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Raising Money in Indian Markets – The Indian Depository Receipts Option

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India's economic growth story is now familiar with a comfortable foreign exchange reserve of over US$200 billion. In this context, if a foreign or a Singaporean company wants to raise money in the Indian stock market how should it go about doing it? The best possible option would be the Indian Depository Receipts (IDRs). They are made simpler now with the issue of a new set of regulations issued by the by the Ministry of Corporate affairs (earlier known as the Department of Company Affairs) on 17 July 2007. IDRs are certificates that represent the shares of a foreign stock.

The IDRs would be listed on the recognised stock exchanges in India and would be freely transferable. The actual shares underlying the IDRs would be held by an overseas custodian (generally an approved foreign bank). This instrument of IDRs has been available since April 2004. However, it had somewhat stiff conditions, acting as entry barriers for overseas companies.

Earlier Ruling

Under the earlier rules, a company proposing to issue IDRs was required to meet the following conditions:

- It needed to have a pre-issue paid-up capital and free reserves of US$100 million and an average turnover of US$500 million during the three financial years preceding the year of proposed issue;

- The issuing company should have been making profits for at least five years preceding the issue and should have declared a dividend of not less than 10 percent each year, for the last five years;

- It should also have a pre-issue debt equity ratio of not more than 2:1; and

- The IDR issued by any issuing company in any financial year should not exceed 15 percent of its paid up capital and free reserves.

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These conditions implied that only large strong global companies were able to issue IDRs. Not surprisingly, no foreign company came forward to issue IDRs. Now the Indian government has taken a positive step to attract foreign companies into the Indian market.

Positive Changes

Following the government notification (see www.corporateaffairs.nic.in) earlier this month, the positive changes included the issuing companies needing to have the following:-

1. Pre-issue paid up capital of and free reserves of US$50 million and minimum average capitalisation during the (last three years) of US$100 million;

2. a continuous trading record of at least three years in the stock exchange of the parent country;

3. a track record of distribution of profits in three out of five years; and

4. the underlying shares shall not exceed 25 percent of the post issue number of equity shares of the company.

Significance of Changes

These are relatively market friendly rules as they are based on net worth (lowered) and market capitalisation, in contrast to the earlier rules that were based on net worth (higher) and turnover based ceilings. They also provide for greater scope as they permit the company to issue larger percentage of outstanding shares.

The issuing company is required to obtain the required permission from the Securities and Exchange Board of India (SEBI), the capital market regulator in India. The minimum issue size is stipulated as Indian Rupees 50 crores (equivalent to about S$19 million).

Entry into Indian Stock Market

What are the key steps for a Singaporean company planning to enter the Indian stock market using the IDRs? Firstly, it will need to hire lead merchant bankers for the issue. Thereafter, it needs to apply to SEBI with a “Draft Offer” document. An “Offer” document covers all the relevant information to help an investor make his/her investment decision. The “Draft Offer” document basically means that the “Offer” document is in the draft stage. The “Draft Offer” document is filed with SEBI at least 21 days prior to the filing of the “Offer” document with the Registrar of Companies/Stock Exchanges (RoC/SEs).

SEBI may specify changes, if need be, in the “Draft Offer” document. The issuer or the lead merchant banker shall carry out the changes in the “Draft Offer” document before filing the “Offer” document with the RoC/ SEs. The “Draft Offer” document is made available on SEBI’s website for public comments for a period of 21 days from the filing of the “Draft Offer” document with SEBI.

Thereafter, the “Red Herring Prospectus” is prepared. It is a prospectus which does not have details of either price or number of shares being offered or the amount of issue. This means that, in case the price is not disclosed, the number of shares and the upper and lower price

bands are disclosed. On the other hand, an issuer can state the issue size, and the number of shares is determined later.

Challenge to IDRs

There is the possibility of the IDR getting undersubscribed if it is not well marketed or fails to catch the imagination of the investors or buyers. This means that the entire amount received needs to be returned. It is, thus, important to have the right kind of mangers to the issue is important. There are many high profile professional companies offering this service in India today.

Conclusion

Whether there would be any takers for the IDRs remains to be seen. It is difficult to make an assessment as it depends on the perception of the foreign companies on the ease of participation in Indian markets and their capital requirements.

The challenge for the Indian government is to market IDRs effectively by disseminating information widely. This is an opportunity for Indian investors to own shares of foreign companies. In any case, this is surely a one step forward for India's global engagement efforts.

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