

19 April 2019

**Securities and Exchange Board of India**

SEBI Bhavan Plot no. C4-A, "G' Block Bandra Kurla Complex  
Bandra (East), Mumbai – 400 051  
India.

Submitted via email to: [abhishekr@sebi.gov.in](mailto:abhishekr@sebi.gov.in)

**RE: Consultation Paper on the Issuance of shares with Differential Voting Rights**

Dear Sirs and Madams,

BlackRock<sup>1</sup> is pleased to have the opportunity to respond to the "Consultation Paper on the Issuance of shares with Differential Voting Rights" ("Consultation Paper") issued by the Securities and Exchange Board of India (SEBI).

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this Consultation Paper and will continue to contribute to the thinking of SEBI on any issues that may assist in the final outcomes.

Unless otherwise indicated, the terms used in this letter shall have the same meanings as in the Consultation Paper.

**Executive Summary**

BlackRock is an advocate of the principle of "One-Share One-Vote" (OSOV), and we generally remain opposed to allowing companies to issue shares with Differential Voting Rights (DVRs), as they expose shareholders who are not DVR beneficiaries to risks of expropriation and management entrenchment. It is a mechanism that can easily lead to weakened corporate governance and stewardship standards. We do recognize that for companies new to public markets, DVR can provide the promoters protection from short term pressures while they establish the company with public investors and demonstrate their ability to deliver the long-term strategy and financial performance.

At the outset, we should like to underscore the potential risks to investors, including retail investors, of introducing a new listing regime to allow companies with DVRs to the market. Hong Kong introduced a system of Dual Class Shares (DCS) as part of a listing regime for emerging and innovative sectors in April 2018. Nine stocks have listed under this regime, of which two had a DCS structure. These two have fallen 29.7% on average from their first day of trading to the end of the recent quarter, destroying a total of USD 31 billion in market value against the China benchmark which on average is up 1.5% for the comparable periods. We have also run an analysis of the performance of companies with DCS listed in the US and find no evidence that as a class they offer superior returns to the market. The data on these findings are provided in our more detailed comments below.

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<sup>1</sup> BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

While we have reservations in departing from the OSOV principle, we note with appreciation SEBI's efforts to provide safeguards to mitigate the risks associated with DVR structures proposed. In particular, we applaud the provision for the superior voting rights to expire after five years unless there is a vote on OSOV basis to extend the capital structure. Should SEBI proceed with the proposal for issuers with DVR structures, we recommend exercising other stringent safeguards for the protection of all shareholders.

We would propose the following among other protective measures to be mandatory for companies listing with DVRs:

- Require the disclosure of voting results calculated on a OSOV basis as well as voting results calculated based on DVRs;
- Require a fully independent Corporate Governance Committee and Remuneration & Nominating Committee to be mandated for companies with DVRs;
- A lead independent director should be identified to act as the point of contact for shareholders to discuss governance issues;
- After an IPO with superior voting rights (SR) shares, prohibit further complexity in the capital structure through any third class of fractional voting rights (FR) shares;
- Beyond the potential first extension of the DVR structure after five years, any subsequent extension should require a super majority of shares voted on a OSOV basis as the case is weaker for having such structures beyond ten years from listing.
- Any change in the constitutional arrangements of the issuer should be through a OSOV majority approval of all shareholders.
- The threshold for shareholders to convene an EGM should be stipulated as the equivalent of 10% calculated on a OSOV basis.

Below we provide more detailed comments on the Consultation paper as well as suggestions on the DVR proposals in the template requested. We reiterate our appreciation for giving investors the opportunity to provide feedback. We welcome further discussion on the points raised, or on any other relevant matter.

Yours faithfully,

**Amar Gill**  
APAC Head of Investment Stewardship

**Winnie Pun**  
APAC Head of Public Policy

## Comments on Consultation Paper

### 1. Introduction

The attraction of DVR shares or dual class shares (DCS) is that they help issuers in fund raising without dilution of control for the promoters. Thus, they serve as a defence mechanism against hostile bids for control. This is a major benefit for issuers and may encourage new and growing businesses to list in the market. However, the benefit should be weighed against the risk of entrenching the control of the promoters through such capital structures. If companies with DVR shares with superior voting power for promoters are introduced to the market, it is imperative that the disproportionate voting rights granted to the promoters be balanced with greater than usual protections for minority shareholders.

Historically, companies with lower voting rights may have been priced at a discount when issued and may have offered higher dividends than ordinary shares. However, the amendments to the regulations in Hong Kong and Singapore last year introducing DCS, and the proposal for DVR shares in India, no longer envisage higher dividends to compensate investors for their diminished voting rights.

The recent Hong Kong experience of introducing dual class shares for “emerging and innovative” businesses should be noted. Nine companies have listed under this new regime since it was introduced in April 2018, of which two were introduced with dual class of voting shares. The table below indicates their abysmal performance. From their first-day close, the two stocks have fallen by an average of 29.7% to the end of the recent quarter (March 2019), significantly underperforming the market returns in this period. This has resulted in USD 31.1bn destruction in market capitalisation for these two stocks since their listing, representing huge losses for the investing public, including a large number of retail investors who participated in these offerings.

#### Companies listed in Hong Kong under new DCS regime

Company	Date of listing	Share price listing date (HKD)	Share price 29 Mar 2019 (HKD)	Change	Market cap on listing date (USD mio)
Xiaomi Class B (1810 HK)	9 Jul 2018	16.80	11.38	-32.3%	51,629
MSCI China		161.49	156.83	-2.9%	
Meituan Dianping (3690 HK)	29 Sep 2018	72.65	52.90	-27.2 %	53,135
MSCI China		148.17	156.83	+5.8%	

Source: FactSet

Their listing was accompanied with much fanfare, touted as special companies with tremendous potential whose listing came under the much-promoted new DCS regime that had only recently been approved by the Hong Kong regulators. While only two companies have listed with dual class shares under the new regulations, a total of nine companies have to date listed by this new listing regime. The performance of these new listings is quite mixed. One has almost doubled, but more than half have fallen in value since listing.

#### Hong Kong: Performance of listings under the Emerging and Innovative Regime

Ticker	Company	Mkt Cap at IPO (USD m)	Date of IPO	Price at end of 1st day (HKD)	Price at 29 Mar 2019 (HKD)	Change in share price
1810	Xiaomi Corporation - W	48,768	09/07/18	16.80	11.38	-32.3%
3690	Meituan Dianping - W	48,583	20/09/18	72.65	52.90	-27.2%
1672	Ascleptis Pharma Inc. - B	2,011	01/08/18	14.00	6.45	-53.9%
6160	BeiGene, Ltd. - B	10,622	08/08/18	107.00	77.20	-27.9%
2552	Hua Medicine – B	1,117	14/09/18	8.28	7.72	-6.8%
1801	Innovent Biologics, Inc. - B	2,004	31/10/18	16.58	28.65	72.8%
1877	Shanghai Junshi Bio. – B, H	1,889	24/12/18	23.75	29.90	25.9%
2616	CStone Pharmaceuticals - B	1,514	26/02/19	12.86	15.88	23.5%
6185	CanSino Bio. – B, H	615	28/03/19	34.70	34.70	0.0%

Source: FactSet

The Hong Kong experience underscores that regulators and financial intermediaries who bring these companies to the market under a new listing regime should highlight the risks to balance the potential exaggeration of the attractiveness of being introduced under a new class of listings. This is especially so where the voting power of the investing public in these companies is significantly diminished relative to the promoters.

## **2. Need for DVRs in India**

We refer to the question posed whether foreign investors would wish to invest in companies where founders hold higher voting rights. Undeniably, where the business model and execution capability is compelling, companies will attract investors, both local and foreign. The Consultation Paper also notes that the “market will be willing to give up control to an insider who has proven to be successful.” This is partly true. Many investors will ride along as long as a stock is doing well and supported with good fundamentals.

The converse, however, is that if/when a business performance turns down, investors will collectively get more skittish if they have limited influence over the company. Lower voting rights encourages a “renter” rather than “owner” mentality for investors. They will hold the stock as it moves up but are more likely in a downturn to dispose and move on, as we see with major technology stocks in the US as well as the major Asian markets in recent months. Without the accountability of equal voting, investors who are nervous about any deterioration in a company’s fundamentals, will sell swiftly rather than hold on to a stock that goes to a large discount to their purchase price. Encouraging investors to ride along stocks for the upside but with limited voting and governance oversight will almost certainly lead to greater volatility in these stocks and attract mainly short-term investors given the limited voting influence offered.

## **3. Advantages and disadvantages for consideration in the context of DVRs**

The points on the advantages and disadvantages to the issuer in the Consultation Paper are fair. They can be summarised as promoters having the advantage of maintaining control even though diluting their economic interest through raising equity capital. The disadvantage to the issuer is the uncertainty over the type of investors such companies will attract, and whether retail investors actually understand *ex ante* the risks related to companies with such structures.

With regard to advantages for investors, a benefit mentioned is that promoters would be more strongly committed to these companies if they have the benefit of superior voting rights. However, this conjecture can be turned on its head: if promoters have proportionately lower economic interest relative to their voting control, they are economically not as vested in the company. Their economic cost of bailing out if things turn sour is lower compared to where their economic interest is proportionate to their voting power. In addition, they can achieve outcomes that benefit them at the expense of other investors as they bear a relatively smaller portion of the economic value at risk.

There is indeed no known research that promoters are more strongly committed to companies where they have superior voting rights. The general observation is that promoters have capitalised on the opportunity presented to them in some markets to maintain higher control while reducing their economic interest through raising fresh equity capital.

Neither have the new regulations in markets that introduced DCS of late (Hong Kong and Singapore) led to any greater economic benefit to minority shareholders in terms of higher dividends to compensate for lower voting rights. This is no longer a relevant supporting point for minority shareholders to consider in these situations. Meanwhile these shares have been offered at IPOs at valuations, which as we have noted in Hong Kong, led to substantial losses thereafter. Overall, the advantages of DVR shares for investors are arguably more apparent than real.

## **4. Regulatory Considerations in India**

This section provides an excellent, comprehensive account of the relevant regulatory framework in India.

## 5. Comparison across Various Jurisdictions

We note again that the markets in Asia that have introduced DCS structures have not had encouraging results to-date. Hong Kong has listed just two companies with DCS under the new regulations introduced in April 2018. The stocks have been value-destructive for most who participated. After much effort and fanfare to introduce similar regulations in June 2018, Singapore has not seen any company list under the Dual Class Share Structure in nine months since the regulations were introduced.

We would also note the lack of evidence to indicate superior performance of companies listed with dual class shares (DCS). BlackRock examined the performance of 311 companies that have such capital structures that are part of the Russell 3000 index in the US. We considered their total shareholder return (TSR): on a simple average basis, stocks with DCS *underperformed* by 0.76% annualised since their listing, or by 0.12% since 2010. The average performance relative to the sector index has not been impressive either: underperforming on average by 1.44% per annum since IPO, while giving very slight outperformance of 0.18% which is negligible against the Russell 3000 index return of 11.6% annualised. A simple average of non-dual class shares performed slightly worse, underscoring that the market return was driven by the larger stocks in the market-cap weighted index. While a handful of stocks with DCS have given good performance, on average there is no real evidence that stocks with DCS give any sustained outperformance over any reasonable length of time relative to the overall index.

### US market<sup>1</sup>: Annualised excess returns of Dual Class Shares & Non-Dual Class Shares

Class of Shares (Number of Companies)	Average market cap (USD mio)	Average excess return since IPO	Average excess return against Sector since IPO	Average excess return since 2010	Average excess return against Sector since 2010
Dual Class (311)	10,967	-0.76%	-1.44%	-0.12%	0.18%
Non-Dual Class (2,639)	9,609	-2.99%	-4.83%	-2.28%	-2.18%

<sup>1</sup> Based on Russell 3000 constituents

Source: FactSet, Bloomberg

## 6. Market Considerations and Companies with Listed DVRs in India

We note from the Consultation Paper that five companies in India have issued DVRs: presently only with fractional voting rights (FR) relative to the ordinary shares. Two of these have seen the FR shares trade at a significant discount of 40% to 65%. As the paper notes, “Very low additional dividends, discomfort with losing voting powers, and lower interest among investors seem to be the reasons.”

We believe that lower liquidity combined with lower voting rights on these FR shares is the main factor that some move to a large discounted value, while none move to a premium. Liquidity should not be a problem under the DVR scheme now proposed, where SR shares are untradeable and held by promoters while all the shares listed for trading have “ordinary” voting rights (at a fraction of the voting rights for the SR shares). As we note in the Suggestions below, liquidity of ordinary shares could become an issue if companies with SRs are allowed subsequently to introduce yet another class of FR shares with even lower voting rights than the ordinary shares. We thus recommend against having unnecessarily complex capital structures. If a company is listed which has one class of superior voting rights shares together with ordinary equity shares that have lower voting rights, it is not clear why there should be any need of a further class of shares with even lower voting rights than the ordinary shares. We would recommend to prohibit companies which already have SRs from subsequently issuing FRs.

Please see below for these and other suggestions made in the requested template detailing the proposals included in the Consultation Paper.

## (I) COMPANIES WHOSE EQUITY SHARES ARE ALREADY LISTED – ISSUANCE OF FR SHARES

Sr No.	Pertains to specific recommendation in DVR Group Report	Suggestion(s)	Rationale
1	First issue of FR Shares	This proposal is permitted by the Companies Act and existing SEBI regulations, but we suggest issuances of FR Shares should not be encouraged.	Shares with fractional voting rights (FR) are at risk of attracting less investor interest relative to ordinary shares with the normal voting rights, hence the FR shares are quite likely to move to a discount negatively impacting the predominantly retail investors that are attracted to these shares. Meanwhile institutional investors will focus on the shares with ordinary voting rights but the availability of these shares is reduced by the existence of FR shares. Thus the ordinary shares of successful companies will likely trade at a premium, which increases the price for institutional investors and reduces the likely returns for end-clients they represent (including retail investors who invest through institutional funds).
2	Rights Issue or Bonus Issue	Companies with FR shares should not just be <u>eligible</u> to transact a rights issue or a bonus issue of FR shares of the same class to all shareholders on a <i>pari-passu</i> basis (as recommended); rather they should be <u>required</u> to carry out a rights or bonus issue on the same terms for all classes of shares.	Shareholders of a class of shares with lower voting rights should not be at risk of having their economic interests diminished if there is a rights or bonus issue where they may not be entitled to the new shares at the same terms as owners of the ordinary shares.
3	SEBI regulations in respect of buy-back, and takeover shall apply to FR shares subject to such modification as may be required in the context of FR shares	SEBI regulations should require that buy-backs, takeovers and other corporate exercises not change the proportion of FR to ordinary shares unless voted on at a general meeting obtaining majority approval of shareholders of each class of shares respectively.	The economic interests of investors in FR shares should not be at risk if buy-backs, takeovers or other corporate exercises do not involve FR shares at the same terms as for the ordinary shares.

## (II) COMPANIES WHOSE EQUITY SHARES ARE PROPOSED TO BE LISTED – ISSUANCE OF SR SHARES

Sr No.	Pertains to specific recommendation in DVR Group Report	Suggestion(s)	Rationale
1	First issue of SR shares and the IPO of companies with SR shares	<p>The need for the SR shares must be clearly explained in the submissions to SEBI for approval of companies to list with SR shares and stated in the subsequent prospectus for the listing.</p> <p>These companies when listed should have a marker for the ordinary shares that have lower voting rights, eg “(LR)”.</p>	<p>The advantage to promoters of having SR shares should be granted only when there is a clear need for the issuer to have a DVR capital structure, which should be explained to the satisfaction of the regulator.</p> <p>Once listed, ordinary shares that have lower voting rights than the SR shares held by the promoters should be marked clearly as such given that these ‘ordinary’ shares do not have the voting rights an investor would usually expect from ordinary shares.</p>
2	A company whose SR shares and ordinary equity shares are already listed shall be permitted to issue FR shares subsequently in accordance with provisions for issue of FR shares	After an IPO of a company with SR shares, there should be no need to make the capital structure even more complex by a third class of shares.	The proportion of total voting power of holders of the ordinary voting shares should not diminish following any potential issuance of FR shares which may be offered to minority investors while promoters/ holders of the SR shares may subscribe for shares with ordinary voting rights that in effect increases their relative total voting power through this exercise. FR shares may also reduce the liquidity for the ordinary shares that committed investors would primarily seek to own.
3	Initial Disclosures – The company shall disclose in the offer document the names of all holders of SR shares with details of all special rights provided to them.	At least one of the holders of the SR shares should be personally on the Board of Directors.	At least one of the owners of the SR shares should be a director on the Board and have the fiduciary responsibility to act in the best interests of all shareholders and be accountable to other directors at Board meetings.
4	Coat-tail Provisions – SR shares shall be treated as ordinary equity shares in terms of voting rights in certain circumstances including the appointment or removal of independent directors and/or auditors.	SR shares treated as ordinary share, i.e. one-share one-vote irrespective of voting class, should also include <i>re-appointment</i> of independent directors and/or auditors.	Investors in the ordinary shares should be able to vote for the appointment of independent directors and/or auditors, as well as their re-appointment, on a OSOV basis.

**(II) COMPANIES WHOSE EQUITY SHARES ARE PROPOSED TO BE LISTED – ISSUANCE OF SR SHARES**  
(Cont'd)

Sr No.	Pertains to specific recommendation in DVR Group Report	Suggestion(s)	Rationale
5	Coat-tail Provisions –Extension of the validity of the SR shares post completion of 5 years from date of listing.	The second and further extensions of the SR shares structure beyond the first 5 years should be approved by a super majority of 75% of total votes calculated on a OSOV basis.	There is a risk that the promoters have affiliated owners who may help the promoter to extend their SR shares validity. A company with such a structure could still be in a growth stage where the original founders who have the SR shares remain the most suitable to lead the companies for a further 5 years. But the argument becomes weaker as the company matures. After 10 years the proportion of shareholders in favour should be higher for the SR share structure to persist.
6	Coat-tail Provisions – Changes to Constitutional documents and/or Articles of Incorporation	Any changes in the constitutional arrangements of the issuer should be on the basis of one-share one-vote irrespective of voting class.	Promoters with SR shares should not be able to exploit their higher voting power to change the Articles of the company in a way that may not be in the interest of all shareholders.
7	Coat-tail Provisions – Transparency	Disclose results of all votes at shareholder meetings calculated both on a OSOV basis as well as with the disproportionate weighting for SR and FR shares.	In the interest of transparency, the company should disclose whether a proposal has been passed only through the use of the SR shares, which would not have been approved if voted on a OSOV basis.
8	Sunset Clause / Conversion of SR shares: The promoters may do an accelerated conversion of their SR shares into ordinary equity shares at any time prior to the 5 <sup>th</sup> anniversary of listing.	Any change in the capital structure, including early conversion of SR shares into ordinary shares, should be on a OSOV basis.  In general, there should be no conversion premium paid to holders of the SR shares for converting these into ordinary shares; this should be specified in the prospectus.	Holders of the ordinary shares should have an equal voting right to determine if it is in their interests as well for the promoters to convert their SR shares into ordinary equity shares which the promoters may dispose of, or pledge for financing, that the promoters would otherwise be committed to holding if they remain SR shares.  The higher voting power to promoters who hold the SR shares should be considered a privilege for a finite period; when these convert to ordinary voting shares there should be no fee or premium paid for becoming shares that have voting rights equal with all other shareholders.



**(II) COMPANIES WHOSE EQUITY SHARES ARE PROPOSED TO BE LISTED – ISSUANCE OF SR SHARES**  
**(Cont'd)**

Sr No.	Pertains to specific recommendation in DVR Group Report	Suggestion(s)	Rationale
9	Companies listed with SR shares – Other Safeguards	<p>Other clauses for protection of shareholders should include:</p> <p>To make mandatory incorporating a Corporate Governance Committee comprising only of independent directors; the Remuneration &amp; Nominating Committee should also consist entirely of independent directors.</p> <p>A lead independent director who should act as the point of contact for shareholders to discuss governance issues.</p> <p>Beneficiaries owning the SR shares should give an undertaking to the issuer and minority investors to comply with the safeguards.</p> <p>Lower threshold for shareholders to convene an EGM from 10% of total voting rights to the equivalent of 10% calculated on a OSOV basis.</p>	<p>The Corporate Governance Committee should review, monitor and report on compliance with safeguards for shareholders in companies with SR shares. Similarly the Remuneration &amp; Nominating Committee should be composed entirely of independent directors to ensure new and existing directors are suitable individuals for the Board to function in the interest of all shareholders.</p> <p>General shareholders should have an identifiable independent director to address concerns to, especially in companies with a DVR structure.</p> <p>Beneficial owners of the SR shares should be legally liable to the company and minority shareholders if they circumvent or undermine any of the safeguards for minority investors in the company.</p> <p>When the voting power of ordinary shareholders is diminished, the percentage shareholding required to convene an EGM should be similarly adjusted, so as not to undermine the ability of minority investors to call for a shareholder meeting.</p>