Startups and their growing focus on overseas listing

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Key takeaways:

- *While start-ups are keen to list overseas and expand internationally, the regulatory challenges acts as a barrier for the same. Therefore, it is important for the industry and government to come together to address this challenge jointly, thereby creating opportunities for the start-up ecosystem to grow.*

Background

In 2021, India emerged as the third-largest[1] unicorn hub, overtaking the U.K. in global rankings. This year saw a record number of 42 startups attain the coveted 'unicorn' title and it is anticipated that India will cross the tally of 100 unicorns in the year 2022.

The year 2021 was a watershed year for the Indian startup ecosystem with several unicorns getting listed on the Indian stock exchanges and related PEs/VCs making partial exits with handsome returns. While the Indian listings have been successful for most of these, few unlisted Indian unicorns, who are ready for public listing are keen to explore the possibility of listing in overseas bourses. The highlights of an offshore listing include:

- An existing peer group of new age companies makes it easy to benchmark valuations
- The Indian stock exchanges, including local analysts, have traditional views on profitability and growth contradicting the new age KPIs
- Overseas bourses have far more depth in terms of number and quality of institutional investors. Some of these overseas institutions' investment thesis does not allow them to take large exposures to international bourses.

Besides, the existing legal framework in India does not permit the direct listing of equity shares of companies incorporated in India on a foreign stock exchange. The only available route to access the equity capital markets of foreign jurisdictions for companies incorporated in India is through American depository receipts (ADRs) or global depository receipts (GDRs) and the concept of direct listing has only been in discussions for over the last few years.

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History in brief

Historically, in the late 1990s, Indian unlisted companies could list overseas through ADRs or GDRs without a primary listing in India. A few dot coms exercised this window to list on the U.S./ Singapore stock exchanges and raise international capital[2]. However, in 2005, the regime was amended, and Indian companies could approach global capital markets, only if they were listed in India.

Indian companies since then have been trying innovative ways to venture into foreign capital markets, either through flipping the ownership to an overseas holding company or listing via Special Purpose Acquisition Companies (SPACs). Some India-centric businesses, including a few leading online travel agents, tapped overseas markets because of their holding structures. However, given the Indian regulatory regime and taxing inefficiencies, such overseas listing routes have been challenging to implement.

In December 2018, the Securities and Exchange Board of India (SEBI) committee proposed listing Indian companies on overseas bourses. The Government of India (GOI) consequently amended the Companies Act to enable overseas listing and reduce the compliance burden for companies. However, there are challenges/bottlenecks that still need to be addressed.

Issues to be addressed

To make overseas listing a viable option for Indian companies, it would be essential to ensure an alignment of regulatory guidelines. Listing an Indian company on the international stock exchange would require three primary regulators, i.e., Ministry of Corporate Affairs, SEBI and Reserve Bank of India (RBI) to work on a unified code as suggested below:

- While, the SEBI committee had recommended several overseas jurisdictions where Indian companies could list, a formal regulation needs to be issued to ensure that situations like Press Note 3 (i.e. marketplace e-commerce guidelines) are addressed much in advance.
- While the overseas jurisdictions recommended are Financial Action Task Force (FATF) compliant and have strong regulatory frameworks, it is essential that Indian regulators, such as SEBI play an oversight role to protect rights/ interests of Indian investors. This may require some bilateral arrangements with overseas bourses.
- Guidance and regulations around foreign direct investments (FDI), round tripping, sectoral guidelines, Liberalized Remittance Scheme (LRS) limits, Employee Stock Ownership Plans (ESOP) etc. need to be provided.
- Other key considerations would also be needed to provide parity on tax implications, such as:
- Transfer of ADR/GDR by non-resident to non-resident is not taxable in India. Such provisions could be extended to shares traded on the recognised stock exchange.
- Gains derived on the sale of shares of a foreign listed company are treated at par with the gains derived from an Indian unlisted company. However, the sale of shares of a company listed on an Indian stock exchange is eligible for a beneficial tax levy. Thus, an amendment under the income

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tax act to extend the beneficial tax rate for shares listed over foreign stock exchange could be a relief for the investor community.

- A relook at the current compliance requirement towards obtaining PAN, return filing and withholding of taxes could provide ease to those buying and selling overseas-listed stocks.

Conclusion

Relaxations in the legal framework will raise new avenues for Indian companies to go global, access foreign capital and raise funds. Thus, it is imperative to have a structured framework established on overseas listing to promote and further scale up Indian startups. A lot still needs to be ironed out to pave the road for emerging startups to access foreign capital markets efficiently, and some policy amendments in this direction could significantly boost the ecosystem.

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[1] *Hurun India Future Unicorn List, 2 September 2021*
[2] Bloomberg BNA World Securities Law Report Vol. 20, No. 3 dated March 2014

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