

Discussion Paper on

1. Alternate Capital Raising Platform and 2. Review of other regulatory requirements

1. Background

- 1.1. With a view to provide easier exit options for informed investors like Angel Investors, Venture Capital Funds (VCFs), etc, SEBI Board in its meeting held on June 25, 2013, approved a proposal to permit listing of SMEs in Institutional Trading platform (ITP) without having to make an IPO.
- 1.2. While such companies are listed on the ITP, they are not permitted to raise equity capital through public issues though they can continue to make private placements. SEBI has been in receipt of suggestions to permit capital raising in the said ITP platform.
- 1.3. Further, as part of the regular consultative process, SEBI in the recent past interacted with iSPIRT (which stands for 'Indian Software Product Industry Round Table', a body dedicated to promote existing Indian software product companies). A few Indian start-ups were also present during the said interaction. It was highlighted that there are around 3000 Indian start-up companies with the pace of setting up such companies picking up lately and that Indian software product companies are impacting nearly 3 million small businesses. They highlighted certain challenges facing the industry players to create a regulatory awareness of the typical needs of the industry.
- 1.4. While recognizing the availability of SME platform for facilitating capital raising by small scale businesses and presence of the novel SME-ITP to facilitate exit of institutional investors like PEs, it was submitted that these existing avenues may be further made amenable for accommodating a larger number of growing companies.

- 1.5. Further, Association of Investment Bankers of India (AIBI), an association of investment bankers in India has submitted suggestions to SEBI to facilitate issuers with lower holding of founding members. AIBI has also been requesting clarifications on applicability of certain provisions of SEBI (ICDR) Regulations, 2009 (ICDR Regulations) in respect of such companies.

2. Need for review

- 2.1. Under the ICDR Regulations, the promoters are required to offer a minimum 20% of post issue capital as lock-in for a period of 3 years. The lock-in provision ensures promoters' skin in the game for a period of at least 3 years.
- 2.2. Further, the detailed disclosure on objects of the issue and basis for issue price ensures that the company justifies the price at which it plans to issue shares and the purpose for which the amount raised shall be utilized.
- 2.3. The said requirements are intended to ensure that interest of investors, especially the retail investors, is protected. However, many start-up companies that have flourished in recent times and several of which have also achieved scale, have lower founding members' holding (often less than 20%) and a large holding of institutional investors.
- 2.4. Thus, founding members of such companies are not in a position to offer the shares for lock-in. It is also cited that such founding members do not have sufficient resources to acquire additional shares to offer for lock in. Further, such companies are often professionally run and hence the founding members are not inclined to be disclosed as promoters.
- 2.5. Such companies are often loss-making and belong to sectors for which there are no comparable financial ratios available.
- 2.6. The institutional investors of such companies generally advise these companies to list overseas citing relaxed regulatory regime in other jurisdictions. In the past, a few measures to relax certain requirements have already been taken by SEBI. However, considering the unique nature of such companies, they seek differential treatment.
- 2.7. If the capital raising process in India is not made further relaxed for such issuers, they may be driven to list on stock exchanges outside India. It has been a challenge

for SEBI to simplify the capital raising process for such issuers while protecting the interest of retail investors.

- 2.8. Considering the role of such companies in nation building and their potential in terms of generating employment and income as well as fostering innovation, it is imperative that necessary enabling environment is provided for these enterprises to flourish.
- 2.9. Various suggestions in this regard were deliberated in the Primary Market Advisory Committee (PMAC) of SEBI.
- 2.10. Pursuant to the recommendations of PMAC and further discussions, a proposal on alternate capital raising platform wherein money shall be raised only from institutions and high net worth individuals by the new-age companies having innovative business model and belonging to knowledge-based technology sector is detailed below. On account of the risk involved in investing in such companies, it is proposed that retail investors be restricted from investing in such companies.

3. Proposal on Alternate Capital Raising Platform

3.1. Eligibility

3.1.1. Going by the developments in the USA, Europe, China and other markets, it is noted that young entrepreneurs are coming out with innovations which are leading to creation of technology companies which are bringing in completely new business opportunities by facilitating creation of new products for consumers or are contributing towards system improvement and process efficiencies in existing operation of companies. Many of the companies have the characteristic that their knowledge based product is not widely understood or appreciated by large number of investors. They do not incur profits in the initial years, but have potential to grow in a big way in a short time frame. It is a global phenomenon that many of them are getting acquired by large companies at high valuations. Innovators are therefore, looking for an environment where their inner strength and potential is fairly recognised.

3.1.2. In India such an eco system has come in existence in many parts of the country such as Karnataka, Kerala, NCR, Maharashtra, etc. For want of a better

price discovery within the country, many of these companies plan to get listed in Singapore or the USA.

3.1.3. One of the challenges in coming out with a special carve out in these knowledge based industries is to define them. It is proposed that the new platform for raising money within the country will be initially made applicable to companies which are in the area of software product development, e-commerce, new-age companies having innovative business model, etc. which create new business opportunities or which serve important efficiency enhancement in existing business activities.

3.2. Modified Institutional Platform

- 3.2.1.** Capital raising shall be allowed on the ITP with certain modifications in the current regulatory framework that may include relaxation on restriction of fund raising, minimum investment from certain category of investors, etc
- 3.2.2.** The proposed platform will have two categories of investors i.e. Qualified Institutional Buyers (QIB) and Non-institutional investors (NII). It has been suggested that the family trusts may also be allowed to apply under the QIB category.
- 3.2.3.** 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 under subscription in non-institutional categories shall be available to QIB category
- 3.2.4.** No QIBs shall be allotted more than 5% of the issue size
- 3.2.5.** The minimum application size in case of such issues shall be Rs. 10 lakhs
- 3.2.6.** The minimum no. of allottees in such issues shall be 500
- 3.2.7.** 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
- 3.2.8.** The minimum trading lot on the said platform shall be of Rs. 5 lakhs. There is also a suggestion that this threshold limit on trading lot be lowered for sale of shares by the employees who have been granted ESOPs
- 3.2.9.** 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.

3.3. **Process**

- 3.3.1.** New-age companies having innovative business model and belonging to knowledge-based technology sector, where no person (individually or collectively with persons acting in concert) holds 25% or more of the pre-issue share capital, may be considered as professionally managed companies and access capital through the said institutional platform. In other words, companies where any person (individually or collectively with persons acting in concert) holds 25% or more of the pre-issue share capital shall access capital through the existing main board
- 3.3.2.** Such issuers shall be required to file draft offer document with SEBI for observations, as provided in ICDR Regulations. The issuers shall ensure compliance with various applicable provisions in ICDR Regulations (including disclosures on key managerial personnel and business model), subject to the following carve-outs.

3.4. **Objects of the issues**

Existing Regulation

Schedule VIII - Part A (VII) of ICDR Regulations requires disclosure of the objects of the issue, inter-alia on the purpose of issue, means of financing such project, proposed deployment status of the proceeds at each stage of the project, Interest of promoters and directors, etc

Proposal

The main object may be for general corporate purpose. Further, the disclosure may be restricted to only broad objects. This is in line with the major international jurisdictions.

3.5. **Lock-in of Shares**

Existing Regulation

Regulation 36 (a) of ICDR Regulation stipulates that the minimum promoters' contribution (20% of post issue capital) shall be locked in for a period of 3 years from the date of commencement of commercial production or date of allotment in public issue, whichever is later. Further, Regulation 36(b) of ICDR Regulation stipulates that promoters' holding in excess of minimum promoters' contribution shall be locked-in for a period of one year:

Regulation 37 of ICDR Regulation stipulates that the entire pre-issue capital held by persons other than promoters shall be locked-in for a period of one year, subject to exemptions carved out for certain cases.

Proposal

Lock in of the entire pre-issue capital should be for a period of 6 months uniformly for all shareholders.

3.6. **Basis of Issue Price**

Existing Regulation

Schedule VIII - Part A (VII) (K) of ICDR Regulations requires the disclosure of the basis for issue price including disclosure of Earnings Per Share, Diluted Earnings Per Share, Price earnings ratio, pre-issue Average Return on Net Worth, etc.

Proposal

The basis of issue price may include disclosures, other than projections, as deemed fit by the issuers accessing the market on the institutional platform in order to enable investors take informed decisions

4. **Review of Other Regulatory Requirements**

The Committee further deliberated and recommended that the following provisions shall be applicable for all issuers irrespective of the listing on main board or the institutional platform:

4.1. **Definition of QIB**

Existing Regulation

Regulation 2 (1) (zd) of ICDR Regulations details the institutions that may be considered as qualified institutional buyer

Proposal

The definition of QIBs may be extended to include systematically important NBFCs as per RBI guidelines and family offices / trusts, subject to such family offices/trust registering itself as Alternate Investment Funds (AIF) under the AIF Regulations. Further, any other entity registered with SEBI subject to minimum net-worth of Rs.500 crore may also be considered as a QIB

4.2. **Disclosure with respect to group companies**

Existing Regulation

Schedule VIII of ICDR Regulation states that "group companies", wherever they occur, shall mean companies, firms, ventures, etc. promoted by the promoters of the issuer, irrespective of whether such entities are covered under section 370 (1)(B) of the Companies Act, 1956 or not.

Proposal

Disclosure with respect to group companies shall be restricted to such group companies as covered under the applicable accounting standard (Currently, Accounting Standard 18). In addition, disclosure shall be given for such group companies as considered material by the board of the issuer. The policy on materiality should be disclosed in the offer document.

4.3. **Disclosure of litigations**

Existing Regulation

Schedule VIII Part A (2) (X) (A) requires disclosures of various Outstanding Litigations and Material Developments such as litigations against the issuer, directors involving 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.

Proposal

- All criminal cases and regulatory actions should be disclosed
- With respect to taxation disputes, separate disclosure regarding claims related to direct and indirect taxes shall be provided in a consolidated manner
- For other litigations, policy for materiality shall be defined by the company and disclosed in the offer document. Based on the same, disclosures shall be made.

4.4. **Disclosures on creditors**

Existing Regulation

ICDR Regulations, Schedule VIII Part A (2) (X) (A) (1) (i) under the outstanding litigations requires the disclosure of the name(s) of the small scale undertaking(s) or any other creditors to whom the issuer owes a sum exceeding Rs. one lakh which is outstanding more than thirty days.

Proposal

Complete details about creditors should be disclosed on the web page of the company. The disclosure in the offer document should be based on materiality thresholds as defined and disclosed in the offer document and shall provide link to the webpage of the company where full details are disclosed. Only consolidated information on dues to SMEs and other creditors shall be disclosed in the prospectus.

4.5. **Disclaimer Clause**

Existing Regulation

Regulation 60 (3) of ICDR Regulations requires a disclosure in all public communications and publicity material issued or published in any media during the period commencing from the date of filing draft offer document with the Board till the date of allotment by the issuer that it is proposing to make a public issue or rights issue and has filed a draft offer document.

Proposal

It is proposed that the product advertisements of the issuers may be exempted from the requirement of 'disclaimer'. However, disclosure shall continue in other corporate and issue related advertisements.

5. Public comments:

Considering the implications of the said matter on the market participants including issuers and investors, public comments on the policy framework proposed at paragraph 3 & 4 above are solicited. Specific comments/suggestions as per the format given below would be highly appreciated:

Sr. No.	Pertains to serial number under paragraph (3)/(4)	Agree / Disagree to the proposal at the said serial number	Proposed changes / suggestions	Rationale

Such comments may please be e-mailed on or before April 20, 2015, to capitalraising@sebi.gov.in or sent by post, to:-

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