Indian Depository Receipts – A Discussion

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Indian Depository Receipt (IDR) is a financial instrument denominated in Indian Rupees in the form of a depository receipt. The IDR is a specific Indian version of the similar global depository receipts in USA and Europe i.e. ADRs and GDRs respectively. IDR is created by a Domestic Depository (custodian of securities registered with the Securities and Exchange Board of India) against the underlying equity of issuing company to enable foreign companies to raise funds from the Indian securities Markets. Each IDR represents a certain number of underlying shares of the issuing company, whose value is derived from those shares. The foreign company must deposit its equity shares with the custodian company with beneficial ownership lying with an Indian depository. The depository would then issue receipts to Indian investors against these equity shares. IDRs are listed and traded on Indian stock exchanges, just like regular equity shares of Indian companies. This gives investors liquidity and the ability to buy or sell IDRs as with any other security. The proceeds of the issue of IDRs must be immediately repatriated outside India by the eligible companies issuing such IDRs.

Central Government notified the Companies (Issue of Indian Depository Receipts) Rules, 2004 (IDR Rules) pursuant to the section 605A of the companies Act. SEBI issued regulations for disclosure with respect to IDRs and notified the model listing agreement to be entered between stock exchanges and the foreign issuer specifying continuous listing requirements. Few of the eligibility criteria given under IDR Rules and Regulations are as under:

(a) The foreign issuing company must have pre-issue paid up capital and free reserves of at least US$ 50 million and have a minimum average market capitalization (during the last 3 years) in its parent country of at least US$ 100 million, (b) it has a continuous trading record or history on a stock exchange in its parent country for at least three immediately preceding years, (c) it has track record of distributable profits for at least three out of immediately preceding five years, (d) It is listed in its home country and has not been prohibited to issue securities by any regulatory body and has a good track record with respect to compliance with securities market regulations, (e) the size of an IDR issue shall not be less than Rs. 50 crores, (f) at any given time, there shall be only one denomination of IDRs of the issuer, (g) the underlying shares of IDRs shall rank pari passu with the existing shares of the same class, (h) IDRs can be purchased by any person who is resident in India as defined under FEMA.

Certain significant stakeholders involved in this program are (a) Custodian Bank, which is a banking company established in a country outside India and has a place of business in India and acts as custodian for the equity shares of issuing company against which IDRs are proposed to be issued of the issuer, (b) Domestic Depository, which is a custodian of securities, registered with SEBI and authorised by the issuing company to issue Indian Depository Receipts, (c) Merchant Banker which is registered with SEBI, responsible for due diligence and through whom the Draft Red Herring Prospectus for issuance of the IDR is filed with SEBI by the issuer company, (d) Foreign issuer which is required to file the Draft Red Herring Prospectus with SEBI, (e) R&T Agent, which provides services to the Issuer company, Domestic Depository and IDR holders by keeping records of IDR holders, co-ordinating corporate actions, and handling investor grievances.

IDRs can be converted into the underlying equity shares only after the expiry of one year from the date of the issue of the IDR, subject to the compliance of the related provisions of Foreign Exchange Management Act and Regulations issued thereunder by RBI in this regard.

The benefit of the underlying shares (like bonus, dividends etc) would accrue to the depository receipt holders in India. On the receipt of dividend or other corporate action on the IDRs, the Domestic Depository distributes them to the IDR holders in proportion to their holdings of IDRs.

Some of the advantages of an IDR issue are: (I) Integration of Indian capital market with the world market (II) Scope of the increased arbitrage opportunity. IDRs are meant to diversify holdings across regions and lower the risk of portfolio getting too concentrated in home markets, (III) Opportunity for Indian investors to buy a foreign stock without attracting restrictive provisions of FEMA (IV) Exposure of Indian stock exchanges to the best practices being followed worldwide (V) Increased chances of Indian corporate sector being more efficient due to global competition in the primary market, (VI) IDRs are traded in Indian Rupees, reducing the currency risk associated with investing in foreign shares, (VII) Lower transaction costs and less complex than investing directly in equity shares of foreign companies. In the absence of IDRs, Indian investors have chosen to invest in units of domestic mutual funds that would in turn invest its corpus abroad in a foreign fund, which invests in international companies. But the mutual funds are directly affected by the currency exchange risk because Indian rupees are converted into global currency before they are deployed in the international markets. This adversely affect the returns to the Indian investors.

The issue of IDRs to the public follows the same process as that of the domestically issued shares, where the listed company will make the public offer and the residents bid for the shares thereon. The Issue Process is the same:

i. The issuer company must file a Draft Red Herring Prospectus which will be examined by SEBI.
ii. The general body of investors will get a chance to read and review the DRHP as it is a public document, available on the websites of SEBI and Merchant

Bankers associated with the issue.

iii. After SEBI issues its final comments, the company sets the issue dates and files the Red Herring Prospectus with SEBI, Stock Exchanges and the Registrar of Companies.

iv. The issue is kept open for a fixed number of days allowing the investors to submit their applications within this stipulated period.

v. After successful closure, the depository receipts will be allocated to the eligible allottees in their "DEMAT" account, in an electronic format.

Investors of IDRs in India are subject to following conditions.

- Minimum application amount in an IDR issue is Rs. 20,000
- Investments by Indian companies in IDRs shall not exceed the investment limits, if any, prescribed for them under applicable laws
- At least 50% of the IDRs issued shall be subscribed to by QIBs with balance 50% available for subscription by non-institutional investors out of which at least 30% has to be retained for retail investors.

IDRs offer Indian investors an opportunity to diversify their portfolios internationally, reducing their exposure to domestic economic conditions and risks. Investing in IDRs is relatively straightforward, as it involves trading on familiar Indian stock exchanges and in Indian rupees. Indian investors gain access to global companies that they might not have been able to invest in otherwise. IDRs provide income to investors through dividends and potential capital appreciation, enhancing their overall return on investment.

For many decades, Indian companies have been raising funds from foreign markets. The trend continues but there is an opportunity to reverse it and witness the other side. With liberalisation and a booming economy, foreign companies are investing in India in every possible way. Foreign companies can gain (a) from larger Pool of Capital. India provides for one the largest consumer markets in the world. This attracts foreign investments to cater the larger pool of potential capital, (b) India has amongst the most developed capital markets infrastructure and policies, (c) Indian markets provide for established investor base, which allows the companies, of foreign origin, to seamlessly and reliably invest in it.

Foreign companies may have concerns around (a) lack of fungibility; (b) stringent eligibility criteria; (c) lack of clarity on the issue of taxation; (d) extensive marketing efforts; (e) large portion reserved for retail investors.

If India aspires to be an economic power, then it will certainly have to integrate with the world of today. An IDR issue will be an ideal example of the confidence shown by world in our economy and markets. IDRs hold significant importance in the global financial arena. They encourage foreign companies to tap into the vast Indian market without the complexities of directly listing on Indian stock exchanges. This, in turn, fosters international investment and strengthens India's position as a key player in the global economy. Additionally, IDRs offer Indian investors an avenue to diversify their investment portfolios across geographies, promoting a more balanced and risk-averse approach to investing.

The government opened this window for foreign companies to raise funds from the country as part of its efforts to globalise the Indian capital market and to provide local investors with exposure in global companies. Standard Chartered PLC was the first global company to issue Indian depository receipts in India in 2010. We need many such IDRs and attract overseas companies to the Indian capital markets.