# How to revive depository receipts market

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ADRs/GDRs have declined as a fund-raising option, following regulatory fears. But they defray risk for domestic, global investors

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A popular path to globalisation of equities in many emerging market economies has been through issuing of depository receipts (DRs), which are essentially negotiable certificates representing shares in a foreign company. These DRs are traded on a local stock exchange of mostly advanced economies and are issued typically by a bank.

DRs act both as a signal as well as a source of funding for a corporate in an emerging market economy. Since the listing requirements in the bourse of an advanced country are often more involved, listing in an advanced economy's stock exchange would give certain positive signals about the quality of management of the domestic corporate.

On the other hand, given the phenomenon of home bias in case of equity holding (whereby the investors tend to hold stocks of domestic companies), the DRs could provide the foreign investors with the alternative of holding shares in the equity of foreign companies.

## Rise and fall

Many Indian corporates, too, have followed this route of tapping the global market via global depository receipts (GDRs) and American depository receipts (ADRs), since 1993. Issuing of ADRs by companies such as Infosys in NASDAQ or VSNL in the New York Stock Exchange (NYSE) in and around 1999 or 2000 had attracted widespread attention.

Of course, not all the DRs were floated in NASDAQ or NYSE. In fact, given the stringent listing in the American stock exchange, in terms of both number and amount issued, the Luxembourg stock exchange emerged as the most preferred destination for DRs issued by Indian corporates.

While the DRs seem to have played a definitive role with regard to accentuating integration of the Indian financial markets with global counterparts, they appear to now be past their prime.

While international investors continue to look for global avenues for portfolio diversification — something that the DRs issued by Indian companies tapped into during the period preceding the global financial crisis — the Indian corporations' appetite for DR issuances seems to have ebbed in more recent years. So much so, that no new ADRs or GDRs were issued by Indian companies in 2016-17 and 2017-18 (see Chart).

Then, in 2018-19, ADR/GDR issuances rose to the tune of $1.8 billion. What explains this sudden increase?

As per data revealed by the Bank of New York Mellon global DR directory, while no GDR/ADR has been issued by an Indian company in any of the stock exchanges across the world in 2019, only three DRs have been issued in 2018. These pertained to GDRs issued by DishTV and Tube Investments at the London Stock Exchange. Further, the 2018 GDR issues were outcome of corporate restructuring activities of these firms.

## Reluctance to issue

Interestingly, the liberalised DR scheme that came into effect from December 15, 2014, failed to rejuvenate the DR market. Why did this lull in the DR market occur?

Two major reasons stand out. First, there was a nagging concern that many GDRs could have been an outcome of conversion of unaccounted money returning to India through a legal route. Thus, Indian regulators were often cagey about these instruments. In fact, in 2017, SEBI seemed to have barred 19 firms from the securities markets in India for manipulation in issuances of GDR.

Illustratively, in case of one aluminum company, it was found that that the GDRs were subscribed by only one entity, by obtaining loan from a bank (SEBI Order No. WTM/AB/EFD-1/DRA-1/27/2018-19). Second, domestic Qualified Institutional Placements (QIPs) have also emerged as a more convenient and cheaper mechanism to raise capital, eating into the attractiveness of DRs.

DRs have been in the news recently owing to the Finance Ministry's directive to SEBI to operationalise the DR scheme of 2014, and subsequent circulars by SEBI dated October 10, 2019 and November 29, 2019 were issued. These circulars offer a framework for Indian companies to issue DRs that are referenced to equity shares and debt instruments that rank *pari passu* (on an equal footing) with those listed on domestic stock exchanges.

While the emergence of QIPs offers much-needed impetus to the development of the domestic capital markets, such a development comes with a concentration of risk.

While DR issuances by Indian firms offer an avenue for international investors to diversify risk in their investment portfolios, domestic institutional investors in India are left with very few avenues (if any) to mitigate home bias.

## Attract foreign companies

It is high time that concerted efforts are undertaken as per the recommendations of the Sahoo Committee to turning Mumbai into a globally competitive International Financial Centre (IFC), by making it conducive for foreign companies to raise capital from Indian investors by issuing Bharat Depositary Receipts (BhDR) — rupee-denominated DRs linked to securities that are issued by foreign companies in their respective jurisdictions.

The current lack of enthusiasm from international issuers for such BhDR schemes is worrisome. Unless Indian policymakers take further concerted efforts towards capital account liberalisation, we may not be able to resuscitate the GDR market.

In conclusion, the future of DRs will crucially depend upon the freedom to issue them vis-à-vis concerns of market integrity and manipulation, and associated actions by the regulators.

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