List in India: Towards FDI 2.0

The traditional view considered Foreign Direct Investment (FDI 1.0) as desirable irrespective of whether its equity structure included public shareholding. Since then, the world has undergone a regime change with the emergence of Internet MNCs Microsoft, Google, Facebook and Twitter etc. that are based on winner-takes-all platform business models. In this regime, it is impossible to have a competing operating system or search engine startup in India. Web services markets are permanently ceded to Internet MNCs so much so that ironically some Government data now resides on Amazon Web Services. Platform businesses at this scale resemble nation-states and control economic systems that are bigger than many national economies. No wonder Brad Burnham, at Union Square Ventures, responded to the introduction of Facebook Credits—a short-lived system of virtual currency for use in playing online games—by wondering what the move said about Facebook's monetary policy. China pro-actively designed her FDI strategy that banned Internet MNCs. U.S. has also been very strategic in selectively blocking Alibaba and Tencent. Learning from the global FDI MNC policy experience, this paper 'List in India: Towards FDI 2.0' segues in to FDI 2.0 in that rather than accepting the current situation of 'winner MNC takes it all' status as fate accompli, it seeks to harmonize interests of all stakeholders including Indian Consumers, Government and Investors by pursuing an equitable logic, i.e. Global Multinational Companies' market value must be equitably distributed across nations in such a way that value derived out of a particular nation must be available to investing citizens of that nation. 'List in India: Towards FDI 2.0' is a strategic policy initiative that would enable passive Indian consumers become active owners in MNCs such as Google, Facebook, SAP, Toyota, Samsung, Huawei, Xiaomi and many others that have exploited Indian markets. 'Listing MNCs' is in the true spirit of give and take. It is a positive sum game because all stakeholders gain. While Indian consumers buy MNC products and are subject to data colonization by technology MNCs, their equity ownership would result in capital formation, create wealth for Indians and offer diversification benefits while making capital markets vibrant. Wealth distribution would create a virtuous cycle of innovative ideas, entrepreneurship, employment, consumption, higher taxes, social & physical infrastructure for the benefit of the Indian society. In fact, one could ask the question – Can we afford NOT to List MNCs in India? This is the essence of this paper.

The 'List MNCs in India' policy paper hinges on the central idea that consumer market of 1.3 billion Indian Citizens is extremely valuable and India must strategically seek equity ownership and share of profits that MNCs derive from Indian consumers creating a win-win for both. China follows coercive methods such as banning foreign Internet MNCs by creating firewalls so as to foster growth of Chinese internet companies such as Alibaba and Tencent (market caps ~$400 Billion) to take care of her national interest. In our democracy such bans were deemed infeasible. Hence, we could not build any Indian Search Engine or Social Media company and missed the opportunity to generate billions of dollars of domestic market capitalization. Moreover, China strategically deploys quid pro quo policy, which requires multinational firms to transfer technology, share patents and enter in to forced 50:50 Joint Ventures with Chinese partners in return for market access.

If the MNCs such as Facebook, Google, Twitter, Amazon, Apple, Ericsson, Samsung, Honda and others remain dominant in India, become inevitable part of our lives and keep increasing billions of dollars of parent market cap, at the very least, the government should expeditiously facilitate Indian citizens' part ownership in these Internet MNCs through listing. Indian Citizens can get diversification benefits and enjoy the future profits emanating from their intellectual property. As foreigners own our markets and as we partly sell our assets to buy their products, we should allow our citizens to own foreign assets (high quality stocks). This may constitute qualitative use of foreign exchange assuming the realized net investment income that piled on top of trade deficit, becomes a second source of investable funds. Moreover, Foreign Stocks may partly act as a substitute for Gold and have negligible effect on forex.

Government Policy in 1978 enabled some MNCs to list. Many MNC stocks have provided handsome returns in the past. Listing MNCs in India will allow Indian investors to get better risk adjusted returns. This initiative is more relevant today due to financialization of Indian society. It will make capital markets vibrant and valuations more reasonable. It is estimated that listing of MNCs India subsidiaries alone could add 33% to NSE Market Cap. In addition, if MNC parents get traded or quoted on Indian bourses, then the growth in capital markets may be exponential. We should follow the dictum 'Incentives always work' so as to shape desired MNC behavior. 'List MNCs in India' could become a potent extension to 'Make in India' to disseminate wealth. Following proposals are recommended for implementing 'List MNCs in India' initiative:

Proposal I: Endeavour to repeat the 1978 success in enabling 'Listing' but this time using Tax Incentives for MNC subsidiaries to List. MNCs where the foreign parent holds more than 51% equity and are listed in India should be eligible to domestic company tax rate whereas MNCs where the foreign parent holds more than 51% equity but are not listed in India should be subjected to suitably higher differential tax rate. Proposal I is the easiest to implement with minimal legislative changes. MNCs are likely to view this proposal in positive light since 'Listing' helps MNCs in getting embedded in the psyche of the local markets (customer loyalty) and as academic research has shown - it 'lowers MNCs cost of capital' due to cross listing[1]. In fact, India's Real Cost of Equity is 3% lower than the U.S. It is also pertinent to note that AB InBev, Royal Dutch shell, Coca-Cola, Walmart and Citigroup are examples of some MNCs that have responded to listing incentives. Mexico, South Africa, Bangladesh apart from the U.S. are examples of few countries that have attracted cross and multiple listings by MNCs. Marico and Berger Paints got listed in Bangladesh responding to tax incentives.

Implementation of Proposal I: For Proposal I to be effective, there are some pre-requisites. This Proposal must be implemented concurrently with rationalization of royalty payments that is under consideration of the Government. We may also link royalty payments to quantum of India based R&D and Intellectual Property Development[2]. Moreover, the Government should

[1] https://en.wikipedia.org/wiki/Cross_listing
[2] https://www.livemint.com/Opinion/9cJ0w68CdgCkybtzZEKwpN/Opinion--Incentivizing-private-sector-RD-in-India.html

disallow formation of 100% MNC parent owned subsidiaries in direct competition with listed MNC India subsidiary.

Characteristics of Proposal I that lead to Proposal II and III: All MNCs may respond to incentives but this proposal I is effective ONLY for Non-Internet MNCs from Indian Investors' returns perspective. This is because non-internet MNCs may be adequately represented in India in terms of Sales, Profits and therefore market capitalization. But in case of Internet MNCs (Apple, Google, Facebook), their India Market Cap may be a tiny fraction of their global market cap because of complex issues in booking revenue that result in very low profits in Indian subsidiaries. If we, as Indian citizens, are the 'product' of internet companies and if they earn revenue by selling our 'attention' to advertisers … but if that revenue gets accounted for more in the U.S. than in India, then it is equitable that we must be allowed to partly own parent Internet MNCs shares and the embedded intellectual property. Hence, to enable ownership of parent MNC shares, there is a need for Proposal II (Trade in India) and Proposal III (Bharat Depository Receipts).

Proposal II [**'Trade in India' i.e. US$ denominated Parent MNC Shares to be 'Admitted for Trading' on Indian bourses**] and **Proposal III** (**Bharat Depository Receipts***i.e. a rupee denominated instrument issued by a domestic depository in India on the back of a foreign stock issued or transferred to the domestic depository and deposited with a foreign custodian*)**:** For Internet MNCs, these proposals would unlock true value and would prevent misalignment of interest that sometimes exists when shareholder ownership in a subsidiary may not align with the parent MNC's focus on extracting maximum cash from the said subsidiary through royalty and technical fees. These proposals should be made transparent in terms of taxation for Indian Investors wherein foreign stocks investment should receive tax treatment at par with domestic stocks. These proposals would significantly increase the number of quality stocks available for Indian investors. The smallest S&P 500 stock has at least $4 Billion market cap that is approximately equal to the market cap of 35th ranked company in Nifty. Hardly any fake companies without revenues can come into S&P 1500, leave alone S&P 500. NSE / BSE could admit S&P 500 Stocks. Mexican Stock Exchange manages the International Trading System (SistemaInternacional de Cotizaciones), an electronic conduit to trade shares listed in other stock exchanges [3]. In 2017, 124 new foreign companies were listed in this System. China has set up a stock exchange link between London and Shanghai where HSBC will be listed[4]. India could replicate such systems.

Implementation of Proposal II and III: The Indian Government may need to facilitate the following measures:

- Persuade parent MNCs to allow trading of their shares in India within 3 years. Make their continued unrestricted India market access conditional to it. MNCs would readily agree to the proposal as it does not involve issue of any new shares for listing in India. Also, MNCs

[3]https://www.bmv.com.mx/en/markets/global-market

[4]https://www.reuters.com/article/hsbc-china/hsbc-on-track-for-shanghai-depositary-receipts-listing-ft-idUSL3N1WY2PQ

need not comply with listing norms in India. Make necessary changes in existing regulations across RBI, SEBI and MCA.

- Indian Bourses may implement international trading system on the lines of Mexico and China.
- Negotiate Estate Tax Treaty with the U.S. [perhaps on the lines of India – U.K. treaty]
- Come up with a low cost but innovative Sovereign Trust structure for addressing U.S. Estate Tax Issue. NSDL / CDSL could create sovereign trusts for holding Parent MNC Stocks and then issue BharatShares / Virtual Shares to retail investors who may place an order for BharatShares of the sovereign trust who in turn places a buy order for underlying foreign stock with a U.S. Broker. Only the Sovereign Trust gets to vote. Thus, Government of India would get voting rights in Parent MNCs.
- Make available 'Fully Disclosed Model' for holding Foreign Stocks in a cost effective way on the lines of NSDL / CDSL so as to address issue of U.S. govt. Influence and credit risk of U.S. Broker.
- Taxation regime applicable to transactions in comparable domestic securities should apply to transactions in Foreign Securities. For Bharat Depository Receipts, enable two-way fungibility.
- Address all the issues in using Liberalized Remittance Scheme (LRS) for buying foreign stocks. The LRS operation should be smooth and should work like Amazon 1-Click functionality.
- Educate Indian Investors so as to eliminate 'home country' bias and correct the perception that Indian Stock Returns have always been higher than Global Stock Returns. Forex investment in high quality foreign stocks should be considered a qualitative and strategic use with potential for appreciation. This is unlike forex spent on foreign vacation that is lost forever.
- Till the time 'Fully Disclosed Model' is not implemented in India, Income Tax Department should consider foreign shares held in Street Name (Omnibus Model) to be eligible for capital gains.
- Low Cost Foreign Stocks Index Funds and ETFs: Government should address all impediments in the path of an entity like Vanguard that could offer ultra-low cost (0.04%) S&P 500 Index Funds such as Admiral Shares (VFIAX)[5] using Indian e-KYC. Indian MFs are 50 times more expensive.

[5] https://investor.vanguard.com/mutual-funds/profile/VFIAX