IDRs: A Source of Raising Fund for Foreign Company in India

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Abstract: *This article shall bestow a clear understanding to investors, professional and public in respect of issuing Indian Depository Receipts (IDRs) as well as investment in IDRs. IDRs are financial instruments used for raising fund by foreign company located outside India. IDRs are indirectly equity shares of foreign company, issued in the form of depository receipts to Indian investors with the help of overseas depository and domestic depository. This article will enable the learners to understand the criteria for issuing the IDRs in India and investing in IDRs by Indian investors. This article will explain the basic requirements of issuing IDRs with the help of Standard Chartered PLC, a British bank, issued IDR in India first time in 2010. An issuing company cannot raise funds in India by issuing IDRs unless it has obtained prior permission from SEBI and other regulatory bodies like Ministry of Corporate Affairs, RBI etc.*
This article will also highlight how issuing company should allot IDRs to investors group in India and what are the minimum requirements for investors in order to invest in such type of financial instrument.

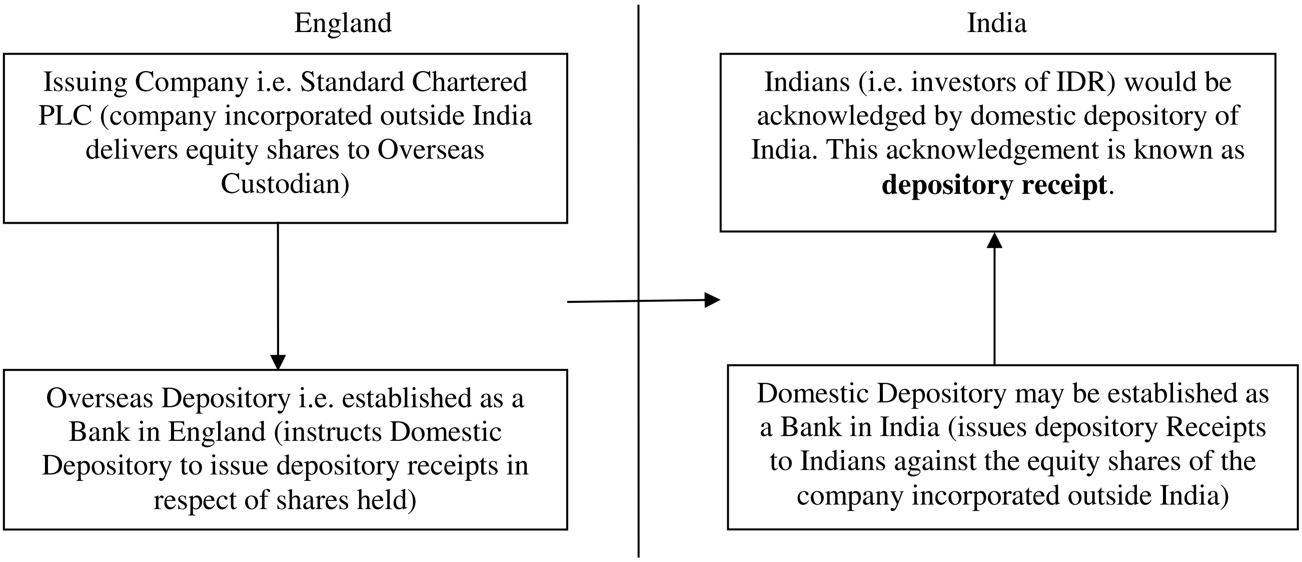
Key Words: *Indian Depository Receipts (IDRs), SEBI, Depository Receipts, Overseas & Domestic Depository*

1. INTRODUCTION:

Investment in Indian Depository Receipts (IDRs) is an attracting investment avenue for the Indian investors who are keen to invest their funds in foreign company's equity. Just like American Depository Receipts or Global Depository Receipts, which are instruments used by Indian Companies to raise money from foreign investors, IDRs are meant for foreign companies looking to raise capital in India from Indian investors. In 2010, Standard Chartered PLC issued IDRs successfully first time in India after fulfilling all the requirements of regulatory bodies. Indian Depository Receipts means any instrument in the form of a Depository Receipts created by Domestic Depository in India against the underlying equity shares of issuing company placed with overseas depository which are located outside India. The Indian IDR holder would thus indirectly own the equity shares of overseas issuer company. IDRs are to be listed and denominated in Indian Currency. A foreign company cannot raise funds in India by issuing IDRs unless it has obtained prior approval from SEBI.

2. MEANING OF DEPOSITORY RECEIPTS:

Before understanding the issue of IDRs, one needs to have knowledge of exact meaning of Depository Receipts. First understand the meaning of depository; it is like a bank where investors deposit their securities instead of cash. Moreover, when investor buys or sells the securities, his Demat Account is debited or credited as per their transactions. Every investor has to open Demat Account with the depository then only investor can trade in Indian stock exchange. No doubt depositories are always registered with SEBI. When issuer company issues its equity shares to foreign investors in that case issuing company has to deposit its securities to overseas depository first and overseas depository confirms this to domestic depository of that country where issuing company is issuing IDRs. Domestic depository then acknowledge about this to its country's investors. This acknowledgement of deposited underlying equity shares with overseas depository against which depository receipts are issued to investors is known as Depository Receipts. The following diagram would be helpful to understand it:



3. INDIAN DEPOSITORY RECEIPTS:

In the Indian domain, a Depository Receipt is reflected to as an Indian Depository Receipt. IDRs are transferable financial instruments listed on Indian stock exchanges in the form of depository receipts. Theoretically, the IDRs shall be issued by the Foreign Company, i.e., Company located outside India thinks of raising capital from the Indian arena through depository located outside India and an Indian depository participant. The last mile issuance of actual instrument is done by an Indian depository participant. The Indian depository participant will issue depository receipts to Indian investors against the underlying equity shares of the foreign company.

4. BASIC REQUIREMENTS OF ISSUING COMPANY FOR IDR ISSUE:

The issuing company cannot issue IDRs unless –

a. Its pre-issue paid-up capital and free reserves are at least US$ 50 million and it has a minimum average market capitalization (during the last three years) in its parent country of at least US$ 100 million.
b. Its pre-issue debt equity ratio is not more than 2:1.
c. It has been listed and continuously trading on a stock exchange in its parent or home country (the country of incorporation of such company) for at least three immediately preceding years.
d. It has a track record of distributable profits, for at least three out of immediately preceding five years and has been declaring dividend of not less than 10% each year for the given period.
e. The number of underlying equity shares offered in a financial year through IDR offerings shall not exceed twenty five per cent of the post issue number of equity shares of the company.
f. The issuing company is not prohibited to issue securities by any regulatory body.
g. The issuing company has track record of compliance with securities market regulations in its home country.
h. Issue size shall not be less than fifty crore rupees.
i. At any given time, there shall be only one denomination of IDR of the issuing company.
j. The underlying shares of IDRs shall rank pari-passu (Equal footing) with the existing shares of the same class.
k. It satisfies such other eligibility criteria as may be laid down by the SEBI from time to time in this behalf.

Compliance officers shall verify all the conditions mentioned above and after the fulfilling all the conditions by issuing company, and then they can file due diligence reports with financial statements of issuer to Ministry of Corporate Affairs.

5. PROCESS OF ISSUING IDRS IN INDIA:

The issuing company has to follow the following procedures for making an issue of IDRs:

a. The issuing company is required to obtain the necessary permissions or exemptions from the appropriate regulatory bodies from the country of its incorporation under the relevant laws relating to issue of capital and IDRs.
b. Foreign company shall take prior written permission from SEBI on an application made in this behalf for issue of IDRs along with the total issue size.

c. An application shall be made by issuing company to SEBI (along with draft prospectus) at least 90 days prior to the opening date of the IDRs issue along with necessary fee and furnishing such information as specified by the SEBI from time to time.

d. SEBI may, within a period of 30 days of receipt of an application call for such further information, and explanations, if necessary, for proceeding of such application and shall dispose the application within a period of 30 days of receipt of further information and explanation. However, if within a period of 60 days from the date of submission of draft prospectus, SEBI fixes any changes to be made in the draft prospectus, the prospectus will not be filed with SEBI or Registrar of Companies unless such changes have been made therein.

e. The foreign company shall file a prospectus, certified by two authorized signatories of the issuer company, one of whom would be a whole-time director and other the Chief Financial Officer, stating the material fact of the resolution of the Board by which it was permitted with SEBI and Registrar of Companies (ROC), New Delhi before IDRs issue. However, at the time of filing of required prospectus with the ROC, New Delhi, a copy of permission sanctioned by SEBI and the statement of fees paid by the Issuer to SEBI shall also be included.

f. The issuing company has to appoint an overseas custodian bank, a Domestic Depository and a Merchant Banker for the purpose of issue of IDRs. Merchant banker has lead manager and co manager. Lead manager overlooks the pre issue activities and tries to make IRD issue popular among Indian investors. They perform the activity of road show for issue of IDR. Co manager discharges the post issue activities.

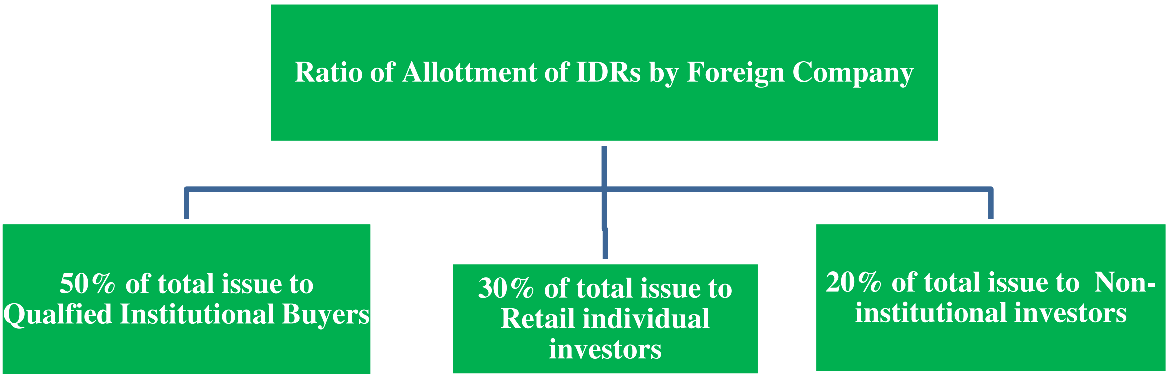
g. The issuing company has to appoint underwriters registered with SEBI to underwrite the issue of IDRs.

h. The issuing company shall place the underlying equity shares with Overseas Custodian Bank and the said bank shall authorize the domestic depository to acknowledge to investors in order to issue IDRs.

i. The issuing company has to obtain in-principle listing approval from one or more stock exchanges having nationwide trading terminals in India.

6. BASIS OF ALLOTMENT OF IDR AS PER SEBI GUIDELINE:

According to prevailing regulations, at least 50% of the Issue is to be allotted to Qualified Institutional Buyers (QIBs), 30% of the issue to the retail individual investors and balance 20% of the issue to non-institutional investors and employees. The percentage of non-institutional investors and employees is at the willingness of the company to decide. The issue will fail if the company does not get QIB investors to the extent of 50% of the issue size. However, minimum 90% of subscription should be received from investors on aggregate basis by issuing company.



7. ELIGIBILITY FOR INVESTORS:

Minimum application amount shall be twenty thousand rupees. When Standard chartered had issued IDRs in India, its maximum and minimum application amount for all three group of investors are:

Type of Investors	Minimum	Maximum
Retail investors (Indian residents)	Rs. 20000	Rs. 100000
Non-institutional investors	Rs.100000	Up to issue size
Qualified Institutional Buyers	Rs.100000	Up to issue size

Applicants are supposed to apply for IDRs only with ASBA (Application Supported by Block Amount) process where amount is blocked by bank till allotment of IDRs by foreign company. IDR holder has equal rights as any normal equity shareholder has rights of Voting, Bonus, Dividend, Right Issue, Splits and rights of legal recourse against the foreign company as well as Domestic Depository. IDR holders can convert IRDs into underlying equity shares only after completion of one year of listing after having prior permission of the RBI. Once conversion is done then investors are allowed to hold the equity shares only for selling purpose within a time limit of 30 days from date of conversion.

8. Issue of IDR by Standard Chartered PLC:

Standard Chartered PLC was incorporated in 1969 through a merger of The Chartered Bank and The Standard Bank Limited. Standard Chartered PLC is listed on both the London Stock Exchange and the Hong Kong Stock Exchange, it ranks among the top 20 companies in the FTSE-100 by market capitalisation**.**

In 2010, Neeraj Swaroop, Regional Chief Executive, India and South Asia of Standard Chartered said that they had already got advisors and they would file for the IDR issue after their results were published by March end. With that, it was reported that Standard Chartered might be inching closer to an issue. This was follow up with reports cited, Standard Chartered Plc files Draft Red Herring Prospectus (DRHP) to issue IDRs in India with SEBI on March 30, 2010.

Standard Chartered opened its IDR offering to Indian investors on May 25, 2010. The price band for the offering is 100 to 115 rupees per IDR. The bank, which makes most of its profits in Asia, issued 240 million equity shares in the form of IDRs through the offer.

Standard Chartered fixed its issue price for Indian Depository Receipts at Rs 104 per unit. At this issue price, the bank will raise Rs. 2,486.35 crore ($530 million) by selling of IDRs. Every 10 IDRs represents one share of the bank. The IDRs opened at the Bombay Stock Exchange and National Stock Exchange on June 11 2010.

Important highlights of Standard chartered PLC issue of IDR:

Draft Red Herring Prospectus (DRHP)	It been filed in accordance with section 605A of the Companies Act 1956 of India, the Companies (Issue of Indian Depository Receipts) Rules, 2004, as amended and Chapter X and Schedule XIX of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations 2009 and will be accessible on www.sebi.gov.in.
Book Running Lead Managers	UBS Securities India Private Limited and Goldman Sachs (India) Securities Private Limited (as Global Coordinators); and JM Financial Consultants Private Limited, DSP Merrill Lynch Limited, Kotak Mahindra Capital Company Limited and SBI Capital Markets Limited.
Co-Book Running Lead Manager	Standard Chartered - STCI Capital Markets Limited

9. Tax Treatment of IDRs

- Secondary trading of IDRs is not subjected to securities transaction tax (STT) and therefore capital gain tax is applicable on such trading profits.
- Dividend distribution tax (DDT) is not paid by the foreign company and thus it is taxable in the hands of the IDR holders.
- Direct Tax Code has proposed to bring parity in tax treatment applicable to equity shares to other securities like IDRs.

Moreover, there is an adverse effect currency fluctuation in case of dividend declaration by the company. There is always different rule and regulation between two countries and due to some domestic laws the issuer company may face some limitations while issuing any right issue and so may have to take some important steps in order to level equal consideration to the IDR holders.

10. CONCLUSION:

The significance of Depository Receipts as a financial instrument for raising funds is acknowledged worldwide and has been widely used by companies to raise capital in overseas jurisdictions. In the Indian domain, the concept of raising capital through the Depository receipts route is not smooth to Indian companies. In spite of complex laws, many Indian companies like Tata motors, Infosys have tapped overseas pool of capital by listing ADRs or GDRs of their companies on overseas stock exchanges. In case of IDR regime, not only it is an alternative option for foreign companies to raise capital in India, but also, an alternative investment avenue for Indian investors to invest in global renowned companies in an effective manner. Limitations of eligible investors being extended to include foreign investors as eligible investors to subscribe to IDRs and successfully issue of IDRs by Standard Chartered PLC, one can anticipate increase in popularity of IDRs as an alternative source of finance for foreign companies raising fund from Indian investors.

In addition, from the recent improvement of company laws and SEBI regulations, it can be said that the Government and regulatory authorities have been taking initiatives to facilitate issue of IDRs by withdrawing several stringent requirements that were applicable to specific category of investors like NRIs, domestic mutual funds and FIIs from investing in IDRs and by introducing friendly procedure for listing of IDRs. The IDR legal framework is now at an emerging stage and many amendments are to be required on several issues like delisting of IDRs from the stock exchanges and the procedure thereof. For smooth trading in secondary market, post issues of IRDs regulations regarding selling of converted equity shares from IDRs are to be amended.

In a developing economic environment, the Indian financial markets are bound to encourage foreign companies to raise capital in India for betterment of market as well as investors.

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