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OVERSEAS DIRECT LISTING - A PROSPECTIVE AVENUE FOR INDIAN COMPANIES?

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ABSTRACT

As the eminent Chinese Philosopher, Lao Tse Tung has said, ‘Even a march of civilization starts with a single step’. India, from taking small steps has taken a big leap into the overseas direct listing system. This is the most appropriate time for this big leap as the Indian economy is expanding rigorously at present. India has moved away from the conventional depository receipt system and has entered into the overseas direct listing system. This is indeed a smart move as the demand for depository receipts were substantially reducing over the period of time and this was also affecting the credibility of the Indian companies in the eyes of foreign investors but with overseas direct listing the transactions are more transparent and the countries coming under the “permissible jurisdiction” are the countries which are members of the Board of International Organization of Securities Commissions (IOSCO) and a member of the Financial Action Task Force (FATF), this will ensure that there is no transfer of illicit funds. Undoubtedly this move is prosperous not just for the Indian companies but also for the economy as a whole. The companies have access to diversified capital, this can in turn reduce the cost of capital. The brand name “India” will be known globally and as the companies will have to compete with their foreign counterparts they’ll have to put in maximum efficiency along with an altered strategy. Direct listing removes frictional cost which is a significant incentive for corporates. This shows a cap market maturity in the part of the Indian government and the Indian regulatory matrix. However, there is some vagueness in the law that should be rectified such as, if corporates can avail LRS (Liberalised Remittance Scheme) or not, other than this the pros outweigh the cons and looking in an overall perspective this move is very ideal for the growth of the Indian companies.

Keywords - *Overseas Direct Listing*

INTRODUCTION

According to the International Monetary Fund, India is one of the fastest growing economies in the world.[1] It's a known fact that economic growth will come primarily from foreign capital investment.[2] Overseas listing of shares would contribute to bringing capital into the country.[3] However, initially the Indian government had a very contrary view on allowing companies to directly list in foreign exchanges and vice versa. The main reason was due to the belief that, if direct listing is allowed then all the capital would leave the country and it would be insufficient for the primary market, this in the end would affect the economic growth.[4] Similarly, if foreign companies were allowed to invest in India then all the investment would be made in the foreign companies and the domestic companies will not have any investment.

Subsequently, the government took into consideration the constant requestsmade by the companies and the unicorns[5] to allow direct listing of the their companies in foreign market. Following which an expert committee was set up by SEBI (Securities and Exchange Board of India) to provide in an opinion for the sameand finally through the Atmanirbhar Bharat agenda the government made it into a reality.

A company is one of the major contributors to the growth of the economy in Indiaand capital is a requisite for the furtherance of a company. Capital in plain words can be laid down as the money that is required to purchase sufficient assets for the furtherance of the business. A capital can be obtained in the form of equity and debt. Debt capital is the type of capital that is obtained by the company in the form of loans and this kind of capital should be repaid by the company to the lender, an example of this is money bonds. Whereas, equity capital is the capital that is raised by

[1]PTI, *India Still One Of The Only 2 Nations To Have At Least Some GDP Growth This Year, Says IMF*,FINANCIALEXPRESS (Apr. 14, 2020, 10:00 AM), https://www.financialexpress.com/economy/india-still-one-of-the-only-2-nations-to-have-at-least-some-gdp-growth-this-year-says-imf.

[2]Eswar S. Prasad, Raghuram G. Rajan and Arvind Subramanian,*Foreign Capital and Economic Growth*,THE FED, Aug. 2006, at 1, 2.

[3]PTI, *Cabinet Okays Direct Overseas Listing Of Indian Firms*,THEECONOMICTIMES(Apr. 04, 2020, 11:00 AM),https://economictimes.indiatimes.com/markets/stocks/news/cabinet-okays-direct-overseas-listing-of-indian-firms/articleshow/74480655.cms.

[4]Jayshree P Upadhyay, *SEBI Proposes Direct Overseas Listing Of Companies*, MINT (May. 01 2020, 10:00 AM), https://www.livemint.com/Money/5l70fVoFY7au71RmSuPpiO/Sebi-proposes-direct-overseas-listing-of-companies.html.

[5]*Unicorns are startup companies with a value over $1 billion.*

the company by giving out some of its ownership to the investors. The companies raise equity capitals from both the domestic market as well as the international market.

Companies incorporated in India can access the overseas equity markets through cross border listing which is done through two methods, direct and indirect methods of listing. Direct listing is when companies offer their shares directly to the investors without any middlemen such as banks, financial institutions, promoters etc.[6]Indirect listing is when listing is done through depository receipts. Previously Indian companies could only follow the method of indirect listing to raise capital from abroad but currently the government has taken a step to allow companies to directly list in overseas stock exchanges.

THE CONCEPT OF DEPOSITORY RECEIPTS

A depository receipt is defined as a negotiable instrument which is issued by a bank representing shares in a foreign company.[7] These instruments are used by domestic investors and foreign investors to trade in international markets. These instruments are of multiple types, GDR (Global Depository Receipts) and ADR (American Depository Receipts) are used by Indian Companies to procure capital from the International market.[8] GDR can be used to avail capital globally whereas ADR can be used for issuing shares in US alone.[9] Then there is IDR (Indian Depository Receipts), this is used by companies incorporated outside India to avail capital from India.[10] Major companies like ICIC bank and Infosys all have used this route to attain investment from the foreign stock markets.[11]

[6]Varun Singh & Simran Sabharwal, *Overseas Direct Listing: Propitious Step For Indian Companies*, NLUJ LAW REVIEW(May. 03 2020, 1:00 PM), http://www.nlujlawreview.in/overseas-direct-listing-propitious-step-for-indian-companies/.
[7]Adam Hayes, *Depository Receipts*INVESTOPEDIA(May. 15 2020, 2:00 PM) https://www.investopedia.com/terms/d/depositaryreceipt.asp.
[8]Nikhil Jobanputra, *Depository Receipts For SFMG (ADR, GDR, IDR*),SFM GURU(May. 15 2020, 3:00 PM) https://sfmguru.in/depository-receipts-for-sfmg-adr-gdr-idr-ca-final-sfm/.
[9]Investopedia, *Global Vs. American Depository Receipts: What's The Difference?*, INVESTOPEDIA(May. 15 2020, 4:30 PM), https://www.investopedia.com/ask/answers/072315/what-are-differences-between-global-depositary-receipts-gdrs-and-american-depositary-receipts-adrs.asp.
[10]*ADR, GDRs and IDRs*, JOURNALSOFINDIA(May. 15 2020, 5:00 PM),https://journalsofindia.com/adrs-gdrs-and-idrs/.
[11]Arnab Mitra, *Primary Listings Abroad Could Help Indian Start-Ups Get Better Valuations*,INDIA GLOBAL BUSINESS (May. 15 2020, 6:00 PM), https://indiaincgroup.com/primary-listings-abroad-could-help-indian-start-ups-get-better-valuations/.

i. *Working of Depository Receipts*

If an Indian company wants investments from France, the Indian company will have to first find a broker who will oversee the whole procedure from the initial stage to the end stage. The broker will be from the country which issues the DR, in this case the GDR. The broker will then find the depository bank. The depository bank should be from the country which issues the DR.[12]

The depository bank will subsequently choose the custodian bank[13]. The broker will purchase the shares from his counterpart in the custodian bank. Considering our previous example, the custodian bank should be located in India.

After this, the depository bank will ask the deliverance of the shares to the custodian bank. Subsequently, after it is notified that the custodian bank has received the shares, each share will be classified into packets containing 10 shares each.[14] Each packet will be issued as depository receipts by the bank. Later, this depository receipts will be taken to the depository bank and then to the broker who will deliver it to the investor.

ii. Downfall of the Depository Receipts

India opted for ADRs and GDRs in the early 2000s, though there was an high demand for this in the initial days but gradually there was a decrease in the number of companies opting for Depository Receipts.[15] A number of factors have contributed to this, one of the most prominent factors are the QIP (Qualified Institutional Placement) & the OFS (Offer For Sale), with the introduction of these modes of raising capital, which is cheaper in comparison to the indirect method, the number of companies opting for DR plummeted.

The second factor is that there were multiple allegations of investment made from illicit funds raised through Depository Receipts.[16] There have been multiple allegations of round-tripping

[12]*Depository Receipts*, FINANCEMANAGEMENT (May. 12 2020, 11:00 AM),https://efinancemanagement.com/sources-of-finance/depository-receipts.
[13]*Id.*
[14]*What Is A Depository Receipt?*,CORPORATEFINANCEINSTITUTE (May. 17 2020, 9:00 AM),https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/depositary-receipt/.
[15]Rajesh Mascarenhas,, *ADRs/GDRs Lose Charm For Indian Firms*, PRIME DATABASE GROUP(May. 17 2020, 11:00 AM),http://www.primedatabasegroup.com/newsroom/M124.pdf.
[16]Surajit Ghosal, *Reparation Of Black Money – India's Cherished Dream Amidst The Challenges Of International Regulations* 3 IJIMS 47, 47-58 (2016).

raised against the depository receipts.[17] Round tripping is the money that leaves the country through various channels and comes back as foreign investment.[18] This in short brings in no real economic benefit, in fact it just boosts the company's reported revenue.[19]

Round tripping mostly involves black money and is often used for manipulating the stock price.[20] This is profusely looked down upon by SEBI(Securities Exchange Board of India). If the domestic investor wanted to invest in the domestic country he could have just invested directly without having to resort to an indirect investment of investing in global funds which has investments in the domestic country. The ulterior motive of the domestic investor is very clear, tax avoidance and this could clearly attract the provisions of General Anti Avoidance Rule (GAAR).

In case of taxation policies there should either be an amendment that causes a change in the Income Tax Act or a change procedurally through a notification by the Income Tax Authorities, this is because the difference between fair market value and subscription price would be subjected to tax under the hands of the person acquiring it and if you do a direct listing you commit market forces to find what the valuation is rather than having a fair market value arithmetical deduction, so a waiver would also be required from this clause.

The number of companies that have raised capital through GDR have gone down significantly in the year 2011 as compared to 2010, In 2011 only 12 companies had raised Rs. 940 crores in comparison to the 34 companies that had raised 4510 crores in 2010.[21] This is because, according to the crisil (Credit Rating Information Services of India Limited) data of 2010, investors have lost money in 85% of the issues and four issues have shown negative returns of 35%.[22]

[17]Bhumesh Verma, *Direct Listing: The Beginning Of Demise Of GDR And IDR Routes*, SCCONLINE (May. 17 2020, 1:00 PM),https://www.scconline.com/blog/post/2019/08/12/direct-listing-the-beginning-of-demise-of-gdr-and-idr-routes/.

[18]Sachin Dave, *Investing In India-Bound Funds 'Can Be Round Tripping'*,ECONOMICTIMES (May. 17 2020, 5:00 PM), https://economictimes.indiatimes.com/markets/stocks/news/investing-in-india-bound-funds-can-be-round-tripping/articleshow/66279790.cms?from=mdr.

[19]Cam Merritt, *The Meaning Of "Round Tripping" in Accounting*, SMALLBUSINESS(May. 18 2020, 9:00 AM),https://smallbusiness.chron.com/meaning-round-tripping-accounting-65720.html.

[20]SACHIN DAVE,*supra*note 18.

[21]Press Trust Of India, *Investors Lose Money In 85% GDRs Issued Last Year: Crisil*, Business-Standard(May. 18 2020, 10:00 AM), https://www.business-standard.com/article/markets/investors-lose-money-in-85-gdrs-issued-last-year-crisil-111092700191_1.html.

[22]*Id.*

A lot of companies have found ways to cheat the system, this has brought down the demand for the depository receipts. An example of this is, the companies issued GDRs, these GDRs will then be acquired by FIIs (Foreign Institutional Investors) who will convert it into underlying shares and the stock brokers who'll sell this to investors used to cheat the investors, as these investors would have paid higher amounts to buy the shares. SEBI has considered this an instance of market manipulation.[23]

Lot of allegations were raised against the depository receipts, SEBI had acknowledged this and has been very meticulously identifying companies that were trying to cheat the system. In 2017, SEBI banned 19 companies for manipulating the stock prices using GDRs. In 2019 SEBI banned Sanraa Media Companies for the same issue.[24] Companies like K Sera Sera Ltd was featured in the top 6 companies whose GDR's were manipulated, SEBI had imposed a ban on these companies and entities like European American Investment Bank have been cautioned by SEBI to follow a more strict regulatory method.[25]

However, currently with the announcement of tax sops the demand for GDRs have a high chance of increasing. Tax rates for the dividend holders of GDRs have been brought down to 10% and the depository receipts holders don't have to pay tax for capital gains if they are not converting the receipts into equity shares.[26]

BENEFITS OF DIRECT LISTING

This is an opportunity for Indian corporates to remain Indian and access global stock markets. This will give the corporates incorporated in India the opportunity to have the ability, freedom and optionality where to list based upon the factors such as cost, branding etc. Direct listing eliminates

[23]UmakanthVarottil, *Issue Of GDRs And Market Manipulation*, INDIACORPLAW (May. 18 2020, 12:00 PM), https://indiacorplaw.in/2011/09/issue-of-gdrs-and-market-manipulation.html.

[24]PTI, *GDR Issue: SEBI Bars Sanraa Media, 7 Others For 5 Years'*,MINT (May. 18 2020, 2:00 PM), https://www.livemint.com/Money/NzmKe2OBsqGfNxg3EVcySI/GDR-issue-Sebi-bars-Sanraa-Media-7-others-for-5-years.html.

[25]KII Limited v. Securities and Exchange Board of India, 2018 SCC OnLine SAT 122.

[26]Ashley Coutinho, *Tax Sops May Turn Depository Receipts More Attractive For Foreign Investors*, BUSINESS-STANDARD(May. 18 2020, 3:00 PM), https://www.business-standard.com/article/markets/tax-sops-may-turn-depository-receipts-more-attractive-for-foreign-investors-120021101743_1.html.

the need for IPOs (Initial Public Offerings), such as banks, promoters, underwriters etc. This can help to reduce the overhead expenses accrued by the company in the form of fees, commissions and other additional charges.

The transition from depository receipts to direct listing of the primary market would be highly beneficial for the unicorns as they wouldnow be provided with a large and diverse pool of capital. Currently, there are over 35 unicorns in India and according to the data providedin the KPMG report of 2019 the average time period for an Indian start-up to become a unicorn is 4-5 years.[27]

The advantages brought in by overseas direct listing – as per the SEBI recommendation report[28]:

The benefits brought in by direct overseas listing is multi-folds:

For the economy:

1. Indian companies will have an increased competition, this will lead to increase in efficiency and growth as Indian companies will be exposed to global competition, which will enable them to put in their maximum effort.
2. Indian companies will be able to get the same benefits such as capital, strategic advancements etc similar to their foreign counterparts.
3. Indian IT companies incorporated outside India can directly list in Indian stock exchanges and this can make Indian stock exchange look more attractive.
4. The name of Indian companies and India as a country will be bolstered with direct listing.
5. Direct overseas listing has indirect benefits for the economy as well, as this can improve bilateral and multilateral relations between the countries and this in the long run can benefit the economy.

[27]Param Shah, *India Start-Ups Are A Big Hit – Six Unicorns In 2020*, INDIA GLOBAL BUSINESS(May. 18 2020, 5:00 PM), https://indiaincgroup.com/india-start-ups-are-a-big-hit-six-unicorns-in-2020/.
[28]SEBI Expert Committee, *Listing Of Equity Shares Of Companies Incorporated In India On Foreign Stock Exchanges And Of Companies Incorporated Outside India On Indian Stock Exchanges*, SECURITIES AND EXCHANGE BOARD OF INDIA (May. 19 2020, 12:00 PM),https://www.sebi.gov.in/reports/reports/dec-2018/report-of-the-expert-committee-for-listing-of-equity-shares-of-companies-incorporated-in-india-on-foreign-stock-exchanges-and-of-companies-incorporated-outside-india-on-indian-stock-exchange_41219.html.

For the companies incorporated in India:

1. The cost of capital in India is high but with direct overseas listing there is an availability of capital in optimum cost.Overseas direct listing brings in diversified capital which helps to reduce cost of capital.
2. There are a lot of strategic benefits with listing companies outside India, increase in brand awareness, international employee strategies etc.

For companies outside India:

1. Foreign companies can access equity capital, reach Indian consumers and recruit skilled labourers from India.
2. India can be a prospective market for foreign companies as there is a credible corporate governance and regulatory framework. The investors have high confidence in the regulatory system.

For investors:

1. Indian investors will have a diversified portfolios to choose from.
2. The foreign global companies listing itself in India would now enable Indian investors to be a part of the wealth created by global companies. It will also reduce the investors risk at same levels of expected returns.
3. Convenient for investors as the legal responsibility, enforceability of contracts, source based taxation is much greater in their own jurisdiction.

The most prominent part of the overseas direct listing policy is that Indian companies can only get itself listed in countries which are members of the Board of International Organization of Securities Commissions (IOSCO) and a member of the Financial Action Task Force (FATF) this is to make sure that there is no instance of money laundering and illegal transactions such as round tripping. Round tripping was one of the major problems that caused the downfall of depository receipts. The same applies for foreign companies that are listing their shares in the Indian stock exchanges, the countries that fulfil these criteria are termed as "permissible jurisdiction". Companies can only list their shares in permissible jurisdiction.

The RBI(Reserve Bank of India) has raised the LRS (Liberalised Remittance Scheme) to $2,50,000 per person per year, this is the amount of assets or other debt instruments an individual investor can hold in a country outside India without the prior permission from the RBI.[29] However, under the Schedule II of the Foreign Exchange Management (Current Account Transaction) Rules, 2020[30] restricts the buying and selling of foreign exchanges abroad. Therefore, can the corporates avail the benefit of LRS is a big question mark altogether.

There are certain vague spaces the law should be cognizant about, as the companies will have to follow the laws of both the jurisdiction. Other than this the companies would have to prepare accounts for both the Indian and the foreign jurisdiction, this can increase compliance charges.

CONCLUSION

Overseas direct listing is an excellent platform for companies that want diverse investors and investors who want diverse portfolios. This will be a big opportunity for the Indian entrepreneurs who believe that they will be able to give a high dynamic growth in the coming period. The companies will get global acknowledgement and each company will increase their efficiency so as to meet the standards of their foreign counterpart, this will lead to the growth of the company and as a natural corollary, the economy as well. Direct listing will put the Indian corporates in an equal cost of capital footing, equal international client and market footing. The most added benefit is that the foreign investors will have a more transparent transaction and a lot of regulations will ensure that no one gets cheated. Tech company, bio-tech, renewable energy companies, health sector were keenly waiting for this listing as this gives them the opportunity to list in global exchanges and be benchmarked to global peers.

[29]Press Trust Of India, *Indians Can Invest Upto $2,50,000 Annually Overseas,* THEHINDU (May. 18 2020, 9:00 PM),https://www.thehindu.com/business/Economy/indians-can-invest-up-to-250000-annually-overseas/article6852407.ece#:~:text=Encouraged%20by%20foreign%20exchange%20reserves,for%20individuals%20to%20%242%2C50%2C000.

[30]Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000.

Overseas direct listing will have a profound impact on the Indian economy, the investments will promote the growth of the economy. The government will have to take steps to make changes in the laws so as to make it more accommodative for the companies but not too accommodative for the companies to find loopholes in the law.