

[2015] 130 SCL 68 (Mag.)

SEBI PROPOSES LISTING OF START-UPS WITH EASIER COMPLIANCE NORMS

GAURAV PINGLE*

Introduction

1. In India there are many incubation and research centers, which provide excellent opportunities for youngsters to work on projects and develop their mind and entrepreneurial skills. To exploit such ideas 'commercially', the young entrepreneurs need capital and, accordingly, they approach institutional/strategic investors. With an intention of promoting the entrepreneurial spirit, SEBI has proposed listing of such new-age companies/start-ups. The recently issued SEBI discussion paper on Alternate Capital Raising Platform has been discussed in this article by giving detailed background of the same and analysis of the proposed exemptions.

Background

2. The extant SEBI ICDR Regulations provide that the promoters of the company (which propose public offer) are required to offer 20% of post-issue capital (minimum) as lock-in for 3 years and the company is also under an obligation to make detailed disclosures (*i.e.*, objects of public issue, basis for issue price, ensuring price-justification, etc.).

SEBI has observed that in recent times many start-up ventures have flourished with lower shareholding of founding members' (less than 20%) and the remaining is held by institutional/strategic investors. Such shareholding structure becomes a hurdle for founding members of start-up companies, as they cannot offer shares for lock-in. These start-ups are often professionally run and the founding members are not inclined to be disclosed as 'promoters'.

SEBI has also noted that institutional investors in start-ups advise overseas listing due to the relaxed regulatory regime in other jurisdictions. SEBI found it difficult to strike a balance on discounting the extant IPO-disclosures (for protecting retail investors' interest) and at the same time ensuring that start-ups raise money in India and prefer domestic listing.

Based on this background and after obtaining recommendations of SEBI's Primary Market Advisory Committee, SEBI has proposed alternate capital raising platform wherein new-age companies/start-ups having innovative business models or belonging to knowledge-based technology sector can raise money from institutions & HNIs.

*Company Secretary.

Overview of Discussion Paper

3. SEBI has floated discussion paper titled as “Alternate Capital Raising Platform and Review of other regulatory requirements”, wherein it has explained the eligibility & process of raising funds, proposed disclosure norms, share lock-in, basis of issue price, etc. SEBI has sought public comments on proposed regulatory framework and is soon expected to notify the regulations, which will help such companies to access capital through institutional platform.

Proposed Exemptions

4. SEBI has proposed the definition of ‘professionally managed companies’ as: New-age companies having innovative business models and belonging to knowledge-based technology sector, where no person (individually or collectively with PACs) holds 25% or more of the pre-issue share capital. These companies may include companies in the business of software product development, e-commerce, new-age companies having innovative business models. SEBI has suggested that the issuers will be required to file draft offer document in accordance with ICDR Regulations, however, it has proposed certain carve outs/exceptions.

Following is the summary of the proposed exemptions alongwith the summary/discussion of the extent regulation :-

- (1) For the disclosure on ‘Objects of Issue’ in offer document, SEBI has proposed that the start-ups will be required to disclose the main object for general corporate purpose and restrict such disclosures till only ‘broad objects’. Presently, companies are required to disclose objects of the issue, purpose of issue, means of financing such projects, proposed deployment status of the proceeds at each stage of the project, interest of promoters and directors, etc.
- (2) SEBI has proposed that the lock-in of the entire pre-issue capital should be for 6 months uniformly for all shareholders. Under the extant ICDR Regulations, minimum promoters’ contribution (20% of post-issue capital) is required to be locked-in for 3 years from date of commencement of commercial production or date of allotment of public issue (whichever is later);
- (3) SEBI has suggested to amend ‘basis of issue price’ to include disclosures, other than projections, for the start-ups to access the market on institutional platform, enabling investors for taking informed decisions. Start-ups are relieved from disclosing extant disclosure requirements like: Earnings Per Share, Diluted Earnings Per Share, Price earnings ratio, pre-issue Average Return on Net Worth, etc.
- (4) As participant in the market, SEBI has suggested to expand the scope of QIBs to include systematically important NBFCs and family offices/

trusts, subject to such family offices/trusts registering themselves as Alternate Investment Funds (AIF) under AIF Regulations;

- (5) SEBI has also sought to amend provisions relating to disclosure w.r.t. group companies and suggested restrictions on disclosures of the group companies as are covered under AS-18, in addition to disclosure given for such group companies as considered 'material'. Presently, the scope of disclosure of group companies is very much wide to include companies, firms, ventures, etc., floated by the promoters of the issuer;
- (6) With respect to disclosure of litigations in offer document, SEBI has suggested to disclose all criminal cases and regulatory action, w.r.t. to taxation disputes, separate disclosure regarding claims related to direct and indirect taxes needs to be provided in a consolidated manner. For other litigations, policy for 'materiality' shall be defined by the company and disclosed in the offer document and then the disclosures shall be made. Under the extant ICDR Regulations, the issuers are under an obligation to disclose various outstanding litigations and material developments, such as litigations against the issuer, directors involved in violation of statutory regulations, tax liabilities or alleging criminal offence; adverse findings on compliance with the securities laws, non-payment of statutory dues, cases in which penalties were imposed, etc.
- (7) With respect to 'disclosure on creditors' in the offer document by the start-ups, SEBI has proposed that complete details about creditors should be disclosed on the web page of the company. The disclosure in the offer document should be based on defined materiality thresholds and disclosed in the offer document and should provide link to the webpage of the company where full details are disclosed. Only consolidated information on dues to SMEs and other creditors should be disclosed in the prospectus. In accordance with extant ICDR Regulations, under the 'outstanding litigations', it is necessary to disclose the name(s) of the small scale undertaking(s) or any other creditors to whom the issuer owes a sum exceeding Rs. 1,00,000/- which is outstanding for more than 30 days.
- (8) SEBI has proposed certain amendments to 'disclaimer clause' offer document and suggested that the product advertisements of the issuers may be exempted from the requirement of 'disclaimer'.

Modified Institutional Platform

5. SEBI has suggested that the capital raising shall be allowed on the Institutional Trading Platforms with certain modifications in the current regulatory framework which will include some relaxation in restriction of fund raising, minimum investment from certain category of investors, etc.

The proposed platform will have 2 categories of investors, *i.e.*, Qualified Institutional Buyers (QIB) and Non-Institutional Investors (NII). It is also

suggested that the family trusts may also be allowed to apply under the Qualified Institutional Buyer (QIB) category.

SEBI has stated that the allotment to QIBs may be on a discretionary basis, whereas to NIIs it shall be on proportionate basis. Allocation between the said two categories shall be in the ratio of 75% and 25% respectively. Any subscription to non-institutional categories shall be available to QIB category.

SEBI has suggested that no QIBs shall be allotted more than 5% of the issue size. The minimum application size in case of such issues shall be Rs. 10 lakhs. SEBI has recommended to have minimum number of allottees in such issues upto 500.

SEBI has recommended that the listing on institutional platform shall be for a period of at least 1 year. Post-1 year, the company will have the option to migrate to main board, subject to compliance with eligibility requirements of the Stock Exchanges. Minimum trading lot on the said platform shall be Rs. 5 lakhs. SEBI has stated that there is also a suggestion that said threshold limit on trading lot be lowered for sale of shares by the employees who have been granted ESOPs.

SEBI has Clarified on the limits of AIF investments in listed and unlisted securities. For Category I and II AIFs, which are required under the SEBI (Alternative Investment Funds) Regulations, 2012 to invest a certain minimum amount in unlisted securities, investment in shares of companies listed on this platform may be treated as investment in 'unlisted securities' for the purpose of calculation of the investment limits.

Conclusion

6. By laying down the discussion paper, SEBI has shown that its aim is to help new-age companies having innovative business models to raise funds from within India and stop their 'flight' to overseas markets.

Under the proposed regime, new-age companies can raise money from institutions and HNIs. Considering the risk involved in investing, SEBI has restricted retail investors from investing in such companies. By taking such steps, SEBI has definitely struck a balance of encouraging these companies in raising funds and protecting market interest by restricting retail investors. It will be interesting to study and apply the final regulations, which are expected by end of June, 2015.

