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EMERGENCE OF FOUNDER CONTROLLED VENTURES: ANALYSIS OF THE CAPACITY OF THE CORPORATE GOVERNANCE SYSTEM OF INDIA IN REGULATING FOUNDER DOMINANCE

***Medhavi Katta**

India.

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***Corresponding Author: Medhavi Katta**
India.

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ABSTRACT

India's start-up boom has produced a new corporate actor: the founder who, through board nomination rights, shareholder agreements, preferred shares and personal authority, controls a company while holding a modest economic stake.It examines the Companies Act 2013, SEBI's issue-of-capital, listing and takeover regulations, and the superior voting rights framework, and tests them against recent governance episodes and the shifting meaning of the term 'promoter .A founder with a single-digit shareholding may nonetheless nominate directors, hold veto rights under a shareholders' agreement, run the company as managing director and serve as the public face of the brand. That combination of limited cash-flow rights and substantial control is the subject of this paper. Its governance architecture grew out of the family-owned business group, in which a promoter holds a majority stake, appoints the board and may extract private benefits through related-party dealings. The Companies Act 2013, the SEBI Listing Regulations and the Takeover Regulations are all organised around that archetype. The founder-controlled start-up fits it badly. The founder may not be a 'promoter' at all, may hold nothing close to a majority, and may exercise control through contract rather than ownership.

The framework regulates founder power with reasonable rigour at the point of listing, but leaves the private phase, in which control is first negotiated and entrenched, largely to contract. It also leaves its central concept, the 'promoter', unstable enough that founders have been able, in some cases, to influence the regulatory consequences of their own control. Part II defines founder control and its governance costs. Part III maps the relevant Indian law. Part

IV tests it against recent episodes. The method is doctrinal and analytical, drawing on statutes, regulatory instruments, judicial decisions and secondary commentary.

II. Founder Control: Concept and Costs

A founder-led company is one in which the founder provides strategic direction but remains accountable to a functioning board and to shareholders. A founder-controlled company is one in which the founder's authority is insulated from those checks. Those mechanisms are familiar. Superior or differential voting shares give one class more votes per share. Founder-friendly option pools, family trusts and holding structures can extend influence further. Each device widens what Bebchuk, Kraakman and Triantis call the wedge between control rights and cash-flow rights, and the wider the wedge, the weaker the controller's incentive to bear the cost of poor decisions.

There is a respectable case for permitting such arrangements. SEBI itself accepted this reasoning when it introduced its superior voting rights framework in 2019 for technology-intensive issuers. Investors who buy into a founder-controlled company also do so with notice, and can price the structure accordingly.

The costs, however, are well documented. The classic agency problem described by Jensen and Meckling concerns the divergence between managers and dispersed shareholders. Where a controller exists, the more pressing problem is the conflict between the controller and the minority, which Gilson identifies as the characteristic governance problem of jurisdictions with concentrated ownership. Indian scholarship has long made the same point about the controlling shareholder, and has observed that independent directors, whom the controller typically selects, are an imperfect check. The founder-controlled start-up transposes this old problem into a new setting, one in which the controller has less capital at stake.

III. The Indian Legal Architecture of Control

A. The Companies Act 2013

The Companies Act addresses founder control only indirectly. The statute therefore tolerates differential voting but restrains it. Articles of association can entrench board nomination and veto rights, and the proviso to section 58(2) makes agreements between shareholders on the transfer of securities enforceable as contracts.

The Act's principal governance safeguards are tied to the type of company rather than to the concentration of control. The requirement of independent directors under section 149(4), the audit committee under section 177 and the nomination and remuneration committee under

section 178 apply to listed companies and to prescribed classes of public companies, defined by capital, turnover or borrowing thresholds. A venture-backed private company, however dominant its founder, falls outside them. Its board is largely a creature of its shareholders' agreement.

Some safeguards apply more widely. Directors owe the duties codified in section 166, including the duty to act in good faith in the interests of the company, its employees, shareholders and the community. Courts have historically looked for conduct that is burdensome, harsh and wrongful rather than a mere loss of confidence, a standard that sits uneasily with controllers whose power is exercised lawfully through contractual rights. The law has also actively facilitated founder control in the early stage. The policy is defensible as a means of rewarding risk-taking, but it confirms that the Act's default posture towards early-stage founders is enabling rather than restraining.

B. SEBI's Regulations: Promoters, Superior Voting Rights and Listing Obligations Regulation 2(1)(oo) of the ICDR Regulations treats as a promoter a person named as such in the offer document, a person who has control over the issuer's affairs, and a person on whose advice or directions the board is accustomed to act, a test that tracks section 2(69) of the Companies Act. Promoter status carries burdens: minimum promoter contribution and lock-in, extensive disclosure, accountability for the offer document and, until recently, a bar on holding employee stock options.

These burdens created an incentive. Paytm's 2021 offer is the best-known example: its founder held well below the twenty per cent often treated as the benchmark for promoter status, and the company stressed that the board, rather than he, would take critical decisions. As reported in 2023, SEBI's own concern was that founders of such companies enjoyed the benefits of being promoters, including eligibility for options, without the limitations and legal responsibilities that accompany the label.

SEBI has since moved in two directions that pull against each other. First, it has widened the net. Its 2024 reform initiative, as reported, would classify as promoters founders holding ten per cent or more who also serve as directors or key managerial personnel, replacing the older twenty-five per cent reference point that reflected the ability to block special resolutions.

Offer-document review now looks to substance, treating shareholding as one indicator of control alongside board participation and decision-making authority; an analysis of more than 150 offer documents filed between 2023 and 2026 shows issuers structuring promoter disclosure around that approach. Second, it has softened the consequences. At its meeting of 18 June 2025, SEBI approved relief allowing founders who received options before

becoming promoters to retain them after classification at the time of an IPO. The commercial incentive has shifted accordingly: reporting on the 2025 listings suggests that founders now seek promoter status, which brings stability of control, more often than they avoid it. A longer-term proposal, floated in 2021, would replace 'promoter' and 'promoter group' with 'person in control' and 'persons acting in concert' across the ICDR, Listing, Takeover and insider trading regulations, with a three-year transition. A control-based test would suit founder-controlled companies, but so far as I have been able to establish, the proposal has not been implemented. Since 2019 the ICDR Regulations have permitted technology-intensive issuers to list with superior voting rights (SR) shares held by founders or promoters who hold executive roles. In October 2021, after noting that issuers had not used the framework, SEBI raised the net worth ceiling for SR shareholders from Rs 500 crore to Rs 1,000 crore. The framework is a considered attempt to make founder control visible and time-limited. Its weakness is that founders have largely not used it. These are the provisions best calibrated to contractual founder control, because they convert a private bargain into an arrangement that public shareholders must periodically approve.

The Takeover Regulations

The Takeover Regulations supply the third strand. 'Control' is defined in regulation 2(1)(e) to include the right to appoint a majority of directors or to control management or policy decisions, and an open offer is triggered on acquiring twenty-five per cent of voting rights or acquiring control. The Securities Appellate Tribunal has distinguished protective rights, such as vetoes that safeguard an investment, from affirmative rights that confer control. The distinction is sensible for investors, but it is fact-sensitive. Whether a founder's combination of vetoes and nomination rights amounts to 'control' is a question on which disclosure and open-offer consequences depend, and the answer is rarely obvious from the face of a shareholders' agreement.

IV. Founder Dominance in Practice

A. Entrenchment by Contract: Tata Sons

The lesson for founders and investors is that courts will respect control arrangements properly embedded in the constitutional documents, which makes the drafting stage, not the dispute, the point at which dominance is effectively decided.

B. Failures in the Private Phase

Several of the most discussed start-up governance episodes occurred while the companies were private. I draw no conclusion on any individual allegation, which remains a matter for courts and investigators. The pattern is nonetheless instructive. The law responded after the fact, through investor litigation, regulatory investigation and insolvency proceedings, because few of the structural safeguards that bind listed companies applied when the questions first arose.

The problem becomes more significant when founders exercise substantial control over management decisions, financial disclosures and the allocation of shares.Excessive regulation may increase compliance costs and discourage innovation. However, the absence of proportionate safeguards may create opportunities for conflicts of interest, inadequate accountability and the misuse of investor confidence. A closer examination of governance requirements applicable to private start-ups may help identify gaps in disclosure, accountability and investor protection, particularly during periods of rapid growth and fundraising.

C. Shareholder Activism Against Founding Families

In 2021, institutional shareholders in Zee Entertainment Enterprises requisitioned an extraordinary general meeting to remove its managing director, a member of the founding family, and to appoint independent directors. D. Classification at Listing

The Paytm episode, discussed above, completes the picture. Taken together, these examples show a framework that reacts. Classification disputes are resolved in the course of offer-document review, governance failures through litigation, and minority grievances through a Tribunal procedure with high entry thresholds. None of this is negligible, but it is a poor substitute for design.At the listing stage, the classification of promoters, the identification of persons exercising control and the disclosure of related-party relationships become particularly significant. An incorrect or incomplete classification may affect how investors understand the company's ownership structure, decision-making authority and accountability mechanisms. Existing mechanisms, including shareholder voting, disclosure requirements, regulatory review and proceedings before the National Company Law Tribunal, provide important avenues for addressing governance disputes. Nevertheless, many of these mechanisms become relevant only after a disagreement, suspected irregularity or regulatory concern has emerged.

V. Is the Framework Equipped? An Assessment

A. A Life-Cycle Gap

The most significant weakness is temporal. Founder control is created in the private phase, through term sheets, shareholders' agreements and articles, at which point the Companies Act's protections for minority and independent oversight are at their thinnest. By the time the company lists, the control structure is a given, and regulation can disclose or ratify it but can seldom reverse it. The legal framework tends to become more demanding as a company approaches the public market, whereas many of the decisions that determine its governance are made much earlier. During the private stage, founders and early investors negotiate voting rights, board representation, veto powers and exit arrangements.The problem cannot, however, be understood simply as an absence of regulation during the private stage. The Companies Act, 2013, already establishes requirements concerning directors' duties, shareholder rights, related-party transactions and remedies against oppression and mismanagement.This life-cycle gap raises an important question for Indian corporate law: should governance safeguards depend primarily on a company's listing status, or should certain protections become progressively stronger as a private start-up grows in size, raises successive rounds of investment and develops a wider base of stakeholders? A proportionate approach could consider factors such as the number and category of investors, the scale of capital raised, the concentration of voting power and the significance of related-party transactions. Such an approach would not necessarily require private start-ups to comply with every requirement applicable to listed companies. Instead, it would examine whether targeted safeguards could be introduced at important stages of corporate growth. These might include clearer disclosures concerning founder control, stronger contractual protections for minority investors, improved access to material governance information and more effective mechanisms for addressing conflicts of interest.At the same time, that flexibility should not prevent investors from understanding how corporate power is distributed or from obtaining meaningful protection against its misuse.

B. An Unstable Definition of 'Promoter'

Because promoter status triggers lock-in, disclosure and accountability, the definition is the hinge of the entire regime.. A definition that depends on case-by-case review of offer documents gives the regulator flexibility, but it also gives issuers uncertainty and advisers room to structure around it. The 2021 'person in control' proposal would have supplied a principled replacement, and its absence is a telling gap.

C. An SR Framework That Disciplines Transparent Control More Than Opaque Control

These features are defensible individually, but together they make formal superior voting rights unattractive, and the evidence is that founders have not taken them up. Meanwhile, a founder can obtain substantial control through board nomination rights, vetoes and a favourable shareholders' agreement without any of those safeguards. That is the opposite of what governance theory would recommend.

E. Independent Directors Who Depend on the Controller

Independent directors are expected to protect minorities, but in a founder-controlled company they are usually nominated by the founder or negotiated with the lead investor. F. F. The Counterweight: Not Over-Regulating Any reform must also respect the legitimate case for founder authority. The objective is therefore not to eliminate founder control but to make it visible, bounded and accountable, with disclosure and sunset mechanisms doing more of the work than prohibition.

VI. Comparative Perspectives

India's SR framework belongs to this family, but it is narrower and more rigid, and, unlike the more mature regimes, it is not matched by serious regulation of control by contract. The comparative lesson is twofold: jurisdictions that permit founder control build sunset and governance safeguards into the permission, and they regulate contractual control as well as share-based control.

VII. Proposals for Reform

Retaining the sunset, coat-tail and independent governance features while easing eligibility would make the transparent route more attractive than informal control, and would bring contractual control into the same discipline.

Third, the private phase needs proportionate safeguards. A threshold-based rule, triggered by outside institutional funding or turnover above a prescribed level, could require a private company to maintain an audit committee with independent members, and to file special shareholder rights with the Registrar. The aim is not to apply the full listed-company regime to early-stage companies, which would be disproportionate, but to ensure that companies that have raised substantial outside capital have a minimum of independent oversight. Fourth, minority remedies should be adapted. SEBI's superior voting rights regime, its

evolving promoter classification practice, the Listing Regulations' related-party and independent director rules, and regulation 31B together form a respectable response at the point of listing. The weaknesses lie elsewhere: in a private phase where control is created with little external oversight, in a definition of 'promoter' that has not yet been rebuilt around control, in an SR framework that regulates the transparent route more heavily than the opaque one, and in remedies designed for an older kind of controller. The framework is therefore partially equipped. The reforms proposed here, a control-based definition, a recalibrated SR route, proportionate private-phase safeguards and adapted minority remedies, would extend the framework's reach without removing the founder's legitimate role. The measure of success is not whether founders hold control but whether those who hold it can be seen, questioned and, where necessary, held to account.

CONCLUSION

The rise of founder-controlled start-ups confronts Indian corporate law with a problem it was not designed to solve. Successive funding rounds leave the founder with a modest economic stake, yet decisive influence is secured through board nomination rights, vetoes, shareholders' agreements and personal authority. This paper has asked whether the existing framework can regulate that kind of dominance. Its answer is that the framework is partially, but not fully, equipped.

Indian law is not blind to the issue. SEBI's superior voting rights framework, introduced in 2019 and relaxed in 2021, is a considered attempt to make founder control transparent, time-limited and subject to safeguards such as sunset clauses and coat-tail provisions. SEBI's growing willingness to look at substance when classifying promoters, the Listing Regulations' rules on independent directors and related-party transactions, and the requirement that special shareholder rights be periodically approved together form a respectable response at the point of listing.

The weaknesses lie elsewhere. First, the framework has a life-cycle gap. Founder control is created in the private phase, when the Companies Act's requirements on independent directors and board committees do not apply. By listing, it is a settled fact that regulation can disclose but rarely reverse. Second, the concept of "promoter" remains unstable. It has moved between shareholding thresholds and control-based inquiries, between bars and reliefs on stock options, and between founders avoiding the label and now seeking it. Third, the SR framework regulates the transparent route more heavily than the opaque one. Its eligibility conditions have discouraged use, while founders can obtain comparable control through

contract without any of its safeguards. Fourth, minority remedies such as oppression and mismanagement actions, with their standing thresholds and demanding standard of proof, were built for a majority abusing a minority. They fit poorly against a minority-owning controller facing institutional investors. The reforms suggested here respond to those weaknesses without dismantling founder authority, which has real value for asset-light, technology-driven businesses. A note of caution is warranted. Over-regulation risks driving high-growth companies to list or domicile abroad, and the evidence on the benefits and costs of founder control is contested. Reform should therefore be disclosure-first and tested incrementally. Ultimately, the measure of success is not whether founders hold control, but whether those who hold it can be seen, questioned and, where necessary, held to account. India has built much of the machinery for that outcome at the stage of listing. The task now is to extend it backwards into the private phase, where founder dominance is born.

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