

Regulatory Hotline

January 07, 2019

TO STRIKE WHILE THE IRON IS HOT: SEBI RELAXES NORMS FOR LISTING OF START-UPS

BACKGROUND

In a welcome move, the Securities and Exchange Board of India ("SEBI") has provided its **in-principle approval** for the much needed amendments to the provisions of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 ("ICDR Regulations") pertaining to the Institutional Trading Platform ("ITP").

By way of background, in 2015, SEBI introduced the ambitious ITP with a view to facilitate listing of start-ups in India. Unlike its western counterparts, the ITP failed to garner traction in India largely due to stringent regulations such as mandatory investments by qualified institutional buyers ("QIB") in the pre-issue share capital of the company, restrictions on promoter/individual shareholdings in the post-issue share capital of the company, high thresholds for minimum number of allottees and minimum application size, etc.

Recognizing the need to address the issues stemming from the ITP framework, SEBI **constituted a group** ("SEBI Committee") in June 2018. The members of the SEBI Committee included Nishith Desai Associates as the only law firm, the Indian Software Product Industry Round Table (ISPIRT), the Indus Entrepreneurs (TIE), the Indian Private Equity and Venture Capital Association, the National Stock Exchange of India Ltd. and merchant bankers.

After much deliberations and multiple road shows with stakeholders, the SEBI Committee presented its proposals to the SEBI and some of the key proposals/recommendations of the SEBI Committee that have been approved by SEBI are set out below.

KEY PROPOSALS/RECOMMENDATIONS APPROVED BY SEBI

1. Change in nomenclature of the platform

In a bid to differentiate the platform and to position it as a platform for new-age start-ups, SEBI has approved the proposal to rename the ITP to 'Innovators Growth Platform' ("IGP").

2. Widening the eligibility criteria

- Under the extant ICDR Regulations, only entities which are intensive in the use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology, shall be eligible to list on the ITP. ("Eligible Entities").

This definition has been retained by SEBI. As per the proposal approved by SEBI, in order to be eligible to list on the IGP, the issuer shall be a company *"which is intensive in the use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology to provide products, services or business platforms with substantial value"*.

SEBI has missed the bus in amending the definition of Eligible Entities to include all start-ups in India irrespective of their business model – a move which would have made the IGP diverse and which would have levelled the playing field for start-ups innovating in fields not covered within the aforesaid description.

- Under the extant ICDR Regulations, at least 25% of the pre-issue capital of an Eligible Entity has to be held by QIBs.¹

If we read this eligibility norm together with the prevailing culture of the start-up ecosystem as it exists in India today, the challenges that this eligibility norm poses turn apparent. There are hardly any startups that would be funded by the institutions falling under the definition of QIBs to the extent of 25% of the pre-issue capital, which means that the definition of QIBs itself restricted a large number of startups in qualifying for the listing on the ITP.

In order to solve for this, the proposed amendment has widened the criteria of eligible investors. Under the widened criteria, 25% of the pre-issue capital of the company should be held for a period of at least 2 years by any of the following investors:

- (i) QIBs;
- (ii) Family trusts with net-worth of more than INR 5,000,000,000;
- (iii) Category III Foreign Portfolio Investors;
- (iv) a pooled investment fund with minimum assets under management of USD 150,000,000²;
- (v) accredited investors ("AIs") (Provided not more than 10% of the pre-issue capital is held by

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Als.)

Also for the purpose of the IGP, Als has been defined to include (a) any individual with total gross income of INR 5,000,000 annually and who has minimum liquid net worth of INR 50,000,000 or (b) Any body corporate with net worth of INR 250,000,000.

The widened definition of eligible investors is a welcome move. More importantly, the inclusion of Als as eligible investors is a huge win for the investor community of angel investors, angel networks and off-shore funds (not registered with SEBI) as a large part of early stage funding flows from these categories of investors.

While the widened eligibility criteria for Eligible Entities is a step in the right direction, clarity is still required for the applicability of the proposed amendments to entities which do not fall within the definition of Eligible Entities stated above. Under the extant ICDR Regulations, companies other than Eligible Entities in which atleast 50% of the pre-issue capital is held by QIBs can also list on the ITP ("**Other Eligible Entities**"). However, the proposed amendments approved by SEBI are silent regarding the applicability of the amendments to this category of Other Eligible Entities. Accordingly, we will have to wait for the text of the amended regulations to understand if Other Eligible Entities would continue to be eligible to list on the IGP and if the answer is in the affirmative, then, whether the relaxations provided for Eligible Entities would apply to Other Eligible Entities as well.

3. Cap on post-issue shareholding

Under the extant law, an individual acting alone or collectively with persons acting in concert is not allowed to hold more than 25% of the post-issue share capital of the company. The proposed amendment has done away with the cap on post-issue shareholding. This will provide comfort to promoters of start-ups who would like to continue retaining a larger share of the company post-listing.

4. Minimum number of allottees and minimum application size

In a bid to make trading on the IGP attractive, the proposed amendments reduce the minimum number of allottees from 200 to 50 and the minimum application size and minimum trading lot from INR 1,000,000 to INR 200,000.

5. Minimum reservation of allocation to specific categories of investor

The extant ICDR Regulations mandate an allocation of 75% to institutional investors and 25% to non-institutional investors. The proposed amendment has done away with the aforesaid allocation to specific category of investors.

Given that the IGP is still in a nascent stage, having a minimum reservation of allocation to a specific category of investors would limit the potential growth of the platform. By doing away with this requirement, SEBI will have the opportunity to analyse the types of investors who are attracted to the IGP organically. Thereafter, once the IGP has developed, SEBI may consider revisiting this requirement of specific allocation.

6. Minimum net offer to public

The proposed amendment preserves the requirement of the minimum net offer to public being in compliance with the minimum public shareholding norms (that is, 25%). The minimum offer size proposed is INR 100,000,000.

7. Migration to a main board

The proposed amendment reduces the time period before migration to a main board from 3 years to 1 year, subject to compliance with eligibility requirements of the stock exchanges.

As SEBI intends to differentiate the IGP as a dedicated growth platform for start-ups, the option to migrate to the main board should have ideally been done away with. By positioning the IGP itself as the main listing platform for start-ups, SEBI could have ensured that the IGP grows into a self-sufficient platform for start-ups just like the NASDAQ in the USA. Such a move would have also garnered more traction for the IGP within the start-up community as investors and start-ups alike would have viewed the IGP as an alternative platform to the main listing boards rather than a temporary option or stop gap arrangement until such time they fulfil the eligibility criteria of the main listing boards. Having said that, the shorter migration period to a main board will be received well by start-ups who are exploring the option to list.

WAY FORWARD

As the amendments open the gates of the IGP to a wide array of investors and start-ups, one can hope that the option of listing on the IGP would be explored more actively by start-ups in India and could eventually lead to a win-win situation for both the investor as well as the startup community at large.

As regards startups, the IGP can provide a timely solution to funding woes faced by most start-ups in India (particularly between the Seed and Series A/ Series B round) as raising additional rounds of capital from investors is becoming more and more difficult. On the other hand, the IGP aims to provide a lucrative exit option to early stage investors.

Countries such as Japan and USA have thriving listing boards purely for start-ups. More than 3000 start-ups have listed on the NASDAQ including Indian companies such as MakeMyTrip Limited. With the new amendments, we are hopeful that India's IGP will also follow suit. The amendments, once enforced, will provide a timely boost to the thriving start-up eco-system in India today.

OUR ROLE

Harshita Srivastava, Head (Venture Capital Investments/Start-Ups) at Nishith Desai Associates, was a member of the SEBI Committee that drafted and presented the recommendations to SEBI.

— Anusha Reddy & Harshita Srivastava

You can direct your queries or comments to the authors

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¹ Per the ICDR Regulations, QIB means:

■ a mutual fund, venture capital fund, alternative investment fund and foreign venture capital investor registered with SEBI;

- a foreign portfolio investor other than Category III foreign portfolio investor, registered with SEBI;
- a public financial institution;
- a scheduled commercial bank;
- a multilateral and bilateral development financial institution;
- a state industrial development corporation;
- an insurance company registered with the Insurance Regulatory and Development Authority of India;
- a provident fund with minimum corpus of INR 250,000,000;
- a pension fund with minimum corpus of INR 250,000,000;
- National Investment Fund set up by resolution no. F. No. 2/3/2005-DDII dated November 23, 2005 of the Government of India published in the Gazette of India;
- insurance funds set up and managed by army, navy or air force of the Union of India;
- insurance funds set up and managed by the Department of Posts, India; and
- systemically important non-banking financial companies.

² The fund should be registered with a financial sector regulator in the jurisdictions where it is resident and should be a resident of a country whose securities market regulator is a signatory to IOSCO's MMOU (Appendix A Signatories) or a signatory to bilateral MOU with SEBI and not a resident in a country identified in the public statement of Financial Action Task Force as deficient in AML and combating financing

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