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Mr Smt. Yogita Jadhav
Deputy General Manager
Corporation Finance Department
Securities and Exchange Board of India
Securities and Exchange Board of India
SEBI Bhavan Plot No. C4-A, "G" Block Bandra Kurla Complex
Bandra (East), Mumbai - 400 051
By email: abhishekr@sebi.gov.in

Dear Mr Smt. Yogita Jadhav,

Re: Consultation Paper on Issuance of shares with Differential Voting Rights (DVRs)

We welcome the opportunity to provide our comments on this consultation.

Hermes Investment Management (Hermes) is an asset manager with a difference. With $42.6[1] billion in assets under management we focus on holistic returns – outcomes for our clients that go far beyond the financial and consider the impact our decisions have on society, the environment and the wider world. Its stewardship team, Hermes EOS, is one of the world's leading engagement resources, advising on $496[2] billion on behalf of over 40 institutional investors across the world. The views expressed in this communication are those of Hermes EOS and do not necessarily represent the views of all clients.

We strongly believe that the principle of one-share one-vote is a prerequisite for effective stewardship, and all shareholders should be given equal rights, which should be aligned with their economic interests and investment risks. As such, we prefer a one-share one-vote listing structure to the differential voting rights (DVR) framework. However, we appreciate the proposed checks and balances set out in the consultation paper, including a limit to the maximum ratio of voting rights of 10 to one, a ban on issuing DVR shares post listing, a ban on the transfer of DVR shares to any person once ordinary equity shares have been listed, and most importantly, the five-year sunset clause, to uphold minority shareholders' rights. We therefore urge the Securities and Exchange Board of India to ensure the effective

[1, 2] As at 31 December 2018

implementation of all the proposed safeguards, should it decide to proceed with the introduction of a DVR structure in India.

In our previous responses to the Singapore Exchange's proposed dual class share structure in April 2017,[3] responses to the Hong Kong Stock Exchange's proposed weighted voting right (WVR) in March 2018,[4] and our responses to MSCI on the treatment of unequal voting rights structures in the MSCI equity indices in May 2018,[5] we have stated our reasons for supporting the one-share one-vote shareholding structure. Our arguments can be summarised as follows:

- Multiple class share structures often disenfranchise minority shareholders and increase the power of incumbent shareholders for a disproportionate financial stake. This is supported by academic studies, including Bebchuk and Kastiel (2017),[6] who noted that DVR beneficiaries have perverse incentives to retain the structure even if they become inefficient over time.
- Family-controlled companies may face board entrenchment and succession planning issues, with difficulty passing on management from one generation to the next. A DVR structure makes it difficult for investors to intervene to ensure concerns are effectively addressed. We are concerned as India has the third highest number of family-owned business globally, according to research conducted by Credit Suisse.[7]
- As long-term shareholder representatives, we focus on the long-term value creation of companies. For the sustainability of the company, this should over time be institutionalised as value embedded in the products, processes, structure and culture of the company. Cremers, Lauterbach and Pajuste (2018)[8] found that despite a valuation premium at companies' IPO with a DVR structure, the premium dissipates over time and turns into a discount six to nine years after the listing.
- One of the claimed benefits of a DVR structure is to allow companies to raise equity without the dilution of promoter control and potentially enhance cities' appeal as a listing destination. We believe that there should be more reflection on using the DVR structure to achieve this goal, as the expected traction is yet to be seen in other markets that have recently relaxed their listing requirement in this way. For example, in Hong Kong, since the introduction of the listing of dual-class shares in April 2018, there have been only two relevant listings on the Hong Kong Stock Exchange, namely Xiaomi and Meituan Dianping, while other recent technology IPOs are "one share, one vote" companies. Singapore seems to lack salient examples since the rules changed in June 2018. This suggests that companies may list in Hong Kong and Singapore for reasons other than the flexibility in the shareholding structure.

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[3] https://www.hermes-investment.com/wp-content/uploads/2018/10/singapore-exchange-on-dual-class-share-structures-13-april-2017.pdf

[4] https://www.hermes-investment.com/wp-content/uploads/2018/10/hong-kong-stock-exchange-new-listing-regime-march-2018-1.pdf

[5] https://www.hermes-investment.com/wp-content/uploads/2018/10/hermeseos-response-to-msci-consultation-on-unequal-voting-rights.pdf

[6] Bebchuk and Kastiel (2017) The Untenable Case for Perpetual Dual-Class Stock, Virginia Law Review 103:585-631.

[7] https://www.hindustantimes.com/business-news/india-has-third-highest-number-of-family-owned-mega-businesses-credit-suisse-report/story-dbXKdZ6sA4V6Rq3wOXMWFP.html

[8] Cremers, Lauterbach and Pajuste (2018) The Life-Cycle of Dual Class Firms, European Corporate Governance Institute (ECGI) Finance Working Paper No.550/2018.

- In fact, we see examples of companies converting non-voting shares into voting shares, such as Vale, a Brazilian mining company, which has earned institutional investor support from the improved corporate governance perspective. Further details can be found in our article '*Regulators and listing rules – why the principle of one-share one-vote remains crucial'* published in the fourth quarter of 2017 in our Public Engagement Report.[9]
- The consultation paper also highlighted some US examples, including Alibaba, which has a partnership structure whereby partners have the right to appoint the majority of the board, which we would caution against. Prior to Alibaba's Annual General Meeting in 2018, we voiced our concerns about its partnership structure and asked for stronger corporate governance practice, including the appointment of a lead independent director as chair of the nominating and corporate governance committee. Further details can be found in our public statement dated 26 October 2018.[10]

However, we note the need for growth companies to raise capital, as well as the benefits of a DVR structure regarding the valuation premium in the first few years, as shown by the study conducted by Cremers et al (2018). If DVRs are implemented due to these reasons in India, we strongly support the proposed five-year sunset clause set out in the consultation paper to ensure the DVR structure is time bound. After the deadline established in the sunset provision, the DVR structure should convert into a one-share, one vote structure. We also support the proposed safeguards set out in the coattail provisions, including the selection rights related to the appointment or removal of the independent directors and/or auditor.

We do not support the potential extension of sunset clause beyond five years. As Cremers et al (2018) pointed out in their study, the valuation premium turns into discount six to nine years after listing. Furthermore, the proposed pre-conditions set out in the consultation paper - that the extension of DVR shares must be authorised by a special resolution passed at a general meeting of the shareholders, with a 75% threshold, higher than the 50% threshold of ordinary resolutions – may not be an effective check on the DVR structure. We caution against its effectiveness, given the dominance of family-led businesses in the Indian market. SEBI's requirement is a minimum 25% public shareholding, and often promoters retain their control of listed companies. Research conducted by the Thomas Schmidheiny Centre for Family Enterprise at the Indian School of Business revealed that promoters had been increasing their stakes in National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) listed family firms to over 50% on average, while non-promoter institutional shareholdings had decreased further between 2007 and 2017.

In short, we support the proposed DVR structure only if the proposed safeguards, including the five-year sunset clause without any extension period, are consistently and robustly enforced.

We are grateful for the opportunity to be able to provide our views on these important corporate governance subjects. Please do not hesitate to contact us if you have any questions.

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[9] https://www.hermes-investment.com/wp-content/uploads/2018/10/public-engagement-report-q4-2017-online-1.pdf
[10] https://www.hermes-investment.com/ukw/eos-insight/eos/hermes-eos-highlights-governance-concerns-at-alibaba/

Yours faithfully

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