted Voting Rights (WVR).[38] The primary aim was to attract innovative issuers, especially in sectors like biotechnology, which require distinct capital structures to support their growth trajectories. In India, DVRs are not limited to specific industries, making the scope broader but less targeted.

To qualify for WVR issuance, companies must meet specific eligibility criteria. Only innovative issuers or biotech companies can opt for this structure during their IPO. These companies must also secure meaningful third-party investments from at least one sophisticated investor before the IPO, with that investor retaining at least 50% of their stake for a minimum of six months post-listing. However, this requirement is relaxed for companies spun off from a parent entity.[39] India's framework does not impose such conditions, allowing more flexibility but potentially reducing investor safeguards.

Market capitalisation thresholds are also significant; a company must either have a market capitalisation of HK$40 billion or HK$10 billion with HK$1 billion in revenue in

[37] Professor Yvan Allaire, 'Dual-class share structures in Canada: Review and recommendations' [2006] The Institute for Governance of Public and Private Organizations.
[38] HKEX Main Board Listing Rules.
[39] John Kong Shan Ho, 'Allowing Dual Class Share Structure Companies in the Premium Listing Segment of the London Stock Exchange: Appreciating International Experiences and Recognising Local Conditions' (2021) 16(3) *Capital Markets Law Journal* 356s

its latest audited fiscal year. Furthermore, the beneficiaries of WVR must hold a minimum of 10% of the economic interest in the total issued share capital and play an active role in the company. This individual must be a director on the board at the time of the IPO. India, in comparison, does not have such specific financial thresholds, offering more accessibility to smaller firms.

A crucial feature of the WVR is its limitation on voting rights. No issuer can provide voting rights per share exceeding ten times that of ordinary shares. Moreover, if a beneficiary of WVR shares dies, ceases to be a director, or transfers their shares, their enhanced voting rights will lapse. Unlike other jurisdictions, there is no defined 'sunset clause' for WVR. Instead, the rights terminate based on specific triggering events.

Singapore

The landscape for DVRs has evolved globally, with several jurisdictions exploring frameworks that balance innovation and investor protection. Singapore's approach to DVRs, introduced by the Singapore Exchange (SGX) in June 2018, offers a noteworthy comparison to India's existing framework. Understanding this framework can provide valuable insights into potential reforms for India's DVR regulations.[40]

In Singapore, companies aiming to list with a dual-class share structure must adhere to specific regulations established by the SGX. Existing companies listed under ordinary shares are not permitted to convert their shares to a dual-class structure. Instead, the SGX evaluates new applicants based on factors such as operational track record, business model, and the role of individuals holding DCS in the company's success.[41] This meticulous assessment ensures that the companies allowed to issue dual-class shares demonstrate substantial investor confidence, particularly from sophisticated investors.

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[40] Pey-Woan Lee, 'Dual-Class Shares in Singapore – Where Ideology Meets Pragmatism' [2018] Berkeley Business Law Journal 440.
[41] SGx Mainboard Rules, Rule 210(10)(c).

A significant aspect of Singapore's DVR framework is the limit on voting power. Similar to the Indian framework, the voting rights for dual-class shareholders cannot exceed ten votes per share compared to ordinary shares. At the time of the IPO, the issuing company must specify the voting power associated with each dual-class share, and any reduction in this voting power requires SGX approval. SGX has also reduced the quorum requirement for general meetings to include ordinary shareholders holding at least 10% of the total voting rights.[42] This provision aims to enhance protection for ordinary shareholders, which is not reflected in the SEBI regulations. Additionally, a minimum of 10% of the total voting power at any general meeting must come from ordinary shareholders, contrasting with India's standard that allows 'superior voting right' shareholders to hold up to 74% of voting rights, including any ordinary shares held by these shareholders.[43]

SGX also mandates that dual-class shares cannot exceed their original proportion in various corporate actions, such as share buybacks. This regulation seeks to maintain a balance of power between different classes of shareholders and ensures that the structure remains equitable over time. In contrast, India's existing regulations lack such stringent checks, raising concerns about potential disparities in shareholder rights.

One notable difference between Singapore's and India's frameworks is the treatment of ordinary shareholders in corporate governance. While SGX has introduced a diluted quorum requirement for general meetings, ensuring that ordinary shareholders retain a minimum of 10% of total voting rights, Indian regulations do not provide similar protections. In India, the voting rights of superior voting rights shareholders are capped at 74%, which can encompass any ordinary shares they hold.[44]

The governance structure surrounding dual-class shares differs significantly between the two jurisdictions. In Singapore, a responsible director must be appointed for each holder

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[42] J. Seligman, 'Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy' [1986] George Washington Law Review 687.
[43] Michelle Dy, '*The Future of a Dual-Class Shares Structure in Singapore*' (Roundtable Discussion Report) National University of Singapore 2016.
[44] Committee on Capital Markets Regulations '*The Rise of Dual Class Shares: Regulation and Implications*' (2020).

group of dual-class shares. This individual is tasked with representing the interests of dual-class shareholders while ensuring compliance with SGX rules. Conversely, the Indian framework lacks explicit provisions for such responsible governance, potentially leaving an accountability gap. Under the Mainboard Rules, DCS convert to ordinary shares under two conditions: if sold to someone outside the permitted holder group, or when a responsible director steps down.[45] If a responsible director from the permitted holder group resigns and no replacement is appointed, the shares will also convert. Any changes to this process require shareholder approval. To reduce risks, SGX mandates that the majority of the committees, like the Remuneration and Nomination Committees, must be composed of independent members. In contrast, SEBI regulations only require the Audit Committee to consist of independent directors, thereby ensuring it remains unaffected by DVR shareholders' excessive voting rights.

Disclosure requirements are another area where Singapore's regulations excel. The SGX requires listed companies to provide comprehensive details about their dual-class share structures in their annual reports and prospectuses, including the risks associated and key provisions of the Articles relevant to the DCS structure.[46] India's regulations, however, do not impose equivalent disclosure obligations, which could lead to misunderstandings about the nature of DVRs and their implications for shareholders.

Lastly, the lock-in period for dual-class shares in Singapore is designed to promote stability. SGX requires a twelve-month lock-in period for all shares held by dual-class shareholders, including ordinary shares. This contrasts with India's approach, where the lock-in period applies solely to DVR shares, leaving ordinary shares unregulated in this context.[47] Furthermore, while SGX permits the transfer of dual-class shares after the lock-in period, India's regulations necessitate a conversion into ordinary shares before any transfer, which can hinder the flexibility of DVR shareholders.

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[45] Aurelio GURREA-MARTINEZ, 'Theory, evidence, and policy on dual-class shares: A country specific response to a global debate specific response to a global debate' [2021] European Business Organization Law Review. 22, (3), 475-515.
[46] Dr. Flora Huang, 'Dual Class Shares Around the Top Global Financial Centres' [2017] Journal of Business Law, Vol.2, pp.137-154.
[47] Lance Lim, 'Recent Amendments to the Companies Act: Rethinking Dual-class Shares in Singapore – Caveat Emptor?' <https://v1.lawgazette.com.sg/2015-01/1219.htm> accessed 14 September 2024.

CORPORATE GOVERNANCE UNDER DVR REGIMES: BALANCING CONTROL AND OVERSIGHT

In India, only five companies have issued DVR shares: Tata Motors, Pantaloons Retail (now Future Enterprises Ltd.), Gujarat NRE Coke Ltd., Jain Irrigation Systems Ltd., and Stampede Capital. Tata Motors was the first to introduce DVRs in 2008, offering 5% higher dividends than ordinary shares but with only 10% of the voting rights.[48] DVRs were aimed at attracting retail investors, who are less inclined to exercise voting rights. However, DVR shares have struggled to gain popularity in India.

One reason for this lack of interest is India's low dividend yield compared to other countries.[49] For large and mid-cap stocks, India's average yield is 1.7%, much lower than Australia's 4.68% or Singapore's 4.25%. For instance, in 2012, Tata Motors offered only a marginally higher dividend for DVR shares—just 0.20 rupees more than ordinary shares, which many investors found unappealing given the substantial reduction in voting rights. Over the years, Tata Motors has not consistently offered dividends, further diminishing the attractiveness of its DVR shares.

This limited interest also stems from the fact that DVRs have failed to distinguish themselves from ordinary shares in terms of performance. Foreign Institutional Investors (FIIs) and Mutual Funds, which prioritize retaining voting rights, have shown little enthusiasm for DVRs. An analysis of the price movements of Tata Motors' DVR and ordinary shares over the last five years reveals similar trends, suggesting that the added 5% dividend has not significantly influenced their market performance. India's regulatory framework for DVRs has been largely ineffective for both investors and companies. Investors find the marginal 5% dividend increase on already low dividend rates

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[48] Sumeet Chatterjee and Sowmya Kamath, 'India's Tata Motors launches $525mln share sale-sources' (*Reuters*, 4 October 2010). <https://www.reuters.com/article/business/india-s-tata-motors-launches-525mln-share-sale-sources-idUSSGE69301V/> accessed 6 September 2024.

[49] Reuters, 'Indian stocks have the lowest dividend yield in Asia' (CNBC TV18, 16 October 2019) <https://www.cnbctv18.com/market/stocks/indian-stocks-have-the-lowest-dividend-yield-in-asia-4534061.htm> accessed 8 September 2024.

unappealing, while companies hesitate to adopt DVR structures due to the complex and stringent regulations. As a result, DVRs have struggled to gain traction.

Given the current landscape, there are a few proposals to reform and improve India's framework for DVRs. *Firstly,* under Section 43 of the Companies Act, 2013,[50] companies are permitted to issue DVR shares. However, the regulatory environment is fragmented. SEBI does not regulate the issuance of DVR shares by unlisted companies, allowing these companies to issue shares with superior or inferior voting rights without facing regulatory barriers. This regulatory gap persists until a company seeks to get listed, at which point SEBI regulations become applicable. This allows unlisted companies to continue issuing such shares indefinitely, even if SEBI regulations might otherwise limit them.

The lack of a uniform framework poses challenges, particularly when a company with DVR shares intends to go public. To address this, it is proposed that a consistent regulatory structure should be developed for both listed and unlisted companies. Without such uniformity, companies may encounter legal complications during their IPOs.[51] In the meantime, there is a pressing need to extend protections to unlisted companies by incorporating relevant provisions into the Companies Act, 2013. Such protections would ensure regulatory clarity and safeguard investor interests, bridging the current gaps in India's DVR framework.

Secondly, the 2019 SEBI regulations restrict the issuance of DVR shares in India to "tech companies" that make "intensive use of technology." However, this term is not clearly defined, creating uncertainty for companies seeking to utilise DVR structures. This limitation stands in contrast to frameworks in other jurisdictions, such as Singapore (SGX) and Hong Kong. In Singapore, there are no such restrictions, while Hong Kong allows companies in the 'innovative' or 'biotech' sectors to issue DVR shares if they meet certain criteria.

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[50] Companies Act 2013, S.43.

[51] Juhi Singh and Tarinee Sudan, 'Striking a Balance on Differential Voting Rights' (*Insights, S&R Associates*, 17 June 2019) <https://www.snrlaw.in/striking-a-balance-on-differential-voting-rights/> accessed 8 September 2024.

Globally, the DVR framework has seen increased acceptance across various sectors, and India should consider expanding its regulatory scope. Limiting DVR issuance to tech companies is arbitrary, especially given the lack of clarity on what qualifies as "intensive use of technology." Non-tech companies should also be allowed to issue DVR shares, as seen in other countries. For example, Hong Kong is moving towards allowing non-tech companies to list shares with dual-class structures.[52] Given the long-term impact of DVRs on corporate governance and growth, clarity is crucial. Companies must be certain about their eligibility before issuing DVR shares to avoid complications when seeking listing. It is, therefore, essential to refine the definition of "tech company" and provide clear guidelines so companies and their boards can confidently determine their eligibility under this framework.

Thirdly, SEBI has yet to clarify the pricing and valuation aspects of DVR shares, which will be crucial for investors. The optimal price for each transaction will depend on various company-specific factors. These include the business's track record, the promoters' reputation, the company's growth stage, its prospects, the sector in which it operates, and proposed voting ratios and dividend payouts. Also, non-resident transactions must comply with pricing regulations under foreign exchange laws. Given the inherent risks, investors are likely to adopt a conservative approach to DVR share pricing.

Quantifying the added value of superior voting rights objectively is challenging. Therefore, determining the premium for SVR shares will require a case-by-case assessment. This situation may lead to ‘fair market value’ pricing and taxation issues. Historically, Indian tax authorities have adopted cautious positions on new investment structures, often resolving principles only after prolonged litigation. They might also utilise powers under the General Anti-Avoidance Rules if they perceive that a transaction involving DVR shares is structured for tax efficiency.[53] Thus, the tax authorities' approach

[52] Interview with Christopher Hui, Secretary for Financial Services and the Treasury, Hong Kong (30 March 2021).
[53] Income Tax Act 1961, Chapter X-A.

will be vital in shaping investor confidence. To alleviate concerns, consistent tax policies must be maintained, as seen in recent developments affecting foreign portfolio investors.

Fourthly, both 'time-based' and 'event-based' sunset clauses have been imposed by the SEBI Regulations for DVR shares. According to these regulations, DVR shares must be converted into ordinary shares after five years from listing. They can also convert in specific circumstances, such as the death or resignation of the DVR shareholder. In contrast, jurisdictions like Singapore and Hong Kong allow DVR shares without such time limitations. There, shares continue until certain events occur, such as the death, resignation, or transfer of the shares by the holder. The absence of mandatory time-based sunset clauses in the United States further highlights the need for flexibility in this area.

It would be prudent for SEBI to reconsider its five-year stipulation. Instead of a rigid timeframe, a case-by-case evaluation or periodic renewal would allow for greater adaptability. This flexibility would empower both DVR and ordinary shareholders to decide when to discontinue DVRs based on changing circumstances. Moreover, ordinary shareholders should have the right to vote against the DVR framework if they suspect misuse by promoters or founders. Such disputes should be taken to SEBI for resolution, with a presumption favouring the promoters but with mechanisms in place for exceptional cases. Currently, SEBI allows only one five-year extension for DVR shares. Instead, it should enable shareholders to determine the extension period according to their preferences. This approach would prevent DVRs from becoming burdensome for the company while ensuring accountability.

Fifthly, *ex-ante* restrictions, such as enhanced corporate governance and sunset clauses, are designed to prevent the misuse of the DVR framework. However, these measures have contributed to the DVR framework's limited popularity across various jurisdictions. Critics argue that an overreliance on such preventive measures hampers the attractiveness of DVR shares. To address this issue, it is essential to consider ex-post measures. These would involve implementing private enforcement against DVR shareholders who misuse their rights and imposing stringent penalties for any abuse of power. Such an approach would shift the focus from complex preemptive requirements to post-incident accountability. By establishing a robust mechanism for enforcement, companies may find the DVR framework more appealing.

Reducing the burden of excessive regulatory controls could encourage more firms to issue DVR shares. This change would not only enhance the operational flexibility of companies but also foster a more vibrant market for DVRs. By balancing proactive measures with reactive ones, India can create a more inviting environment for DVR frameworks. Ultimately, this could lead to increased investor confidence and participation in the market.

Lastly, to enhance the DVR framework in India, it is vital to introduce economic incentives that align the interests of DVR shareholders with those of ordinary shareholders. For example, the Hong Kong Exchange mandates that DVR shareholders retain at least 10% of the economic interest in the total share capital issued by the company. This requirement is notably absent from SEBI's regulations on DVRs. By ensuring that shareholders maintain a significant economic stake in the company, it can mitigate the risk of financial fraud against ordinary investors. This alignment of interests would encourage DVR shareholders to make decisions that benefit the company as a whole.

CONCLUSION

The Differential Voting Rights framework in India presents a unique opportunity for companies to grow while preserving founders' control, yet it has not seen widespread adoption. This hesitation, despite SEBI's recent reforms, highlights a need for more than regulatory change. To encourage broader acceptance, India must foster a nuanced approach that addresses the concerns of all stakeholders involved—founders, minority shareholders, and investors.

DVRs are structured to give founders the flexibility to raise capital without diluting control, a system that has proven successful in the United States, where 8.9% of listed companies have adopted DVRs. In India, however, this framework faces significant obstacles. Investor apprehension, largely stemming from fears of voting rights abuse, and limited awareness among corporate actors have kept DVRs from realising their potential. Despite regulatory efforts since the 2000 amendment, only a handful of companies have embraced this structure. This stagnation suggests that the regulatory environment alone is not enough to build confidence in DVRs; a broader educational and communicative effort is needed.

For DVRs to truly succeed, India's regulators, companies, and financial institutions must work in harmony. Regulators should continuously refine policies to enhance transparency and accountability, especially to protect minority shareholders from potential exploitation. Concurrently, companies adopting DVR structures should actively engage with investors, building trust through open dialogue and commitment to fair governance practices. Additionally, efforts to educate the business community on the benefits and risks of DVRs will be essential to dismantling misconceptions and fostering a positive perception of this framework.

If India can strike this delicate balance, DVRs could become a valuable tool for fostering corporate innovation and growth. By creating an environment where DVRs are trusted and widely understood, India can ensure that this framework becomes a sustainable, beneficial asset for the nation's evolving corporate ecosystem.