

Differential Voting Rights Shares Class apart

Instead of restricting their scope, companies should be allowed to issue shares with inferior voting rights but higher dividend rate to the public shareholders

Differential voting rights shares (DVRS) are quite popular in foreign countries. Some of the global giants that have issued DVRS include Berkshire Hathaway, Google and Newscorp. However, DVRS have not yet become popular in India despite the fact that they have been on the statute book since the past more than eight years. Section 86 of the Companies Act, 1956, was amended from 13 December 2000 to permit issue of differential shares. The amended provision of the Act classifies the equity share capital into two kinds: equity share capital with voting rights, and equity share capital with differential rights as to dividend, votes or otherwise.

When the voting rights on new shares are different from the voting rights on the equity shares already issued, the new shares are known as DVRS. DVRS are different from non-voting shares because Section 87 of the Companies Act states that all the equity shares shall carry voting rights. Hence, Indian companies cannot issue non-voting shares.

A company can issue new equity shares with higher or lower voting rights as compared with the rule of one share one vote applicable for the existing equity shares. For example, it can issue new shares with right for just one vote for every five or 10 shares held, which are known as shares with inferior voting rights. It is also possible to issue shares where the voting right may be 10 or 20 votes for each share. These are called shares with superior voting rights. Superior voting rights shares enable the promoter group to enhance their voting rights at a low cost and, thus, gain control over the company with fewer shares. Thus, the promoters can altogether eliminate the possibility of hostile takeovers even if they dilute their shareholding in the company by issuing further equity shares to raise funds for expansion projects. This is because they would be holding DVRS, thereby substantially increase their voting power.

Shares with inferior voting rights are meant for issue to the public shareholders as they are not much concerned about voting rights. Their basic aim is capital appreciation and reaping good dividend,



Tata Motors (left) and Pantaloon Retail have issued DVRS

which can also be achieved through DVRS. Rather, the rate of dividend on DVRS, with inferior voting rights, is more than normal equity shares.

In November 2008, Tata Motors issued 6.4 crore equity shares with DVRS as part of its Rs 4145-crore rights issue to pay back the loan taken for the acquisition of Jaguar-Land Rover. The rights issue portion comprising normal equity shares was priced at Rs 340 per share and DVRS with 1:10 voting right was priced at Rs 305 per share, i.e., at a discount of 10.29%.

In February 2009, Pantaloon Retail (India) issued bonus equity shares with DVRS to the existing equity shareholders of the company in the ratio of one bonus DVRS for every 10 equity shares held. These bonus DVRS were termed as "Class B shares". Ten Class B shares entitled their holders to cast one vote.

The main benefit of DVRS is that they provide better return in the form of dividend. DVRS of Tata Motors as well as Pantaloon are entitled to additional 5% dividend over and above the rate of dividend proposed for payment on the normal equity shares in any financial year.

Trading volume in the DVRS of Tata Motors is very low. This may be due to lack of awareness among retail investors and also because institutional investors do not like to invest in inferior voting rights shares. The DVRS of Tata Motors were trading at a discount of 39.64 % to normal equity shares on the BSE compared with a discount of 10.29 % at the time of issue of these shares by the company. Whether such a steep discount is justified in view of the 1:10 voting rights on DVRS is a million-dollar question.

The Securities and Exchange Board of India (Sebi) amended the erstwhile Sebi (Disclosure and Investor Protection) Guidelines, 2000, from 24 February 2009 by inserting a new clause 8.3.5.2 to facilitate listing of DVRS on the stock exchanges. A listed company may get its DVRS listed on the stock exchanges if it satisfies the following conditions:

- Such equity shares have been issued to all the existing shareholders by way of rights or bonus issue.
- The issuer company has complied with the conditions of minimum public shareholding not only for the equity shares

rights in the ratio of 20 votes for each share to its promoter Karamjit Jaiswal and his company, LP Jaiswal and Sons Pvt Ltd, who together held a 23.59% equity stake before such issue. After the issue of DVRS by way of preferential allotment, their combined stake in JIL increased to 32.1%. But since these shares conferred on them superior voting rights their corresponding voting rights or voting power jumped to 62%, thereby giving Karamjit Jaiswal complete control over the company.

Aggrieved over the issue of these DVRS, his brothers, Anand Jaiswal and Jagatjit Jaiswal, who together held a 12% stake in JIL, filed a petition before the Company Law Board (CLB) to declare the shareholders' resolution passed on 16 June 2004 for issue of DVRS as null and void. The CLB concluded that the issue of DVRS shares is permissible under Section 86 of the Companies Act, 1956, read with the rules prescribed by the Central government. Accordingly, in its verdict delivered on 12 March 2009, the CLB upheld the validity of the shareholders' resolution. However, the DVRS issued by JIL could not be listed on the stock exchanges as they were issued to the promoters on a preferential basis and not by way of rights or bonus issue as stipulated by Sebi guidelines.

Subsequent to the CLB ruling, Sebi changed the rules of the game to provide a level playing field to public shareholders. At its board meeting held on 18 June 2009, Sebi proposed that no listed company can issue equity shares with superior voting rights. If apprehended that the precedence set by JIL may be followed by the promoters of other listed companies to increase their voting power through preferential allotment of DVRS. Moreover, the pricing formula for preferential allotment of shares, i.e., the average of the closing price of the share at the stock exchange during the last 26 weeks or the last two weeks preceding the relevant date, whichever is higher, cannot be applied as it is for the issue of DVRS because the issue of superior voting rights shares on preferential basis considerably dilutes the voting power of the other shareholders compared with the promoter group. Sebi issued a circular on 21 July 2009 instructing the stock exchanges to amend the equity listing agreement by inserting a new clause 28A, thereby prohibiting issue of shares conferring on any person superior rights on voting or dividend as against the rights on equity



No more DVRS with superior voting rights

shares that are already listed.

Listed companies have, thus, been forbidden from issuing not only superior voting rights shares but also inferior voting rights shares if such inferior voting rights shares confer on their holders superior dividend rights. Inferior voting rights shares would always carry higher dividend rate to make them attractive for investors. Otherwise, why would investors subscribe to such shares? When a higher dividend rate is offered on new shares, it tantamounts to contravention of clause 28A of the listing agreement because clause 28A prohibits issue of shares conferring on the holder superior rights compared with the dividend on the already listed equity shares.

Sebi (DIP) guidelines were replaced with Sebi (Issue of Capital and Disclosure Requirements) Regulations, 2009 from 25 August 2009. Provisions for listing of DVRS on stock exchanges were issued afresh on 3 September 2009. The amendment has not only altogether banned the issue of superior voting rights shares but also marred to a great extent the possibility of issue of inferior voting rights shares. Whether the treatment meted out to inferior voting rights shares is intentional or unintentional is not ascertainable. The DVRS issued by Tata Motors and Pantaloon Retail are valid as they were issued before the amendment to the listing agreement. Henceforth, however, no listed company can issue DVRS on the same terms and conditions because although these DVRS carry fewer voting rights (1:10), they entitle their holder to 5% additional dividend every year over and above the dividend paid on normal equity shares.

The Companies Bill, 2009, introduced in the Lok Sabha on 3 August 2009, also proposes to do away with the concept of equity shares with DVRS. Accordingly, unlisted companies will also not be able to issue DVRS once the new Companies Act is enacted. Thus, DVRS are proposed to be nipped in the bud.

The issuance of equity shares with DVR is not bad per se. The danger is of such instruments being issued to the constituents of the promoter group. If such shares are held by unbiased institutional investors, then perhaps they can exercise better control over the activities of the promoter group, which is in the interest of all the stakeholders. Hence, DVRS should not be done away with completely. Shares with inferior voting rights may be beneficial for retail investors as such shares will not only be issued at a discount to the prevailing market price of the normal equity shares but also provide better dividend yield.

Moreover, inferior voting rights shares are much less susceptible to misuse compared with the shares with superior voting rights as they are issued to the investors at large, who would subscribe to such shares only if they trust the company's management. Instead of restricting the scope for issue of DVRS by listed companies as per clause 28A of the listing agreement and by unlisted companies as proposed in the Companies Bill, 2009, it will be appropriate if suitable provisions are made by the government for issue of shares with inferior voting rights but higher dividend rate to the public shareholders.

— Rajesh Relan