Dream of Desi Depository Receipts comes True*
The Indian Capital Market in the recent months is witnessing a large number of Initial Public Offers (IPO’s) wherein the foreign institutional investors have shown a keen interest and invested a major chunk of money. Among the Asian countries, India is seen as a potential place for prospective investment. With the downslide of dollar against the Indian rupees, falling rates of interest and lesser rate of inflation, Indian Capital Market received major inflow of money from abroad. With the economy shining and feel good factor, it may not be an exaggeration to say that the country is a hotspot for investment opportunities. In the capital market, lot of restructuring has been done paving way for LPG economy. New instruments like derivatives have started slowly percolating and the Government is committed with series of reforms. Few of the giant companies in India were taking the international route to mop capital especially through the Depository Receipts in the version of ADR’s and GDR’s. The dream of the local to have shares of foreign companies, which was a distant reality, is now no more a distance. With the on set of favourable conditions in the South Asian capital market, depository receipts which were once (videsh) international are now to be made available for the (desi) local investors too. The reform in this connection, which was done through the Companies (Amendment) Act three years ago have now been brought into force by the Department of Company Affairs in its recent notification (vide G.S.R. 131(E), dated 23rd February, 2004) under section 642, read with section 605A of the Companies Act, 1956.
With the Rules now in place, facilitating a new face of instrument in the capital market, the locals can participate in the issue of security by foreign companies and whose shares are to be listed in the Indian stock exchanges. The instrument named as Indian Depository Receipts (IDR’s)
marks another milestone in the process of reforms. The central advantage of a depository receipt is that the issuing company need not have to fulfil the conditions of the local stock exchange of its country origin.

**What are Depository Receipts?**

Basically a depository receipt is a negotiable trustworthy security that is issued by a foreign public-listed company and listed on a local stock exchange of a country in which it is issued. By this, investors can hold securities of a foreign company through depository mode. This type of instrument has been in existence since 19th century and was common in American and New York Stock Exchanges. IDR’s are just like shares but of a foreign company trading on a local stock exchange.

**How IDR’s work?**

The Indian Depository Receipts (IDR’s) will operate within the framework of rules framed by the Government in this regard, known as Companies (Issue of Indian Depository Receipts) Rules, 2004. The issue of IDR’s works on the model shown separately:

**Norms for IDR’s by issuing company**

**Basic**

- The issuing company (a company incorporate outside India) has pre-issue paid-up capital and free reserves are at least US$100 millions.
- It has and had an average turnover of US$ 500 million during the three financial years preceding the issue.
- It has been making profits for at least five years preceding the issue and declaring dividend of not less than 10% each year during such period.
- Its pre-issue debt-equity is not more than 2:1.
- It also fulfills other eligibility criteria laid down by SEBI from time to time in this behalf.

**Others**

- The repatriation of the proceeds of issue of IDR’s are subject to laws relating to export of foreign exchange.
- IDR’s shall not be redeemable into equity shares for at least one year from the date of its issue.
- IDR’s shall be denominated in Indian Rupees.
- IDR’s shall be listed in the recognised local stock exchange and they may be purchased, possessed and are freely transferable.

**Conditions for issue**

- Prospectus for issue of IDR’s shall be in the specified form and accompanied by a Statement of Expert.
- After the issue of IDR’s there shall be continuous disclosure requirements and the issuing company shall furnish a certificate obtained from the statutory auditor of the company or a Chartered Accountant about utilisation of funds and variations from the projections of utilisation of funds. This should be given at quarterly intervals and published in one of the English language newspapers having wide circulation in India.
- Quarterly audited financial results should be prepared and published.

**IDR’s Pricing strategies & Privileges**

Basically, IDR’s are arbitrage instruments and therefore the pricing mechanism is based on the purchasing power of currencies and its exchange rate valuations and fluctuations in the local market. In order to trade at the best price for IDR’s, one compares the price of IDR’s at which it is issued with the equivalent value of that currency in the local market. If the domestic value of the currency is lower than at which it has been issued, then it may be worthwhile to buy shares in the domestic market. The continuous buy and sell action may lead to the parity, and the price differential in the process will be minimal or sometimes very close. The holders of IDR’s are like equity shareholders who enjoys voting rights, title to dividends, participation in rights issue and share of bonus issue

**Benefits of IDR’s**

- A new instrument for the capital market to attract capital from domestic investors.
- Better security through safe depository mode
Scope for integration and convergence of global financial market
Higher liquidity due to international exposures and risks
Better portfolio management and diversification for investors
Competitive Price for the IDR’s

The idea for the journey of IDR’s has just begun. The conditions set for the issue are stiffer, yet taking into the confidence and realities of market conditions, it is one more step for convergence and harmonisation of world stock markets. The aura and flavour of videsh stocks are going to land up in Indian soil as desi depository receipts. How far the capital market will react and accept is a time-testing factor. Rules have come after nearly two years. Let investors watch for the new type of security and acclaim “What a great feel and shining Indian Depository Receipts” (IDR’s).

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IDR’s Mechanism

Issuing Company
(A Company incorporated outside India)

Issues

Equity Shares (IPOs)

to

Overseas Custodian Bank

Gives

Domestic Depository
(Custodian of Securities)

to

Depository Receipts (IDRs)

to

Local Investors