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Unmasking the Misuse of Global Depository Receipts – Psychological Analysis of Select Cases

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Abstract
Purpose:
The objectives were to Understand the trends in the issue of depository receipts by Indian companies, to identify how some Indian companies have allegedly misused the process of depository receipt issue against the interest of retail investors and get exposure to rules concerning depository receipts in India.
Theoretical framework:
The study's theoretical foundation is based on trends analysis, misuse analysis, and an assessment of the regulatory framework for depository receipts. It also takes into account the various participants' roles in the process.
Design/methodology/approach:
Design, methodology, and approach: The research methodology examines historical data and trends on the issuing of depository receipts by Indian companies in great detail. It entails studying regulatory frameworks, evaluating pertinent literature, and looking into examples of misuse. To obtain data and reach findings, the study uses primary and secondary data sources.
Findings:
According to the report, Indian corporations have issued significantly less depository receipts in recent years, with no issuances since 2021. The tougher supervision of the Securities Exchange Board of India has contributed to this drop. The study finds instances where businesses secured loans from foreign banks against GDR sales rather than receiving actual proceeds from GDR sales. Due to the selling of the underlying shares as a result of loan defaults, Indian investors suffered financial losses.
Research implications:
This study shows the necessity for more stringent regulatory procedures and throws light on the misappropriation of depository receipt issuances by some Indian enterprises. To safeguard the interests of retail investors, it emphasises the necessity of establishing openness and accountability in the GDR issuing process.
Practical implications:
The conclusions of this study have applications for Indian regulatory bodies like the Securities Exchange Board of India (SEBI), among others. The report helps regulators create more effective supervision mechanisms by shedding light on the problems and gaps related to the issuance of depository receipts. Additionally, it makes investors more aware of the dangers of financing businesses that abuse the GDR issuing procedure.
Social implications:
This study has important social consequences since it sheds insight on how Indian retail investors are affected by dishonest practises in the issue of depository receipts. The report helps to advance ethical business practises and investor protection by outlining the misuses and their effects. To protect the interests of investors and uphold the integrity of the Indian securities market, it advocates for increased openness, accountability, and regulatory vigilance.
Originality/value:
This study offers novel insights into the fall in the issuing of depository receipts by Indian companies and the alleged abuse of the procedure. By revealing the relationships between numerous parties engaged in fraud, it adds to the body of knowledge on corporate finance and securities markets in India. Regulators, investors, and

other market participants can benefit greatly from the study's conclusions and suggestions in comprehending the complexities of GDR issuances and the steps necessary to reduce risks and safeguard investors' interests.

Keywords: Fraudulent Activities, Depository receipts, Securities, International investments, Oversight

Introduction: Businesses endeavour to identify inexpensive sources of capital to finance their operations. Due to a constraint of resources that are domestically available, foreign sources of capital are frequently viewed as crucial for many emerging economies. In addition to stimulating domestic economic activity, foreign investments also serve as an economic stimulant. In 1991, as part of the economic reforms that commenced that year, a significant policy change permitted Indian companies to source capital from international equity markets. Prior to liberalisation, the source of capital available to Indian businesses was international debt. In light of the currency crisis at the time, allowing companies access to equity in addition to debt appeared to be a prudent move that encouraged Indian businesses to fund their operations and also move internationally. As a result, many companies raised capital via global depository receipts (GDRs). Many Indian companies adopted the facility over time.At the end of the 20th century, Infosys and VSNL issued depository receipts on the NASDAQ and New York Stock Exchange, respectively, to great interest. Often, GDRs were listed at the Luxembourg stock exchange. With stringent listing requirements in the American stock exchanges, the Luxembourg stock exchange became chosen destination for depository receipts issued by Indian companies **(Madhavan, Ray, 2020).**

Depository Receipts: Depository receipts are financial instruments issued in a foreign capital market representing shares of domestic markets. These are negotiable instruments representing publicly traded securities of a foreign company wherein the actual foreign company is neither listed nor traded on the exchange. The underlying shares are held by a custodian. The GDRs are listed in an exchange in a foreign country with the underlying share being traded in the home country of the company. The depository receipts issued in America are known as American Depository Receipts or ADRs. SEC identifies that ADR may represent the underlying shares on a one-for-one basis, a fraction of a share, or alternatively represent multiple shares. Thus, one company's ADR may represent several shares of the underlying security, while another company's ADR may represent a fraction of the underlying security. GDRs may represent different amounts of the underlying securityto facilitate their value at a figure that is more representative of prices for market in the country where GDRs are traded.

In India depository receipts are defined under section 44 of the Companies Act, 2013 and governed under the Companies (Issue of Global Depository Receipts) Rules, 2014. Summary of the rules governing depository receipts are as follows:

i. Depository receipts are financial instrument that are in the form of a depository receipt and are created by a depository in a foreign country after authorisation by company.
ii. Indian company needs to take approval of shareholders after passing a special resolution at its general meeting
iii. A company can issue GDR only if it is eligible under the depository rules and Foreign Exchange Management Rules and Regulations.
iv. While depository receipts are issued by an overseas bank, the original shares remain in the custody of an Indian bank.
v. GDRs are issued through private placement, public issue or through any other manner prevalent in a specific country.
vi. The manner in which proceeds of the depository receipts are to be remitted are clearly defined. There is control as the proceeds are to be remitted to an Indian bank in India or abroad. Foreign banks are also allowed provided they are Scheduled under the Reserve Bank of India Act, 1934.

Review of Literature: The capital markets help companies to raise capital and accelerate growth. Real investments have a majorimpact on economic growth rates (Lenuța, 2012). Capital market issuances are linked to faster growth in countries with developed capital markets in comparison to banks. (Didier, Levine, Montanes, Schmukler, 2021). It has been noticed that the companies that are facing severe financial constraints are able to significantly accelerate their growth through the enhancement of productive capabilities achieved through funds from capital markets. In the last couple of decades, the opening up of economies and development in technology internationalized the capital markets as the funds easily moved from one country to another.There has been a rise in financial globalization with deregulation in the last fifty years encouraging the progress of banking and capital markets across the world (Miranda, 2021).Depository receipts as a vehicle of investment have extensively been used by companies. Depository receipts are about a century old as they were developed by JP Morgan in the year 1927 to provide an option to US-based investors to register and earn dividends on non-US stocks (Karolyi, 1998). Cross-listing can assuageobstacles to capital flows that can result in a better share price and a decrease in the cost of capital (Miller, 1999).

There are significant benefits of GDRs. Large companies may find it challenging to raise capital from local markets and attract a wider shareholder base. Raising funds from international markets increases the goodwill and reputation of the company on an international scale apart from meeting the capital requirements. Raising funds from international markets also improves investor quality and expands the shareholder base (Gosavi, 2021). Beenhakker, 2001 provides different objectives that a firm hopes to achieve by listing shares on foreign exchanges. Through cross-listing across different geographical jurisdictions a firm may provide a secondary liquid market that can support new issues in the foreign market. The firm is also able to improve the liquidity of its existing shares by making it simpler for foreign shareholders to trade in their domestic markets in local currencies. Cross-listing establishes a secondary market for shares that are used to acquire local firms. In the case of illiquid and segmented domestic capital markets, cross-listing brings possibilities for an increase in share prices by overcoming mispricing. Cross-listing increases the visibility of the firm and brings political acceptance by the host government. It also creates an additional market that can be used by local management and employees in foreign affiliates to compensate themselves.

Cross-listings have the ability to improve global corporate governance (Lel, Ugur, Miller, 2008). A globalposition implies continuous evaluation of the value of the company and increases in the accountability of management for financial performance. Offerings in International markets enhancethe legitimacy of shares with an increase in compliance and an increase in discloser standards (Chouksey, 2008).Companies deciding to cross-list their shares need to follow regulations, disclosure requirements, and corporate governance practices in foreign countries apart from the requirements of the home country. It is identified that there is a significant difference between compliance with corporate governance practices between domestic companies and those that are cross-listed (Jain and Gupta, 2018). Depository receipts have a positive impact on the company. Post issuance of ADRs and GDRs there is a positive change in the operating characteristics (assets, sales, profit, cash retained earnings, capital expenditure, net pay-out) between one year before the issuance and one year to three years after issuance. It is seen that ADR firms perform marginally better than GDR firms which may be on account of greater access to capital in the American markets. (Sivaprasad, Sheeja, Adami, Puwanenthiren, Mathew, 2021).

Cross-listings of shares in more developed markets create more value for shareholders (Roosenboom, Dijk, 2009). However, it is also identified by Bantwa, 2020 that there is no significant difference in the returns from the shares cross-listed on international exchanges and shares in India. ADRs derive their prices from the prices of their underlying shares as the movement in prices strongly follows the movement of underlying shares in India. Tripathy, 2020 also identified that cross-listing of shares is not able to bring any considerable benefits in the domestic country as issuance of GDRs by Indian firms does not majorly impactreturns from the underlying local stocks.

GDRs, a legitimate instrument to raise acrossborders have been used in a fraudulent and manipulative manner. (Khakase, Ronald, Rathi, 2021).The depository receipts seem to have passed their peak in the integration of the Indian and global financial markets(Madhavan, Ray, 2020). New Depository Receipts Scheme, 2014 was introduced in India and framed in a transparent and progressive manner with the involvement of stakeholders and lawyers. However, an obstacle to the implementation of policies is the coordination of a multipronged implementation strategy on account of diffused governmental and regulatory setup (Datta, 2015). The globalization of the capital market, with its wide range of transactions, considerably complicates the responsibilities of national financial regulators to regulate the activities of banking and securities firms.

(Simmons, 2001). South Asian financial market integration is expected to improve as stock and bond markets develop. However, the degree of integration is dependent on reforms in the financial sector (Perera, Wickramanayake, 2012). Developing capital markets is a gradual process that requires strong commitment, time, and resources by the government. The experiences in various countries show that the benefits of developing capital markets can be significant and long-term. The strategic imperative is to develop approaches that are customized to the specific requirement of a country. (Meera, Blitzer, Carvajal, 2017).

Sources of data and cases: The significance of data for a case study based analysis cannot be overstated. It serves as the basis for comprehending and evaluating the issue at hand and draw meaningful conclusions. Depending on the nature and scope of the study, data are collected from primary and secondary sources in order to effectively analyse the problem. In this particular case-study paper, secondary data sources were utilised.Secondary data sources refer to information that has already been collected and analysed by other organisations or researchers. Data with regards to the depository receipts are publicly made available by the Bank of New York Mellon Corporation (BNY Mellon). BNY Mellon is an investment banking services holding company in America. The company maintains a directory of depository receipts which is publicly available.
Further SEBI, on the basis of complaints or market surveillancemechanisms routinely investigates instances of abrasions under the SEBI Act and rules framed thereunder. The process,*inter alia,* involves show-cause notices, hearings, and the release of orders. For the purpose of this paper,six final orders by SEBI related to Global Depository receipts in the financial years 2021-23 were analysed as listed below:

Date of Order	**Name of Company issuing GDR**
Aug 13, 2021	Teledata Technology Solutions Ltd
Oct 22, 2021	Rasoya Proteins Limited
Oct 26, 2021	Winsome Yarns Ltd.
Dec 15, 2021	Winsome Textile Industries Ltd.
Mar 24, 2022	Pentamedia Graphics Ltd.
Feb 28, 2023	Texmo Pipes and Products Ltd

Objectives: The case study will serve the following objectives:

1. Understand the trends in the issue of depository receipts by Indian companies.
2. Identify how some Indian companies have allegedly misused the process of depository receipt issue against the interest of retail investors.
3. Get exposure to rules concerning depository receipts in India

Sharp fall in number of issues of depository receipts: In recent years, there has been sharp reduction in the number of issuances of depository receipts by Indian companies. From the year 2019 onwards, there has been one GDR issuein the year 2021. The fall is despiteliberalized scheme on Global Depositary receipts released in the year 2014. No new scheme of depository receipts was released in the year 2019, 2020, 2022 and till date in the current year.While throughout the history of depository receipt issues the number have not been very high as there have been only three instances of double digit issues in the year 1994, 2005 and 2006. (See figure below)

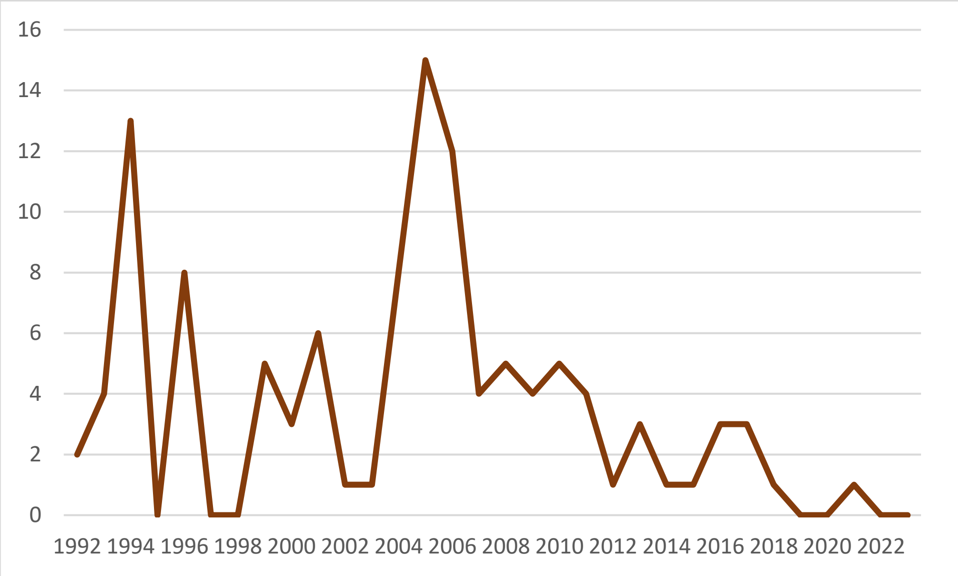

Figure 1: Year-wise number of issues of depository receipts by Indian companies**.**

The fall in the number of GDRs in India in recent times is not without any reasons. **Madhavan and Ray (2020)** highlighted two primary causes for the low frequency of GDR concerns in recent times. First, there have been assertions followed by investigations by the regulators that many GDRs are the result of illegal money returning to India through a legal method. Second, domestic Qualified Institutional Placements (QIPs) has emerged as a more convenient and cost-effective alternative for raising capital than depository receipts.

Contrary to the Indian situation, international investors persistently continue portfolio diversification through global opportunities. This trend is evident from the data as, throughout the second decade of this century, the number of depository receipts has been in the range of 103 to 146.(See annexure). However, there has been significant fall in the number in last two years, post Covid 19, possibly on account of challenges presently being faced by global economy.

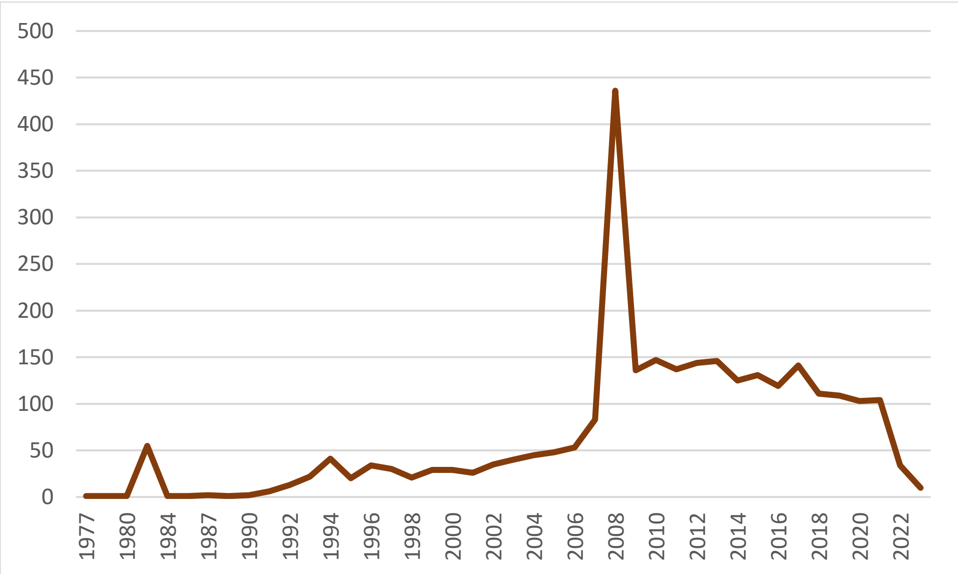

Figure 2: Year-wise number of issues of depository receipts at global level

Case based analysis of GDR misuse: In the past, several global depository receipts issued by Indian companies have been matter of controversy. The SEBI investigated GDR issues by Indian companies after receiving a complaint in 2009 about a few companies abusing the GDR route to defraud Indian investors. The investigation initially revealed that in many of the GDR issues, money for a subscription to GDR was obtained as a loan from an overseas bank, with the issuer company providing security for such loan taken by the subscribers by pledging/creating a charge on the GDR issue proceeds. Using a very similar processes a foreign entity took a loan from a Bank that signed a Pledge Agreement with the GDR issuing company. The SEBI conducted a preliminary examination of a number of scrips.A summary, simplified for academic relevance, of the final orders of SEBI explaining modus operandi identified and common to the cases can be explained in the following manner:

1. A Company Z registered in India with its shares being traded in Indian stock exchanges issues GDRs for raising capital at global level.In the scheme of GDR issue there were local custodian for the GDR issue and a global depository bank. The GDRs of Z Company are listed on a Stock Exchange abroad.
2. A foreign based entity P, with A as its Managing Director acts as the Lead Manager of the GDR issue of Z. It was alleged/identified in the cases that A is closely linked to other entities involved in the process of GDR issue.
3. There was a single subscriber V to the issue which is also registered in a foreign jurisdiction with A as its beneficial owner/Managing Director. V obtains a loan by entering into a Loan Agreement with Bank E. The Loan Agreement is signed by the Managing Director of V, A for the subscription of GDRs of Z Company.
4. Z Company opens an account with E Bank to deposit the GDR proceeds. The bank is a private bank established and regulated in a European nation that specialises in private banking, asset management, and alternative investments.

   The bank provides V with a loan to subscribe to GDRs, but maintains complete control over the utilisation of the loan amount as issue proceeds and GDRs held in its custody were subject to a lien.Account holding the GDR proceeds is given as security for the loan availed by V for subscribing to the GDRs of Z Company. V is the only entity from whom money is received in this account signifying that there in only one entity subscribing to the GDR. The Z Company also enters into a Pledge Agreement with Bank E for a loan that is availed by V towards the subscription of GDRs issued by the Company.Through the Pledge Agreement between Z Company and Bank E, the account holding the GDR proceeds is given as security for the loan availed by V for subscribing to the GDRs of the Company.
5. The loan taken by V is to be paid to Bank E by the subscriber. Entity V makes partial payments to Bank E and thereafter defaults on the repayment of balance loan amount. Bank E set-offs the pledge deposit with the outstanding loan amount and interest against loan account of V.
6. The E bank acquired GDRs from V and subsequently transferred/sold them to sub-accounts / Indian Funds that are under SEBI-registered FII umbrellas. Relationships were also identified between the managing director of the lead manager and these sub-accounts.it was revealed that certain FIIs/Sub-Accounts (allegedly linked to A) were converting the GDRs held by them into shares and then selling the resultant shares in the Indian markets.
7. Thus, it was observed that GDRs to the extent of default of principal and interest are issued without consideration to V, at the cost of other shareholders / investors of Z Company. The sale of the equity shares received by way of fraudulent issue of GDRs was facilitated in Indian capital market.

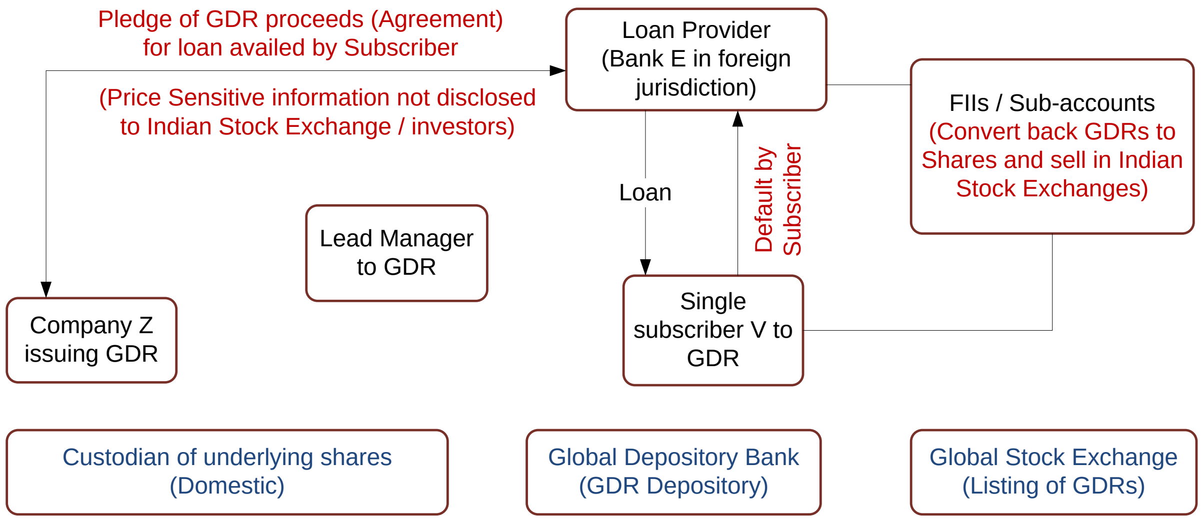

Figure 3: Operational diagram on misuse of Global Depository Receipts

Impact on retail investors: The Pledge Agreement between the company and Bank is not disclosed to the stock exchanges that makes the Indian investors believe that the said GDR issue was genuinely and successfully subscribed by foreign investors. It is also discovered that subscribers to the GDRs subscribed without any valid consideration and then sold the underlying shares in the Indian securities market. The process of fraudulent GDRs involved linkages between multiple parties. In such cases SEBI observed that issues were facilitated by the issuing organizations to route capital from India and with suppression of material information to mislead Indian retail investors that GDRs were genuinely subscribed. SEBI on the basis of market surveillance observed that issuance of depository receipts was done in a misleading and fraudulent manner to the detriment of retail and other investors.

Regulatory Challenges: While legal framework needs to protect the interest of the stakeholders, various parties find illegal, unethical or deceptive ways to defraud others. In the issues of depository receipts it was noted in various orders and instances that different parties have colluded together to cause loss to a section of investors. At the same time while laws can be made stringent to protect the interest of all the investors, they may impede ease of doing business. Tougher laws may act as stumble block many businesses who otherwise function in lawful manner. In 2014, new rules for issue of global depository receipts were framed to plug the loopholes and encourage companies to adopt the route. However, in spite of the same there has been a downward trend in the number of GDR issues to reach a position where no company is coming forward for fresh issues. As an emerging economy India continues to need foreign capital.

Conclusion: Investigation by SEBI revealed that in several cases, depository issuance was devised and structured in a manner to cause loss to the Indian Investors. Scrutiny by the regulator coupled with the option of institutional placement caused Indian companies to avoid the route of depository receipt issues in foreign jurisdictions. However, interest in the GDRs waned away and in recent years hardly any company has adopted the route of raising capital through depository receipts.A trend of data on number of depository issues at the global level and in India reveals that the GDRs are not a preferred mode of raising capital in our country. Two reasons cited in are:

1. Availability of alternative mode in form of domestic Qualified Institutional Placements.
2. Excessive legislation.

In the case of alternative modes for funding, companies need to choose the mode that is best suited to them to achieve their business objectives. At the same time legislation needs to balance to have a conducive environment that stimulates growth.

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