

Study on a Lasting Relationship Between Promoters and Other Shareholders

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Abstract:

This research paper delves into the intricacies of promoters, specifically focusing on the conflicts that may arise when promoters hold a stake in the companies they are instrumental in forming. The study aims to analyze the legal and ethical implications of such conflicts, the impact on corporate governance, and possible solutions to mitigate these conflicts. It explores various cases and legal frameworks, offering insights into the consequences of promoters- other shareholder's relationship when arises a conflict. shareholders' inadequate due diligence, the competition between other shareholders and promoters for control of the shareholder's firm, and the promoters' lack of emphasis on corporate governance are some of the contributing causes to these disputes. this paper also aims to implicate the role, importance, legal responsibilities, conflicts of interest, impacts, ethical considerations, mitigating conflicts, taking regulatory measures, related case law, and the role of promoters in corporate governance. This research leads to the issues that arise between promoters and the other shareholders that cause a heavy impact on corporate governance but will burst out silently. other shareholders-promoter disagreements are not common today. For a long time now, they have raised worries for both promoters and shareholders. Let's have a brief explanation in this research paper.

Introduction:

Promoters play a pivotal role in the establishment of a company, shaping its foundation and strategic direction. The process of incorporating a company involves multiple shareholders, with promoters, often playing a dual role by being both the architects of the company and significant shareholders. This dual position can lead to conflicts of interest that may have far-reaching implications for corporate governance and the overall health of the company. Disputations are an unavoidable aspect of the business and commerce world, and this also applies to organizations. Shareholding disputes can occur between promoters and other shareholders, which can seriously hinder the company's ability to run efficiently. Several things, including divergent strategic visions, decision-making authority, profit distribution, or even interpersonal issues among shareholders, can give rise to these conflicts. For a business to remain stable and expand, these conflicts must be resolved quickly and amicably. The process of resolving disagreements between promoters and other shareholders is known as dispute resolution in company shareholding. Finding a middle ground, mending rifts, and guaranteeing the business's survival are the goals of this procedure. This research paper seeks to provide an in-depth analysis of these conflicts and their effects, examining the legal and ethical dimensions of such scenarios, and exploring potential remedies.

Promoters and Their Role in Company Formation:

promoters play different roles in the formation of the company. Although promoters play a drastic role in the company's incorporation, they also participate in the promotion of the company after the incorporation. let's have a view of how promoters play in the company in this research paper.

Definition and functions of promoters:

Promoters are individuals or entities responsible for conceiving, organizing, and initiating the process of forming a company. They play a pivotal role in the company's early stages, being the driving force behind its establishment. Promoters often bring together the initial capital, develop the business concept, and attract other shareholders. Promoters' functions encompass identifying business opportunities, negotiating with potential investors, and ensuring legal compliance throughout the incorporation process.

Importance of promoters in company formation:

Promoters serve as visionary leaders who set the corporate path and lay the foundation for the company's future success. Their ability to articulate a compelling business idea and attract initial investors is essential in launching new enterprises and stimulating economic growth.

Legal responsibilities and fiduciary duties of promoters:

Promoters are entrusted with fiduciary duties to act in the best interests of the company and its future shareholders. These duties include loyalty, care, disclosure, and utmost good faith. Breaches of these duties can lead to legal liabilities.

The legal responsibilities of promoters extend to full disclosure of personal interests, potential conflicts, and accurate representation of the company's financial health during the incorporation process. Mechanisms for resolving disputes offer organized ways to deal with issues, promoting communication, compromise, and settlement. They provide an option to escalate disputes through expensive and time-consuming legal action. By using dispute resolution, parties can steer clear of drawn-out court cases that could strain company finances, sour relations, and interfere with day-to-day operations.

Conflicts of Interest Arising from Dual Roles:

carrying out a single role in the company is tough in this real world but playing a dual role has many consequences though we play perfectly. here promoters carry out the promotion of the company and the shareholders of the company. Now, it makes sense to realize that conflicts arise out of the promoters and other shareholders.

Identifying conflicts between promoter and shareholder roles:

Promoters often acquire a significant stake in the company they create, which can lead to inherent conflicts of interest. These conflicts may arise when promoting personal interests and the company's best interests diverge, such as in matters related to salary, equity distribution, or investment decisions. Identifying these conflicts is crucial for effective governance and conflict resolution.

The partnership concept is expanded upon by business endeavors. For the shareholders to grow confident in the enterprise, the promoters must regularly provide them with financial and other business updates. shareholder's participation ought to be encouraged when the company is making important business decisions. Averting potential conflicts between other shareholders and promoters can be achieved by

taking these little measures and this does not arise often, Having stated that, given the COVID pandemic and the impending global financial crisis, investors or other shareholders and promoters must make well-informed business decisions after carefully considering all possible outcomes and carrying out appropriate due diligence. It would be wise for both parties to the deal to seek competent legal guidance and help when creating the transactional agreements and when performing due diligence. The most frequent issues that arise with Indian promoters are related party transactions, noncompliance with contractual obligations, and improper salary and compensation takeaways.

Even though many Private Equity funds in India continue to hold the view that "promoters know best," an increasing number of funds are exerting more of an influence over the corporate governance procedures of the businesses in which they invest. In the nation, buyout transactions—where the fund takes over the company and either works with the current promoters or completely changes the management—are becoming more common as a percentage of Private Equity investments. A Chief Financial Officer who reports to the board is typically preferred by the Private Equity Funds. Furthermore, a few Indian promoters remain uneasy with this strategy and are unwilling to give the management group any authority. When negotiating with Promoters, other shareholders or investors typically have the upper hand. A few Indian promoters become embroiled in a power struggle because they don't realize that cutting equity entails losing power.

Conflicts among shareholders may arise from disparities in the distribution of profits. While some investors might want a more equitable distribution or larger dividends, promoters might prefer to keep profits for themselves or reinvestment. This may be especially important if the business succeeds financially or encounters difficult economic times.

When figuring out what shares or assets are worth fairly, disagreements over valuations occur. It is common for these conflicts to surface during capital raising, mergers, acquisitions, and share transfers. The interests of shareholders and the total value of their investments may be impacted by disagreements regarding the valuation techniques, underlying assumptions, or fairness of the suggested valuations.

Investors have the right to hold promoters or management accountable for poor management, oppressive behavior, or actions that hurt minority shareholders' interests. Frequently, these conflicts entail accusations of self-dealing, misappropriation of business funds, omission of crucial information, or actions taken in bad faith. The reputation of the business and legal compliance may suffer significantly as a result of these disputes.

There may be disagreements regarding the buyout conditions, the terms of the transaction, or the events that precede a buyout when a shareholder wants to sell their shares or leave the company. Conflicts may arise concerning the right of first refusal, right to be dragged along, right to be tag-along, or the calculation of the fair price for the shares.

It is crucial to remember that these conflicts can frequently overlap or have connections to one another and are not exclusive of one another. If disputes aren't resolved quickly and amicably, they could get worse and result in lawsuits, strained relationships, and detrimental effects on the business's operations and image. To prevent disputes from escalating and to implement appropriate mechanisms for resolution, the first step is to recognize and understand the different types of disputes that may arise.

Desperate Promoters vs demanding investors or other shareholders

The demand for a large portion of equity is justified by the high risks associated with investing, as Private Equity and Venture Capitalists believe that only a small percentage of start-ups go on to become successful, so they feel that they must own a sizable stake in the winning company to earn a profit.

Secondly, there is a significant shortage of available capital, which means that a small number of investors end up making all the decisions. Finally, Promoters tend to lose sight of the control game in their desperation to raise capital and dilution of the company.

Impact on decision-making and corporate governance:

Promoters think of their company as a baby, so they work on the mode that gives profit in the future, but here the main and foremost conflict between the promoter and shareholder is that the thought processes of the promoter and other shareholders are not the same it also need not to be same. Investing their capital and taking their returns quickly without waiting for future profit of the company is the main motive of the shareholders. this will be in twists and turns for the promoters. hence hereby maintaining their governance will not be in a balanced manner. due to conflicts and issues arising between promoters and other shareholders leads to unstable corporate governance. Promoter- other shareholder conflicts can influence crucial decisions, including corporate strategy, executive appointments, and financial transactions. This impact on governance can potentially hinder the company's ability to operate in an unbiased, shareholder-centric manner.

Ethical considerations in promoter-shareholder conflicts:

Ethical considerations come to the forefront when promoters navigate dual roles. Here the ethical considerations will favor the shareholders, even though they concentrate on short-term returns, they will work on the company's profit. Transparency, honesty, and fairness are essential to addressing these ethical dilemmas. Failure to uphold ethical standards can damage a company's reputation and trustworthiness. There is pressure on funds to deploy capital because there aren't many opportunities. Additionally, a lot of investments were made at exorbitant valuations during the market's apex, when investors or other shareholders went crazy. Shareholders become uneasy when companies perform poorly, so they make every effort to increase their investment's value.

Examination of real-world cases involving promoter-stakeholder conflicts:

To gain practical insights, this delves into specific case studies where promoter-other shareholder conflicts have arisen. These case studies offer real-life examples of the complexities and consequences associated with such conflicts. They may involve legal disputes, ethical dilemmas, or challenges in corporate decision-making. As per the collected data, this paper concludes some of the examples that are happening till now in the corporate sector. such as if promoters and other shareholder invest their initial capital in a tea shop startup business then the business goes well but shareholders who invested in the business will not wait for long to take the profit they seek short-term returns. Likewise, promoters will only aim for long-term returns.

The latest group to jump on board were the shareholders of Signature Bank, who filed a proposed class action lawsuit against the bank and three of its former senior executives. They claim that the bank misled them about its strong financial position only three days before being acquired by a state regulator.

Based on poor corporate governance and financial mismanagement, there have also been conflicts in the past between Texas Pacific Group, Bain Capital, and the promoters of Lilliput Kidswear Ltd. In the end, Lilliput applied for corporate debt restructuring as a result of the disagreement. The Lilliput brand suffered a great deal as a result, and many of its stores closed in 2012. The New Silk Route and Baring PE Asia-backed KS Oils experienced comparable financial mismanagement problems.

Relevant legal regulations and precedents:

An analysis of existing legal frameworks and precedents is essential to understand how different jurisdictions address promoter-shareholder conflicts. This sub-topic explores the legal remedies available to mitigate these conflicts, including shareholder agreements, disclosure requirements, and corporate governance regulations.

The procedure should cover other significant aspects as well, such as the shareholders's contacts, brand image, mentoring, and other variables, rather than just financial values. The promoters must also determine how much control they are willing to give other shareholders or investors, reserve investor seats on the board, exercise their veto power, and agree to terms like non-compete, non-solicitation, liability restriction, and others.

Recently, the supreme court bench consisting of justice K.M Joseph B.V. Nagarathna has stated that, in a private company a group of shareholders who have a large disproportionate share rights increase the shareholding percentage of the company to the other shareholders.

Given the international scope of businesses, it's crucial to compare how promoter-stakeholder conflicts are handled in different legal systems and jurisdictions. This can provide valuable insights into best practices and regulatory variations, allowing for a more comprehensive understanding of the global landscape. There are a few main legal implications such as,

1. Before investing in a company, carry out a thorough environmental, social, and governance (ESG) audit as well as appropriate legal and financial due diligence.
2. Investigations into the management and promoters of the invested company.
3. Regular audits of finance, legal, and secretarial matters.

In addition to safeguarding their investment in the investee company, the aforementioned steps will lessen the likelihood of a dispute between the parties. Planning an exit strategy at the time of investment is also essential for investors.

Consequences of Promoter-Stakeholder Conflicts:

There are many consequences faced when clashes arise between the promoter and other shareholders but those issues are not coming out from the company because of the company's promotion and consequences such as,

Erosion of trust and investor confidence:

Promoter-stakeholder conflicts, when left unaddressed, can erode the trust and confidence of investors and the broader market. This sub-topic explores how such conflicts can lead to decreased shareholder value, declining stock prices, and impaired investor relations.

Financial and reputational risks:

These conflicts can result in financial risks, including lawsuits, regulatory fines, and lost opportunities. Additionally, they can pose significant reputational risks, damaging a company's brand and market standing.

Long-term implications for the company's success and sustainability:

This sub-topic delves into the long-term impact of promoter-stakeholder conflicts on a company's success and sustainability. It examines how these conflicts can hinder growth, innovation, and strategic decision-making, ultimately affecting the company's ability to remain competitive and viable in the long run.

Mitigating Promoter-Stakeholder Conflicts:

Every problem has a solution, in the same way, certain measures could overcome those issues and reduce some more conflicts. To select the best investor for their business, the promoters must also conduct due diligence on potential investors. The investors should provide the promoters with more than just a valuation; they should also provide contacts, strategy, and mentoring. Along with providing all pertinent information, the promoters ought to maintain regular, excellent communication with the investor. Additionally, the promoter needs to be adaptable and ready to change with the times. The company that is seeking investment from venture capital or private equity firms will typically face stringent responsibilities and restricted rights, with the promoters accountable for the majority of their actions, since the investor makes their investment decision based only on the promoters' statements. While talking over and settling on investment terms with the investors or other shareholders, a lot of issues come up. If we use adaptable measures can prevent conflicts from arising out such as

Regulatory measures to prevent and address conflicts:

This section explores the role of regulations and legislation in mitigating promoter-stakeholder conflicts. It covers the legal requirements for disclosure of conflicts of interest, shareholder agreements, and regulatory bodies responsible for enforcing compliance.

Corporate governance best practices:

Corporate governance practices, including the composition of the board of directors, independent oversight, and transparent decision-making processes, are instrumental in addressing conflicts. This sub-topic delves into recommended best practices and guidelines for promoting good corporate governance.

Transparency and disclosure mechanisms:

Transparency and disclosure mechanisms are critical in managing and mitigating promoter-other shareholder conflicts. Companies can adopt policies that require full disclosure of conflicts and recusal from decision-making when conflicts exist. Transparency helps maintain the trust of investors and the market.

Conclusion:

The study on promoters and incorporation contracts, with a specific focus on conflicts arising when promoters to other stakeholders, underscores the multifaceted nature of such conflicts. It has been observed that these conflicts can have profound implications for corporate governance, investor trust, and the long-term sustainability of a company. As the cases and legal frameworks analyzed in this paper reveal, regulators, companies, and promoters themselves need to address and mitigate these conflicts comprehensively.

Balancing the interests of promoters and other shareholders while maintaining ethical standards and legal compliance is a challenge that requires careful consideration. The paper's findings emphasize the importance of regulatory measures, corporate governance practices, and transparency in promoting the harmonious coexistence of promoter and stakeholder roles. By addressing these conflicts effectively, businesses can enhance their corporate governance and bolster investor trust, ultimately contributing to a more stable and prosperous business environment.

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