



A STUDY ON CORPORATE REGULATORY FRAMEWORK OF INDIA

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ABSTRACT

After the 1991 reforms, the Indian economy primarily relied on PE investments to drive capital growth. Demand for PE investments is rising in India as the economy recovers to pre-Covid levels. Private Equity firms buy non-listed private companies and restructure them before selling them for a profit. Private equity uses debt heavily to fund acquisitions, allowing for large returns on equity. The rules governing PE funds have changed dramatically in recent decades. However, the existing business regulatory environment is unfavourable to PE investments. Due to legislative constraints, PE businesses in developing nations use a customised model rather than the typical western approach. The existing PE regulation is illogical, superficial, and too rigid, impeding the smooth operation of PE investments. The Companies Act, 2013 incorporates anti-PE measures on private placement, mandatory convertible debentures, leverage buyouts, and director liability. Another issue is that the SEBI Regulations, particularly those governing Alternative Investment Funds, include few criteria that make PE investment difficult, such as valuing portfolio firms even at an early stage. The current SEBI AIF revisions did not depart from the preceding legislation in a way that benefited the PE regime. Concerns about exit strategies also deter potential PE investors.

KEYWORDS: Companies Act, SEBI, Corporate.

INTRODUCTION:

India's economic and commercial environment is primarily reliant on investment, or fundraising. Private equity, venture capital, angel broking, and other funds are channelled to an organisation. The country's laws govern the procedure and extent of such investments. In this context, private equity refers to money invested in non-public firms. This investment tries to restructure the private entity and sell it for a profit. However, the current corporate regulations complicate private equity operations, particularly capital structuring and profit sharing. A lack of regulatory flexibility, erroneous valuation, and fierce competition for good-quality investments are the key difficulties hurting the private equity regime. Also, India is experiencing exit overhang, and the burden to depart is projected to increase.

Private equity deals have been important in India's capital generation for two decades. Globalization drew global attention to the Indian economy. The increased demand for private equity investments has many causes. A developing economic structure, increased openness and regulation are all contributing factors. Various government laws, policies, and regulations apply to a private equity fund during its formation or throughout a private equity transaction. Moreover, both the fund manager and the investor must follow the laws set in this respect. The standard private equity investment model has worked in Western economies, but due to legal constraints, private equity firms in India use a tailored approach.

REGULATORY FRAMEWORK VIS-À-VIS PRIVATE EQUITY INVESTMENT:

Private equity deals in India are governed by a number of laws, including the Companies Act of 2013, Securities and Exchange Board of India (SEBI) regulations, and the Income Tax Act of 1961. The private equity funds are mostly registered as Alternative Investment Funds (AIF) in the form of a trust under the SEBI (Alternative Investment Funds) Regulations, 2012.

COMPANIES ACT, 2013:

The Companies Act of 2013 primarily addresses the circumstances and processes governing the transfer and issue of shares, as well as enlisting rules for shareholder and board control. In comparison to public firms, private enterprises were not tightly controlled under the Companies Act of 1956. However, the revised Act of 2013 blurred the line between private and public corporations, requiring private enterprises to adhere to the same stringent regulations as public companies.

Private Placement:

Private firms are not permitted to issue their shares to the public under Indian company law; however, securities are offered to chosen individuals through private placement. Because private equity is so closely linked to the elements of private placement, the Companies Act's regulations on private placement also apply to private equity transactions.

In the previous regime, issuing securities through a private placement to raise capital was quite simple. As previously stated, the laws governing private placement were modest due to the 1956 Act's permissive stance. However, since the revised Act of 2013, the requirements for completing a private placement have

become more stringent. To effectuate a private placement, for example, a lengthy record of disclosures by the firm issuing the securities to possible subscribers, as well as numerous other corporate acts, is required. A corporation proposing to issue securities through a private placement should also get a valuation study, which will be used to price the offered stocks.

This has resulted in an excessive amount of regulation, which is unwelcome in a private placement. Because the stakeholders are private entities that do not include the wider public, including retail investors, such regulation is unnecessary. Furthermore, modern Private Equity firms with investment competence do not require comprehensive disclosures from the corporation selling their assets. Due to the difficulties of private placement under the Act, private companies have been encouraged to address the issue by issuing securities through a "rights issue"⁹, in which existing shareholders have the right to purchase additional shares of the company in proportion to the number of shares they currently own.

In this regard, several adjustments to the Companies Act 2013 were made in relation to the procedure of private placement, specifically Section 42 and Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014, whereby most of the unnecessary procedural snags were eliminated. However, the majority of these adjustments were mainly clarifying in nature, with only a few meaningful alterations. Parallel to these amendments, which aimed to eliminate overlapping and additional disclosure specifications for prospectuses, the Ministry of Corporate Affairs (hereinafter MCA) could have resolved the conflicts and overlapping issues that existed between Rule 13 of the Share Capital Rules and Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, as well as the SEBI regulations for preferential. Furthermore, for greater efficiency, the MCA may have omitted the Form PAS-4's substantial disclosure requirements. For example, the criterion of "lack of a statutory or regulatory action" taken against a promoter in any of the previous three years (prior to a private placement) can be replaced with "no current legal action."

DIRECTOR'S LIABILITY:

The 1956 Act, which was heavily based on common law norms at the time, did not place a strong emphasis on the fiduciary duties of a company's directors. However, as a result of multiple corporate governance crises, the 2013 Act has broadened the scope of a director's liability. A non-executive director who does not actively participate in the day-to-day activities is liable for any corporate misbehaviour in this regard. The rationale for imposing such liability is that even a non-executive director is considered to have knowledge of how a company operates.

Extending the liability of directors is harmful to private equity investments. A seat on the Board of Directors of a portfolio business is typically offered in a Private Equity deal. The problem occurs when a director chosen by the Private Equity fund is subject to the Companies Act's strict responsibility provisions. Furthermore, Private Equity funds demand portfolio businesses to get insurance plans for nominated directors and to indemnify these directors against any liability. Apart from that, a PE fund could forego a seat on the board of directors and instead appoint a "observer" to keep an eye on the portfolio company's operations. In terms of policy, it has played an important role in reducing the danger of corporate governance scandals; nonetheless, more clarity on the parameters of

director accountability, particularly in the context of private equity, is needed.

In a larger sense, current regulations on director liability subject non-executive directors to investigations and criminal prosecutions for any misbehaviour or wrongdoing by a firm, regardless of their knowledge or involvement in the default. Furthermore, the loss of one's reputation, stress, and adversities resulting from never-ending legal proceedings have prevented some PE fund applicants from accepting board posts. Furthermore, the start of criminal proceedings against non-executive directors without proof of their involvement has resulted in such directors filing applications in several High Courts to have criminal proceedings under Section 482 quashed. As a result, the judicial system is overburdened with protracted legal battles.

SEBI (ALTERNATIVE INVESTMENT FUNDS) REGULATIONS, 2012:

Alternative Investment Monies (hence referred to as AIF) are funds gathered privately from sophisticated individuals, regardless of citizenship, and invested in accordance with India's investment policies in order to generate profits. 16 AIF includes private equity funds, which are defined as a fund that is primarily focused on investing in equity, equity-related securities, or partnership interests of the investee firm based on the fund's objective.

AIFs must give their investors with information about the asset valuation process and the techniques used to evaluate the assets. Asset review by an independent valuer chosen by the AIF is required once every six months for Category I and II AIFs, which include private equity. However, the rule lacks a precise definition of an independent valuer. If the AIF's managers were to assess the definition of a valuer under the SEBI (Real Estate Investment Trusts and Infrastructure Investment Trusts) Regulations, the independent valuer's qualifications would be taken into account.

CONCLUSION:

The fact that private equity will play a significant role in generating capital in the current economic climate is undeniable. Despite India's commitment to developing rules that facilitate 'ease of doing business,' the country has tightened its regulatory grip on acquiring funds through private equity and venture capital on several occasions. As a result, structural adjustments are needed to close the gap between capital seekers and capital providers. Furthermore, as lockdown limitations related to the ongoing pandemic are lifted around the world, PE investments are on the rise. As a result, a regulatory framework that ensures ease of doing business while allowing for flexible compliance is critical. However, under the current regime, various legislations governing companies have given the government unnecessary authority to interfere with private company operations, disrupting the balance between creating a lenient regulatory structure for booming companies aiming for global markets and safeguarding stakeholders' interests.

SEBI has often attempted to relax the PE regime's rigorous compliance requirements. As a result, the present laws governing AIFs are frequently amended to benefit the stakeholders. SEBI has played a significant role in smoothing the outlines of the present restrictive regulatory regime governing AIFs; yet, certain issues remain unresolved.

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