

Minimum Public Shareholding Norms- Need for a Review?¹



Cyril S. Shroff
Managing Partner
Cyril Amarchand Mangaldas

Introduction

Indian regulations provide for minimum public shareholding (**MPS**) norms to be complied with by a company undertaking an initial listing and for listed companies, in the form of minimum public offer to be undertaken as part of the initial listing of securities and a minimum float in the hands of the public on a continuous basis, respectively. These norms have been prescribed in terms of a percentage of the issue size (in the case of initial public offering) and total public shareholding (in the case of continuous listing), under Rules 19(2)(b) and 19A, respectively, of the Securities Contracts (Regulation) Rules, 1957 (**SCRR**).

The SCRR were issued to inter alia provide for the key requirements to be complied with by a public company for listing its securities on a stock exchange in India. This also includes ensuring that a minimum volume of shares is made available to the public in order to establish principles of fairness and transparency, by preventing price manipulation, and securing liquidity and depth in the Indian capital market. The SCRR primarily seek to achieve this objective by prescribing the MPS requirements.

This article seeks to review the impact of the MPS requirements, the efficacy with which these requirements have been implemented and points out certain concerns with respect to the present MPS norms.

Evolution of MPS Norms in the Indian context

Prior to 2001, the thresholds for MPS were prescribed only with respect to initial listing under the SCRR.

The requirement for listed companies to maintain MPS on a continuous basis was introduced in May 2001 in the Listing Agreement, which was linked to the threshold of minimum public offer required of such companies at the time of their initial listing. As a result, the MPS requirements in listed companies on a continuous basis varied basis the provisions applicable to a particular company at the time of its listing.

With effect from May 2006, all listed companies were required to maintain at least a 25% public shareholding on a continuous basis with an exception for companies which were permitted to make an initial public offer with at least 10% offer to public or had at least 2 crores outstanding listed shares and market capitalization of INR 1,000 Crores in respect of such shares, and allowing such companies to maintain the MPS at 10%. The government companies (**PSUs**), infrastructure companies and companies referred to BIFR were exempted from these requirements.

In June 2010, the SCRR was amended and the MPS requirement was made uniform to 25% for all companies, listed or seeking to list. In cases where the post issue capital of companies was more than INR 4,000 Crores, for initial listing, such companies were permitted to offer a 10% public shareholding. All non-compliant companies were required to increase their public shareholding by at least 5% per annum until the required 25% MPS requirement was met. In August 2010, it was provided that PSUs were to achieve 10% MPS within 3 years and the companies in private sector were to achieve 25% MPS in 3 years (by June 3, 2013). Currently, the MPS norm for PSUs is 25% MPS, to be complied with by August 2018. Further, if at any time, the MPS threshold of any listed company falls below 25%, the same has to be increased to at least 25% within a period of 1 year from the date of such fall. In November 2014, a varying MPS threshold for companies going for listing, depending upon the post issue capital of such company was introduced, ranging from 10% to 25%. Companies which are permitted to make a public offer of less than 25% at the time of listing have to increase the public shareholding to 25% within 3 years from the date of listing.

In February 2015, Securities and Exchange Board of India (**SEBI**) excluded – (i) equity shares of a company underlying the depository receipts (unless inter alia the holders of such depository receipts have the right to issue voting instructions); and (ii) equity shared held by a trust set up for implementing employee benefit schemes from 'public shareholding', narrowing down the scope thereof.

SEBI has provided specific methods to aid a listed company/its promoters in meeting such MPS norms, which include public issue, offer for sale through prospectus or secondary market, institutional placement programme and rights issue/bonus issue to public shareholders.

MPS Norms: Global Scenario

By prescribing the 25% MPS norm, it appears that the Government and SEBI have chosen to include a wider spread of dispersed shareholding in listed companies. Globally, the MPS requirements generally vary between 10-25% and

the table below sets out the MPS requirements in certain developed securities markets, like Singapore, UK, US and Hong Kong.

Country	Initial listing Requirement	Continuous Listing Requirement
Singapore (SGX) ²	Decreases in the range of 12-25% as market capitalisation increases over S\$ 300 million	10%
UK (LSE) ³	25%	25%
US (NYSE) ⁴	1.1 million publically held shares (for domestic companies) and 2.5 million publically held shares (for non-US companies)	0.6 million publically held shares
Hong Kong (HKEX) ⁵	25% of total issue share capital subject to a minimum of HK\$ 50 million; if market capitalisation > HK\$ 10 billion, varies between 15-25%	25%

Implementation of MPS Norms

Prior to the June 2013 deadline, some companies requested SEBI to relax the norms, either by a deadline extension or by allowing them to adopt other methods and, in some cases, companies held back their plans for the last minute hoping for an extension, citing bad market conditions.⁶ However, out of the 1,666 and 5,211 companies listed on the NSE and BSE, respectively, as on March 31, 2013⁷, SEBI's June 4, 2013 interim order named only 105 companies as non-compliant, it therefore appears that most listed companies had successfully diluted the promoters' stake to 75% and below.

SEBI in its interim order against such 105 non-compliant companies, passed several directions including, freezing of voting rights and corporate benefits, prohibiting promoters/promoter group from buying, selling or otherwise dealing in securities of their respective companies and restraining directors from holding any new position as a director in any listed company.

In response to such interim order, many non-compliant companies promptly filed their replies, seeking to comply with the MPS norms. For instance, Batliboi Limited sought approval to transfer shares to an independent trust, which was approved by SEBI, and it provided a specific time period for such transfer to be completed.

In contrast to companies which promptly complied with the MPS norms (though belatedly), in cases of non-compliant companies with inordinate delay, SEBI referred some of these companies for adjudication proceedings for imposition of penalty. The table below (based on our analysis of the information available on the SEBI website as of June 2017) gives an indicative picture of the status of interim order with respect to such 105 companies:

Interim order vacated and no further action ordered	37
Interim order confirmed	33 (additionally, undertaking of any other appropriate action by SEBI ordered) 2 (no further actions to be taken by SEBI)
Interim order vacated and adjudicatory proceedings ordered for imposition of penalty	17
Interim order vacated due to delisting or winding up of the company	14
Status not known	2

Position vis-à-vis PSUs

As mentioned above, initially in June 2010, the MPS requirement of 25% was made uniform to all companies, PSUs and non-PSUs, alike. It was however reasoned that in order to comply with the new MPS requirements, offloading a heavy stake in PSUs would lead to raising huge chunks of capital from the markets (despite the general slowdown in the capital markets across the globe at the time), not leaving enough room for non-PSUs to meet MPS norms. Accordingly, in August 2010, the SCRR was amended to provide a 10% threshold for PSUs, to be met within a period of 3 years, which requirement had been further amended to 25% threshold to be met by August 2017. Concerns were raised by the PSUs that the said deadline should be extended primarily on account of 3 years considered insufficient for meeting the MPS requirement as nearly 24 PSUs have government stake of more than 75%.⁸ Though SEBI acknowledged these concerns, it also expressed its unequivocal intention to not accord preferential treatment to PSUs.⁹ However, pursuant to a recent amendment on July 3, 2017, PSUs have been granted an additional 1 year (until August 2018) to comply with the MPS requirement. It may be noted that a similar extension was also sought by non-PSUs prior to the June 2013 deadline however, no such extension was granted by SEBI, citing the sufficiency of the 3 year period.

In effect, whilst the non-PSUs were given a period of 3 years to comply with the 25% MPS norm, PSUs have been given in aggregate a period of 8 years to meet the MPS norms (from June 2010-2013 10% MPS and from August 2014–2018 25% MPS).

Consideration of certain challenges/concerns in relation to MPS Norms

Timelines and impact on valuation

Whilst the SCRR provided flexibility to a listed company to increase its MPS to 25% in 3 years, initially, and within 1 year (if it drops below such level at any time), in practice, such timeline were/ may not be sufficient, and mandatorily undertaking issuance/sale of large quantum of shares in such period could impact the share prices/valuation. In the past, companies such as, Jaypee Infratech, Mahindra Holiday & Resorts India and Fortis Healthcare experienced high price volatility, with stock prices being affected significantly in their attempt to comply with the MPS requirement.¹⁰ Further, Tata Teleservices had to reduce their floor price in its offer for sale due to inadequate demand, in order to be compliant with the MPS norms¹¹. Thus, a mandate to sell or issue a minimum number of shares to the public in an initial public offering or otherwise (especially, when a large portion of shares has to be sold in a short period) may force companies to bring down their fair valuation due to poor market appetite/response, so as to make attractive offers.

Need for flexibility on methods to achieve MPS

As stated above, for the purposes of MPS compliance, certain specific methods that can be adopted by the companies have been prescribed. Such methods exclude some of the usual capital raising modes such as through a qualified institutional placement (**QIP**) and preferential allotment. A company can adopt any other mode of meeting the MPS requirements (other than those prescribed) provided however, that SEBI has granted prior approval for the same. Thus, it may be helpful if SEBI considers a non-restrictive approach in relation to the prescription of methods for achieving MPS compliance and instead, provides flexibility to the companies to adopt any method, including a preferential allotment or QIP (without the need for specific SEBI approval) to meet MPS, so long as the shares are issued to 'public' and not to promoter/promoter group or persons linked to promoter/promoter group. This would also resolve the anomaly with respect to certain shareholders considered 'public' for the purpose of voting and disclosed as such in the shareholding pattern filed with the stock exchanges, but not considered public for the purpose of MPS norms.

Consideration of certain persons as 'public'

Employee welfare trusts

As discussed earlier, a trust holding equity shares for implementing an employee benefit scheme is not to be considered 'public' for the purpose of MPS norms, as SEBI's concern in 2013 was that trusts were set up to deal in their own securities in the secondary market, which was not envisaged within the purview of the relevant guidelines. Whilst subsequently SEBI has expressly permitted such employee welfare trusts to acquire shares (on primary and secondary basis), subject to checks and balances, it has mandated that such trusts have to be treated 'non promoter non public'.

Whilst acknowledging the regulator's legitimate concerns, trusts with independent trustees, who are not linked to promoters in any manner, should be considered 'public', including for the purposes of MPS norms, as promoter and promoter group do not have control over voting rights over shares held by trust and the employees (who are considered 'public') are the ultimate beneficiaries.

Promoters reclassified as public

During the implementation of the 25% MPS norms, Gillette India and Gokaldas Expats had attempted to comply with the 25% MPS requirement by reclassifying a promoter as a public shareholder, which was rejected by SEBI on the ground that it was not leading to a dispersed/ broad based ownership and therefore, is against the spirit of the SCRR. SEBI has thereafter, expressly provided that an increase in the level of public shareholding pursuant to reclassification of promoter, shall not be counted towards compliance with the MPS requirements. This results in the adoption of dual standards, one for the purposes of MPS compliance and other for voting and disclosure purposes. Given the threshold of 10% (if new promoter replaces old promoter)/ 1% holding (if company becomes professionally managed) and non-continuity of any special rights upon reclassification of a promoter as public shareholder as well as the requirement of shareholders' approval, consideration by SEBI of such shareholding of reclassified promoters for the purposes of MPS compliance will make the MPS regime more flexible and the compliance procedure simpler. SEBI may even consider providing a cool-off period of 1 year for treating such shareholding as 'public' for the purpose of MPS norms.

Whether 25% threshold is the correct threshold?

Whilst optically, 25% seems to be a relatively large number to ensure a dispersed shareholding, one may argue its effectiveness in terms of the level of public participation in decision making since, at the current level of 75% it may be easy for promoters to pass special resolutions for important matters, consequently, reducing public participation (except in cases of related party transactions and certain other items requiring only public to vote). On the other hand, a reduced threshold for instance, 10% as was previously prescribed in the case of PSUs, may be argued considering factors such as fluctuating market appetite (which may adversely impact the floor price), etc. Eventually, the correctness of a MPS threshold has to be seen in light of the broad objectives behind setting the MPS limits under the SCRR, which are primarily to stave off price manipulation and to make the listing instrument an effective tool for redistribution of wealth in the country.

Conclusion

Since the introduction of changes to the MPS regime, initial concerns were expressed over the changes introduced such as the adequacy of the 3 year time period and the anomaly created by the MPS requirement of 10% in case of companies with a post issue capital of INR 4,000 Crores or more, thereby, requiring a company just short of INR 4,000 Crores post issue capital to dilute about INR 1,000 Crores to the public whilst, the other company at INR 4,000 Crores market capitalisation was required to dilute only INR 400 Crores. Whilst some industry concerns were addressed by SEBI by introducing necessary amendments to the regulations such as, by introducing a market capitalisation range in order to determine MPS threshold for companies with a post issue capital of less than, equal to or more than INR 4,000 Crores, in case of concerns such as those related to time period for implementation, no relaxation was made. However, on the whole, based on the compliance status, it seems that the listed companies have responded well and complied with the MPS norms. Some may however, argue that SEBI has adopted a less severe approach towards PSUs, for example, by granting an extension of deadline and granting certain specific exemptions. Nevertheless, recent trends indicate that the steps undertaken by SEBI are aimed to place PSUs at par with non-PSUs and to make the 25% threshold uniform to all listed entities.

It will be interesting to see if PSUs will respond equally well and comply with the MPS requirements, and, whilst it may be too soon to gauge SEBI's reaction to non-compliant PSUs upon expiry of the deadline, it will be equally interesting to see if a similar enforcement standard as applied by SEBI in the case of non-PSUs is also applied by it in the case of non-compliance by PSUs.

Lastly, it remains to be seen as to how some of the issues and concerns highlighted in this article such as, those relating to sufficiency of the timelines for MPS compliance, adequacy of the prescribed methods for meeting the MPS threshold and the likely adverse impact on pricing/ valuation, will be addressed and dealt with by Government and SEBI in the future.

¹ July 15, 2017

² Part III, Chapter 2 and Part IV, Chapter 7, SGX Mainboard Rules

³ Release 17, June 2017, Listing Rules, Financial Conduct Authority; Main Market: A guide to listing on London Stock Exchange, Free Float Requirement

⁴ New York Stock Exchange Listed Company Manual

⁵ Chapter 8.08 and Chapter 13, Listing Rules and Guidance, HKEX

⁶ Companies to seek extension of June deadline, easing norms from Sebi, March 05, 2013; Retrieved from: <http://economictimes.indiatimes.com/markets/stocks/policy/companies-to-seek-extension-of-june-deadline-easing-norms-from-sebi/articleshow/19893072.cms> (Last accessed on: July 06, 2013)

⁷ Annual Report of the SEBI for financial year ended 2014. Available at http://www.sebi.gov.in/reports/annual-reports/aug-2014/annual-report-2013-14_27807.html

⁸ Janhavi Behere, Government seeks relaxation of MPS norms for PSUs, October 21, 2016; Retrieved from: <https://www.cmie.com/kommon/bin/sr.php?kall=warticle&dt=2016-10-21%2011:40:55&msec=553> (Last accessed on: July 06, 2017)

⁹ Need similar norms for both public, private sector firms: Sebi, July 04, 2017; Retrieved from: <http://indianexpress.com/article/business/business-others/need-similar-norms-for-both-public-private-sector-firms-sebi-4734157/> (Last accessed on: July 06, 2017)

¹⁰ Analysis of Indian Listed Companies Non-Compliant with Minimum Public Shareholding Norms, Article by Mohan Kumar K, Lead Analyst, InGovern Research Services Private Limited; Retrieved from: <http://www.ingovern.com/wp-content/uploads/2013/03/Compliance-with-Minimum-Public-Shareholding-Norms.pdf> (Last accessed on: July 13, 2017)

¹¹ S. Varadharajan, Many cos still to comply with shareholding norms, June 04, 2013; Retrieved from: <http://www.thehindu.com/todays-paper/tp-business/many-cos-still-to-comply-with-shareholding-norms/article4779771.ece> (Last accessed on: July 06, 2017)