



### **What is the meaning of the term ‘Founders’?**

The founder of an institution, organization, or building is the person who got it started or caused it to be built, often by providing the necessary money. In general parlance it means a person who has conceptualized the innovative idea and started a company to commercialize that idea. Founder is not a defined term. Promoter is defined under Companies act, SEBI LODR and SEBI ICDR.

### **How is ‘Founder’ different from ‘Promoter’**

Founder terminology is used in the context of start-up entities which have been formed based on a new idea. E.g. phone pe, razor pay, Zomato. The Founders of this business means the persons who conceptualized the idea of starting business with their idea. Promoter if understood in general dictionary meaning means a person who takes all efforts in forming a company. He brings all required stakeholders together. He is the person who shapes the company, decides structure of the company and brings the company in existence. Founders not being a defined legal terminology is not recognized by law. Promoter as defined legal term has liabilities and duties attached to it. Hence there is reluctance in Founders classifying themselves as promoters.

### **Whether it is advisable to term ‘Founder’ as ‘Promoters’?**

As per section 2(69) of companies act 2013 and SEBI ICDR, “Promoter” shall include a person:

- i. who has been named as such in a draft offer document or offer document or is identified by the issuer in the annual return referred to in section 92 of the Companies Act, 2013; or
- ii. who has control over the affairs of the issuer, directly or indirectly whether as a shareholder, director or otherwise; or
- iii. in accordance with whose advice, directions or instructions the board of directors of the issuer is accustomed to act.

For a Founder to be classified as a Promoter he should have following characteristics:

- a) He should have control over the affairs of the company directly or indirectly as a shareholder, director or otherwise.
- b) Board of directors should be accustomed to act in accordance with his advice, directions or instructions.

Definition of Promoter is inclusive in nature and not exhaustive. Hon’ble Supreme Court has held that, *“The word “include” is often used in interpretation clauses in order to enlarge the meaning of words and phrases accruing in the body of statute when it is used, these words and phrases must be construed as comprehending not only such things as they signify according to their nature and*



*interest, but also those things which the interpretation clause declares that they shall include<sup>1</sup>*". Hence definition of promoter has a wider connotation. We will see what 'Control' and 'accustomed to act' here means?

### **Control**

Control is defined under section 2(27) of companies act 2013 shall include the right to appoint majority of directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

#### **Definition**

So, a person is to be considered as Promoter if he is able to exercise control over the affairs of the company directly or indirectly in any of the following ways:

- a) If he has right to appoint majority of the directors
- b) If he is be able to control the policy decisions or management decisions, individually or acting together in concert by virtue of shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

Definition of control is also inclusive one. It also has wider connotation to include persons exercising control over the company.

Not only ability to appoint but being able to appoint majority of directors on the board of directors of company and being able to control the policy decisions or management decisions of the company is also considered as promoter.

### **Accustomed to act**

Promoter is also a person in accordance with whose advise, directions or instructions board of directors is accustomed to act. Board of directors are appointed to provide an independent judgment. It is a rare scenario where board of directors are accustomed to act on the advice or instructions of a single person. There may scenarios in foreign countries where appointment of shadow director exists. In Indian companies this is a rare phenomenon.

Hence this brings us to understanding that a person who exercised the right to appoint majority of directors on board of directors of company or exercises control over policy decisions or management decision individually or acting together in concert may be considered as promoter.

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<sup>1</sup> *The Commissioner of Income Tax, Andhra Pradesh v. M/s Raj Mahal Hotel, Secunderabad, AIR 1972 SC 168.*



### **Identification of Founders as Promoters**

So, if the above referred parameter is fulfilled Founder(s) may be classified as Promoters. Founders reclassify themselves as promoters in an IPO primarily to consolidate strategic control, signal long-term commitment to investors, and retain key incentives such as ESOPs. Being labelled a promoter ensures they remain influential in company decisions, gives confidence to shareholders about their dedication, and allows them to preserve certain privileges and rights that non-promoters wouldn't have post-IPO.

### **Reasons for Founders Becoming Promoters in IPO**

- **Control and Influence:** Promoter status ensures founders can maintain de facto control over the company's affairs after going public, despite dilution of ownership from multiple funding rounds. This means they can still direct company strategy and protect their interests against large external investors like PE/VC funds.
- **Signalling Commitment:** Taking the promoter tag signals to public investors, especially retail shareholders, that founders are locked in for the long term and accountable for company performance. This builds confidence among investors who are looking for stability and a clear leadership vision.
- **Regulatory and Incentive Benefits:**
  - SEBI rules often classify founders with certain minimum equity (10% or more) who hold key operational roles as promoters.
  - Promoters have restrictions but also privileges like retaining and exercising employee stock options (ESOPs) granted before being classified as promoters. This protection preserves early-stage incentives crucial to founders.
  - Founders classified as promoters can exercise pre-IPO ESOPs granted at least a year before the IPO board decision, helping address dilution concerns.
- **Avoiding Loss of Rights:** The promoter classification is sometimes not entirely voluntary but a regulatory outcome when founders meet criteria such as shareholding and management roles. Since promoters cannot receive fresh ESOPs post-IPO, reclassification clarifies who qualifies for existing ESOPs versus regulatory restrictions.
- **Strategic Positioning:** After rounds of dilution via private investment, founders with small ownership stakes gain promoter status to "reclaim" their role as key decision-makers and avoid losing control to external investors.



## Summary

Identification of Founders as Promoter is not mandatory. Founders reclassify themselves as promoters at IPO so they can maintain operational control, demonstrate long-term dedication to investors, safeguard their pre-IPO stock option incentives, and strategically position themselves as the leadership core despite ownership dilution. While promoter status brings added scrutiny and responsibility, it also provides critical governance leverage and investor assurance in the public market.

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