A STUDY ON SHARES WITH DIFFERENTIAL VOTING RIGHTS AND SUPERIOR VOTING RIGHTS

Rohit Soni, SVKM'S NMIMS Kirit P Mehta School of Law, Mumbai

ABSTRACT

Without a doubt, stock markets are a vital and necessary aspect of a country's economy. However, the impact of stock markets on the country's economy may differ from how stock markets in other countries affect their economies. This is because the impact of stock markets on the economy is determined by a variety of factors such as the organisation of stock exchanges, their link with other components of the financial system, the country's governance system, and so on. Because each of these characteristics is unique to each country, the impact of stock markets on a country's economy is likewise unique. The Indian capital market system has experienced considerable fundamental institutional changes over the years, resulting in lower transaction costs, significant increases in efficiency, and openness.

Buying stock is one way to acquire a piece of a firm. A company's shares can be considered as a financial asset that provides for the equal distribution of retained earnings in the form of dividends. Stockholders who own a company's shares but do not get dividends do not share in its financial success. Instead, they anticipate an increase in stock price as a result of the company's performance.

So the focus of this paper is to study in depth about the share, the types of shares and the voting rights related to the same.

1. Introduction

One way to own a piece of a company is to purchase shares of stock. A company's shares may be viewed as a financial asset that allows for the equitable distribution of retained earnings in the form of dividends. Stockholders who own a company's shares but receive no dividends do not share in the company's financial success. Instead, they look forward to increasing stock price as a result of the company's success.

There are two types of shares in a company limited by shares

- Equity share capital
- Equity share capital with voting rights
- Equity share capital with differential rights as to dividend
- Preference share capital

Equity share capital

In financial market, equity share capital refers to the money a company has raised from the public by issuing shares of stock. Capital made up of equity shares is a form of risk capital.

Companies solicit subscriptions for their shares from the general public in order to raise the necessary capital. Investors provide capital in exchange for company shares. Equity share capital therefore refers to the money amassed from the sale of all shares.

When a company goes public through an IPO (Initial Public Offering), the proceeds from the sale of its stock are a reliable source of capital. They are also not redeemed and paid off until the company is liquidated.

However, the equity shareholders reap the benefits of the shares as well. In exchange for their financial investment, they are now part owners of the business and entitled to a dividend pay-out. Indeed, you'll be surprised to learn that They are entitled to a portion of the proceeds from the liquidation as well.

The primary reason for issuing equity shares is to generate capital for development and expansion. IPO is the process by which a company offers its stock to the general public (initial public offer). As soon as the stock is listed, you will be able to buy and sell it at your leisure.

Equity share capital with voting rights

This generally means that the shares that the company will issue will have all the facilities along with the voting rights in the company.

Equity share capital with differential rights as to dividend

About the Equity share capital with differential rights as to dividend, we will study in detail about it in the later part of the chapter.

Preference share capital

An organization's preference share capital is the money it has raised through the sale of preference shares (also known as Preference stock). Investors who hold preference shares are prioritised for dividend payments even ahead of common stockholders.

2. Research objectives

- To study shares with differential voting rights
- To study shares with superior voting rights

3. Research questions

- What are shares with differential voting rights?
- What are shares with superior voting rights?

4. Shares with differential voting rights

In 1920s France was the first country to introduce the idea of company having differential voting rights.

These shares were issued by companies in both the United States and Canada. However, the idea is only recently introduced to India. If an investor is willing to forego their voting rights in exchange for a higher return, they can do so through a DVR.

The promoter's stake in the company is protected from dilution while the company's equity is reduced. When they put their money into a company, some people do it purely for the financial gain and not because they want a say in the company's management. DVRs, which are also known as "Dual Class" of shares, are increasingly popular in the present day. Google, Ford, BMW, Bombardier, Brown Forman, Comcast Corp, Fiat, Forest City, Telephone & Data System, Viacom, Volkswagen, Haverty Furniture, Hubbel Inc, Lennar Corp, News Corp, Samsung Electronics, and many more companies around the world have all released digital video recorders. U.S. manufacturers have distributed the vast majority of DVRs. DVR is prohibited on the Singapore Stock Exchange, among others. [1]It has been found by those studying the US market that dual class of shares incur a greater agency cost than ordinary shares

Only four Indian companies have released [2]DVRs as of now [3] observed in 2009 that a company had issued shares with superior voting rights, or 20 votes per share. The promoters, who previously only owned 32% of the company, now have 62% of the voting power as a result of this. Consequently, minority shareholders Anand Jaiswal and Jagatjit Jaiswal (who held a combined 12%) petitioned the Company Law Board (CLB).

Advantages of issuing DVRs

An advantage to the company - Is that it can increase its capitalization without changing its share structure. (DVRs) are useful for both price discovery and preventing hostile takeovers.

When purchasing DVR shares, investors receive a discount compared to purchasing ordinary shares. It allows them to collect a larger dividend than they would with common stock.

Disadvantage of issuing DVRs

To the company - Devaluation of a Company occurs when its value decreases.

Such stock is off-limits to institutional investors. Lack of investor education could lead to DVRs becoming illiquid.

To investors - Institutional investors would be worse off. As a result of its illiquidity, it may reduce investment returns. To put it another way, it prevents itself from being acquired. Recording-on-demand services give administration way too much control.

DVRs issued by Indian Companies

[1] (Ingovern, 2010-12).
[2] Differential voting right
[3] Anand Pershad Jaiswal et al v. Jagajit Industries Ltd et al

Tata Motors made history in India when it issued DVR rights in 2008. The second company to issue DVRs in 2009 was Pantaloon Retail India, which did so in February.

Tata Motors DVR: Tata Motors was the first company to issue equity shares with DVR in 2008, seven years after the rules were notified by the Central Government.

DVRs worth Rs. 6.4 billion were issued by Tata Motors as part of the company's Rs. 4145 crore rights issue. This problem arose because of the need to pay back a loan used to finance the purchase of Jaguar Land Rover. The DVR share was priced at Rs. 330, while the ordinary rights issue was priced at Rs. Tata Motor, however, promised a 6% dividend on a DVR for every 1% dividend paid on ordinary shares. As a result, the voting power of shares with differential voting rights was lower than that of ordinary shares. One vote is equal to ten Tata Motors shares.

Bonus DVR shares were offered to shareholders of Pantaloon Retail India Limited (now part of Futures Enterprises Limited) in February 2009.

For every 10 equity shares owned as of a certain date, shareholders were offered one bonus share with differential voting rights. Class B shares, as the new stock is known, gave investors a 5% dividend increase over the previous year's payout for class A shares.

Shareholders of Gujarat NRE Coke Limited received one bonus DVR share for every ten equity shares they held in September 2009. For every 100 DVR shares you own, you get one vote.

As a bonus to its existing shareholders, Jain Irrigation issued its first DVR in November 2011. Investors receive 1 vote for every 10 DVR they own.

Lack of education about DVR in India has limited the number of companies that have issued DVR-enabled instruments to just four.

There is a risk that common shareholders will lose money due to abuse of companies' concentrated power to make decisions. On July 21, 2009, SEBI issued a rule prohibiting the issuance of shares with voting rights that were superior to those of common stock.

Shares with less voting power are, however, allowed.

[4]Companies Act 2013 on equity shares with differential voting rights

The following requirements must be met before a company limited by shares can issue equity shares with differing rights as to dividend, voting, or otherwise:

- The company's AOA permit the issuance of shares with voting rights.
- An ordinary resolution adopted at a general meeting of shareholders authorises the issuance of shares.
- Provided that the issue of such shares shall be approved by the shareholders via postal vote when the company's equity shares are listed on a recognised stock market.
- Neither the number of shares with differential rights nor the percentage of the total post-issue paid-up equity share capital that consists of all equity shares, including equity shares with differential rights, issued at any given moment may exceed 26%.
- For the past three years in a row, the company has maintained a profit that may be shared with shareholders.
- The company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares.
- No event of default exists with respect to the payment by the Company of any dividend declared to its shareholders, the repayment of any of its matured deposits, the redemption of any of its preference shares or debentures that have become due for redemption, or the payment of interest on any of the foregoing.
- In the past three years, the company has not been fined by a court or tribunal for violating any law that applies to companies in the same industry as the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992, the Securities Contract regulation Act, 1956, the Foreign Exchange Management Act, 1999, or any other special Act under which such companies are regulated by sectoral regulators.

5. Shares with superior voting rights

History

With the 2019 amendments to the ICDR Regulations, SEBI has implemented a new voting

[4] The companies Act, 2013.

rights framework tailored to issuer firms that make extensive use of technology. Superior Voting Rights (SR) shares were introduced on the theory that most modern technology firms are capital-poor and have diluted the stakes of their founders and promoters in order to grow. The promoters/founders play a crucial role in the growth and development of new technological companies. It is stated that shareholders, such as financial or economic investors, who are only concerned with returns or economic worth of their investments, need a structure that allows them to preserve decision-making powers and rights.

Promoter/founders in such firms are permitted to hold SR shares under the current structure in Chapter II of the ICDR Regulations, provided that the SR shareholder is an executive in the issuing company and does not belong to a promoter group with a net worth of more than Rs. 500 crores. Voting rights ratios, SR share issuing procedures, and other requirements have also been outlined.

There are also safeguards built into the structure, such as a sunset clause and "coat tail" rules, which state the circumstances in which SR shares have the same rights as ordinary shares.

The SR shares framework has not yet been used by issuer firms. Interaction with market participants revealed that several of the framework's rules are burdensome and unhelpful. These are especially related to the prerequisites. Currently, subject to specific requirements, a firm with SR shareholders is allowed to conduct an initial public offering (IPO) of ordinary shares under [5]Regulation 6(3) of the ICDR Regulations. The following two conditions have been requested for review by the market participants:

- The promoter group, whose total net worth exceeds Rs. 500 crores, should not include the SR shareholder.
- Prior to the Red Herring Prospectus's filing, SR shares had to be held for at least 6 months (RHP)

The possibility of allowing SR shares to be issued to trusts, holding companies, and other entities has also been raised.

After considering the issue, PMAC suggested that a public consultation be held. As a result, on July 1, 2021, a consultation paper (Annexure I) was posted on the SEBI website asking for public feedback.

[5] Issue of capital and disclosure requirements regulations, 2018.

Seven entities, including law firms, auditors, academicians, merchant bankers, and corporations, have provided comments. They have all backed the plans.

6. Conclusion

DVR shares are unattractive for investors who think that they should have a say in how the corporation makes decisions because of their few voting rights.

However, investing in the DVR would undoubtedly be a compelling idea if one is a minority investor and isn't particularly bothered with voting rights in general. DVRs typically trade at a discount, partly because they have less voting rights than other securities.

However, there are occasions when there is a significant difference between DVR and common shares, giving investors a wonderful opportunity. An investor will be entitled to bigger dividends in the event that, over time, the price differential between the ordinary and DVR share decreases due to increased public awareness of the product in addition to capital appreciation. Additionally, he can always exit DVRs whenever the differential narrows and reinvest in common shares. As a result, the risk reward ratio of buying DVRs appears to be slightly biased in favour of the latter. The only restriction is that, prior to purchasing a DVR, investors must feel confident about the company's prospects and fundamentals, as well as, more crucially, its management.

7. Bibliography

- Adams, R. and D. Ferreira, "One Share, One Vote: The Empirical Evidence", ECGI, Finance Working Paper No. 177/ (2007).
- Mohamad O, Ramayah T, Puspowarsito, "Incidence of marketing activities in medium-sized manufacturing firms in Indonesia: Comparing export intenders and non-export intenders" ,Scopus Preview (2011).
- Zhiqiang Ye, Xiang Ren and Yaling Shan, "Stock Market - Scientific Journals" journal of stock & Forex Trading (2002).
- T. Chordia, C. Vega, P. Pasquariello, "Investor attention and municipal bond returns" journal of financial market, (2016).
- Barca, F. and M. Becht, eds. The Control of Corporate Europe(2001).
- Bebchuk, L, "Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments", Harvard Law Review Vol. 102(2001),.
- Bebchuk, L. and A. Cohen, "The Costs of Entrenched Boards", Journal of Financial Economics Vol. 78(2001),.
- Bebchuk, L., A. Cohen and A. Ferrell, "What Matters in Corporate Governance?", Harvard Law School John M. Olin Centre Discussion Paper No. 491(2001),.
- Becht, M., "Reciprocity in Takeovers", ECGI, Law Working Paper No. 14/(2003).
- Becht, M, "Beneficial Ownership in the United States", in F. Barca and M. Becht (2001),
- The Corporate Control of Europe, FEEM Studies in Economics, Oxford.
- Becht, M, "European Corporate Governance: Trading off Liquidity against Control", European Economic Review, Vol 43 (4-6) (2001).
- Becht, M. and E. Böhmer, "Ownership and Voting Power in Germany", in F. Barca and M. Becht (2001).
- M., P. Bolton and A. Röell "Corporate Governance and Control", in G. Constantinides(2003).
- H. Harris and R. Stulz (eds.), Handbook of the Economics of Finance, North-Holland, Amsterdam. Becht (2005).
- M., A. Chapelle and L. Renneboog "Shareholding Cascades: The Separation of Ownership and Control in Belgium" (2001).

- Barca and M. Becht The Corporate Control of Europe, FEEM Studies in Economics, Oxford(2001),.
- Ben-Amar, W. and P. André "Separation of Ownership from Control and Acquiring Firm Performance: the Case of Family Ownership in Canada", Journal of Business Finance and Accounting Vol. 33(3) (2006).
- Bennedsen, M. and K.M. Nielsen "The Principle of Proportional Ownership, Investor Protection and Firm Value in Western Europe", ECGI, Finance Working Paper No. 134/2006(2006).
- Bianchi, M. and M. Bianco "Italian corporate governance in the last 15 years: from pyramids to coalitions", ECGI, Finance Working Paper No. 144/(2006).