INDIA'S CORPORATE LUST FOR OVERSEAS FINANCING AND ITS DRIVING FORCES - A STUDY

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ABSTRACT

Over the past few years, India has led all other Asian emerging markets in terms of growth of private inflows from equity and debt issued and loans raised overseas by domestic companies. India has emerged as the fifth most indebted country out of 20 other developing nations, even as external capital flows to the country took a big hit in 2008-09 on account of the global financial crisis. In the light of the above lines paper will make an attempt to present the Indian current scenario about the overseas financing for the last one decade and it would focus on the External Commercial Borrowings (ECBs), American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs) of India for the last decade. This study would also find out the driving forces of the Indian's corporate lust for overseas financing, and in the end the study will give suggestions based on the conclusion drawn from the study.

INTRODUCTION

Over the past few years, India has led all other Asian emerging markets in terms of growth of private inflows from equity and debt issued and loans raised overseas by domestic companies. Growth over this period averaged 51% per year. Taking overseas borrowings and equity issues together, a total of US$16bn was raised in fiscal 2005/06, a hefty 75% increase over 2004/05.

According Reserve Bank of India reports, India Inc raised over $ 2.06 billion from overseas markets in the month of April, 2011 through external commercial borrowings (ECBs) and foreign currency convertible bonds (FCCBs),

Around 55 companies rose over $1.54 billion for various projects through the automatic route, which does not require RBI or the government approval. Another $ 520 million were raised through the approval route.

The main force has been a sharp increase in investment--as befits doing business in a surging economy. To refurbish the old and build the new, Indian companies need money--and they are exploring every avenue at home and abroad to find it. Traditionally they have relied on corporate profits and loans from financial institutions and banks for financing. But in recent times raising funds overseas has become increasingly attractive because of the lower cost, greater flexibility, speed and depth that international financial markets offer. That the Indian government has eased its policy on external borrowings adds to the allure.

OBJECTIVES OF THIS PAPER

1. To study the theoretical background of ADR/GDRs and ECBs
2. To examine the overseas finance during the last decade
3. To find the reasons, why the Indian corporate are lust for overseas finance

ADRs: A negotiable certificate issued by a U.S. bank representing a specific number of shares of a foreign stock traded on a U.S. stock exchange. ADRs make it easier for Americans to invest in foreign companies, due to the widespread availability of dollar-denominated price information, lower transaction costs, and timely dividend distributions

GDRs: A negotiable certificate held in the bank of one country representing a specific number of shares of a stock traded on an exchange of another country. American Depositary Receipts make it easier for individuals to invest in foreign companies, due to the widespread availability of price information, lower transaction costs, and timely dividend distributions also called European Depositary Receipt.

ECBs: External Commercial Borrowings (ECB) are defined to include

1. commercial bank loans,
2. buyer’s credit,
3. supplier’s credit,
4. securitized instruments such as floating rate notes, fixed rate bonds etc.,
5. credit from official export credit agencies,
6. commercial borrowings from the private sector window of multilateral financial institutions such as IFC, ADB, AFIC, CDC etc. and
7. Investment by Foreign Institutional Investors (FIIs) in dedicated debt funds

Applicants will be free to raise ECB from any internationally recognized source like banks, export credit agencies, suppliers of equipment, foreign collaborations, foreign equity - holders, international capital markets etc. Offers from unrecognized sources will not be entertained.

WHO CAN ISSUE ADR’S AND GDR’S?

Indian companies are allowed to raise equity capital in the international market through the issue of GDR/ADRs/FCCBs. These are not subject to any ceilings on investment. An applicant company seeking Government's approval in this regard should have a consistent track record for good performance (financial or otherwise) for a minimum period of 3 years. This condition can be relaxed for infrastructure projects such as power generation, telecommunication, petroleum exploration and refining, ports, airports and roads.

There is no restriction on the number of GDRs/ADRs/FCCBs to be floated by a company or a group of companies in a financial year. There is no such restriction because a company engaged in the manufacture of items covered under Automatic Route is likely to exceed the percentage limits under Automatic Route, whose direct foreign investment after proposed GDRs/ADRs/FCCBs is likely to exceed 50 per cent/51 per cent/74 per cent as the case may be.

There are no end-use restrictions on GDRs/ADRs issue proceeds, except for an express ban on investment in real estate and stock markets. The FCCB issue proceeds need to conform to external commercial borrowing end use requirements. In addition, 25 per cent of the FCCB proceeds can be used for general corporate restructuring.

WHO CAN RISE HOW MUCH?

ECB entitlement for new projects

All infrastructure and Greenfield projects: 50% of the total project cost

Telecom Projects: up to 50% of the project cost (including license fees)

In the case of power projects, greater flexibility will be allowed, based on merits.

END – USE

ECBs are to be utilized for foreign exchange costs of capital goods and services (on FOB and CIF basis). Proceeds should be utilized at the earliest and corporate should comply with RBI's guidelines on parking ECBs outside till actual imports. RBI would be monitoring ECB proceeds parked outside. However, in the case of infrastructure projects in the power, telecommunications and railway sectors, ECB can be utilized for project - related rupee expenditure. License fee payments would be an approved use of ECB in the telecom sector.

ECB proceeds may also be utilized for project - related rupee expenditure, as outlined above. Proceeds must be brought into the country immediately.

However, under no circumstances, ECB proceeds will be utilized for:

i. Investment in the stock market

ii. Speculation in real estate

iii. ECB may be raised to acquire ships/vessels from Indian shipyards

REVISED GUIDELINES RELATING TO EXTERNAL COMMERCIAL BORROWINGS (ECBS)

The ECB guidelines were revised vide A.P.(DIR Series) Circular No.60 dated January31, 2004. ECB's can be accessed under two routes, viz., the automatic route and approval route.

(I) AUTOMATIC ROUTE

ECBs for investment in the real sector-the industrial sector, especially the infrastructure sector in India are under the allotment route, i.e., they do not require RBI/ government approval.

The maximum amount of ECBs which can be raised by an eligible borrower under the automatic route is US$500 million or its equivalent during a financial year. Corporate registered under the Companies Act, except financial intermediaries (such as banks, financial institutions, housing finance companies and NBFCs) are eligible borrowers. They can raise ECBs from internationally recognized sources such as international banks, international capital markets, and multilateral financial institutions (such as IFS, ADB and CDC) export credit agencies; and suppliers of equipment, foreign collaborators and foreign equity holders.

Under the revised ECB guidelines, however, and uses of ECBs for working capital, general corporate purpose, lending or investment in capital market, real estate and repayment of existing rupee loans are not permitted

(II) APPROVAL ROUTE

- Eligible borrows under the approval route are the following.
- Financial institutions dealing exclusively with infrastructure or export finance such as IDFC, ILFS, Power Finance Corporation, Power Trading Corporation, IRCON and EXIM Bank.
- Banks and financial institutions which had participated in the textile or steel sector restructuring package as approved by the government are now permitted to the extent of their investment in the package and assessment by the RBI based on prudential norms. Any ECB availed for this purpose so far will be deducted from their entitlement.
- Cases falling outside the purview of the automatic route limits

ECB proceeds should be parked overseas until their actual requirement in India. Prepayment of ECB s up to US$ 100 million is permitted without prior approval of the RBI, subject to compliance with the stipulated minimum average maturity as applicable for the loan. The all in cost (rate of interest and other fees and expenses in foreign currency) ceilings over the six month LIBOR is 300 basis points for ECBs with here years and up to a five-year maturity period and 500 basis pints for ECBs with a maturity of more than five years.

In December 2005, the Government changed the pricing norms for GDR, ADR and FCCB issues. The new norms stipulate that the floor price must be an average of the weekly highs and lows during the 26 weeks ending a month before the relevant date or the average of the daily highs and lows in the last fortnight of these 26 weeks, which is higher. The relevant date is the day the company's AGM approves the issue. This new norm may make it more difficult for companies to raise money from overseas markets, especially in declining markets since the floor price determined by this formula will be high

TRENDS IN OVERSEAS FINANCE

The following table shows the capital raised through ADRs/GDRs and ECBs during 2000-01 to 2009-10 by Indian corporate

TABLE: CAPITAL RAISED THROUGH DURING 2000-01 TO 2009-10(US $ MILLION)

Year	ECBs	ADRs/GDRs	Total	Annual Growth in %
2000-01	4303	831	5134	-
2001-02	-1,585	477	-1,108	-121.6
2002-03	-1,692	600	-1,092	2.5
2003-04	-2,925	459	-2,466	-125.8
2004-05	5,194	613	5,807	235.5
2005-06	2,508	2,552	5,060	-12.9
2006-07	16103	3776	19879	292.9
2007-08	22,609	6645	29,254	47.16
2008-09	7,941	1162	9,103	-59.7
2009-10	2,522	3328	5,850	-35.7
Total	**54,978**	**20443**	**70,287**	
Average	**5,498**	**2,044**	**7,029**	**22.2**

Source: RBI Note: The figures are shown in the table are net values

The Table shows that Total $54,978 million are raised for the last ten years (2000-01 to 2009-10) and on average $5, 498 million per year in the form of ECBs. On the other hand on average

$7,029 totaling $70,287 million has been raised by corporate on the name of ADRs/GDRs. It is observed that during 2001-04 corporate has redeemed ECBs, hence the figure are in negative. During period 2006-08, there is a significant increase in inflow resulting a reverse trend. 2004-05 year onwards we can see a positive trend overseas financing. On the whole growth rate which is 22.2 percent in the overseas finance concludes that the corporate is very keen for going overseas finance.

REASONS

The main reasons behind corporate India's overseas financial foray and looks at the instruments they favour. It also considers the challenges and benefits for Indian businesses seeking financing overseas. The main reasons identified in the paper include:

1. LOW INTEREST RATES

Indian companies increasingly are seeking cheaper, quicker loans abroad. The number of Indian companies issuing money overseas over the past few years has grown swiftly, albeit from a small base. In 2004/05, only 15 firms issued American depositary receipts (ADRs) and global depositary receipts (GDRs); this number almost tripled to 43 between April 2005 and February 2006. In addition, more than 50 Indian companies raised external commercial borrowings (ECBs) per month between January and March 2006.

2. IPO’S HAVE TURNED TOO RISKY

In majority cases issue of IPO’s turned to risky to raise as well as to invest the funds except in few case like Bharti Airtel. The reasons may be due to bunching up of offers in super-heated markets, stiff asking prices and the risky nature of businesses has made IPO’s funds too risky to borrowers and to investors. .

3. DIVERSIFICATION OF DEBT INSTRUMENTS

Indian companies are entering the US private debt placement market. Indian companies have traditionally used a number of instruments to raise pure debt, ranging from various types of bonds to syndicated loans. Reliance Industries, one of India's largest companies, in September 2006 became the first Indian issuer to enter the US private debt placement market, where investors selectively consider only "investment grade" companies (based on high credit ratings).

4. SURGING OVERSEAS EQUITY ISSUES

The start of India's economic reforms in the early 1990s led to a flood of overseas equity issues via ADRs and GDRs. The surge in overseas ADR/GDR equity issues has resulted in their share of total funds, raised via public issues, private placement and overseas equity issues.

5. BUOYANT DEMAND

Robust domestic and export demand is fuelling dramatic growth in corporate investment. This demand, especially in the industrial and infrastructural sectors, has encouraged businesses to implement investment programs to expand capacity, modernize and diversify. Strong export demand has been aided by buoyant world trade, which has enabled internationally competitive Indian companies to benefit from an improved trading environment. At the same time, India's strong economic growth has driven domestic demand. Rising household incomes and consumption expenditure, infrastructural spending, and higher demand for a variety of intermediate inputs have led to an expanding market for many industrial sub-sectors.

6. REGULATORY LOOSENING

An easing of regulations has facilitated borrowings and equity issues abroad by Indian companies. The Indian government and the central bank, the Reserve Bank of India (RBI), have streamlined and liberalized ECB procedures and policies in order to promote domestic companies' access to international financial markets. At the same time, policies on overseas equity issues have been eased and are currently more liberal than those on ECBs and FCCBs. Policies towards ADRs and GDRs have also been liberalized over the past few years and unsurprisingly are much less restrictive than those towards ECBs and FCCBs.

7. INNOVATIVE INSTRUMENTS

Indian banks have been allowed to issue innovative instruments in foreign currency to raise capital funds for capital-adequacy needs. Since January 2006 domestic banks can issue perpetual debt and debt capital instruments in foreign currency to raise capital funds for capital-adequacy purposes. This increase in bank capital is needed to meet Basel II capital requirements as well as to support growth. In July 2006, further liberalization was introduced by dispensing with the need to obtain prior RBI approval for such issues on a case-to-case basis. These reforms mean Indian banks have a better capacity to lend to the corporate sector both at home and abroad.

8. EXCHANGE-RATE RISK TOLERANCE

Indian companies have become more tolerant of exchange-rate risk. This has encouraged the use of ECBs, which expose issuers to exchange-rate risk since repayment of the principal and interest is in foreign currency. In the case of FCCBs, the option to convert enables pricing at relatively low yields. Moreover, the documentation and regulatory approval processes for overseas financing are often quicker and easier than for raising domestic funds. Indian companies gain not only in terms of cost and speed, but also in terms of reputation and other hard-to-quantify factors. For instance, foreign stakeholders increase an Indian company's "visibility" abroad. This is increasing in importance as Indian companies conduct more and more business outside the country.

9. THE SEARCH FOR ALPHA

Foreign portfolio investors' search for alpha--or returns exceeding expectations given the perceived risk of an investment--has proved enticing. Bullish trends in the Indian capital market reflect sound macroeconomic fundamentals, rapid growth, a robust industrial base accompanied by strong corporate profitability, rising investment and the implementation of ambitious corporate strategies including expansion, modernization, and mergers and acquisitions at home and abroad. The booming capital markets have greatly enhanced foreign investors' interest in FCCBs, ADRs and GDRs issued by Indian companies.

10. PERSISTING CONSTRAINTS

Constraints to international financing include India's sovereign credit rating, exchange-rate risk and stringent compliance requirements. India's sovereign credit rating has affected international financing opportunities for many Indian companies. Although some Indian companies have been rated higher than the sovereign rating, thanks to their large offshore operations, it has been difficult to assign domestically oriented, profitable and well-run Indian companies a rating higher than the sovereign rating. Exchange-rate risk is another restraining factor, especially when loan maturities are medium- to long-term. And the demand for relatively high accounting standards has deterred many Indian companies from US equity issues.

11. FUTURE TRENDS

Indian companies will continue to raise large amounts of funds in the form of both debt and equity. Recent trends suggest that there will be many more large transactions for the bigger Indian companies. The latter are growing in size and ambition and will continue to look at foreign-currency resources to fuel growth, both for capacity expansion and acquisitions.

CONCLUSION

Indian companies need money--and they are exploring every avenue at home and abroad to find it. In addition to it Indian government has eased its policy on external borrowings. There fore we can for the past few years raising funds overseas has become increasingly attractive because of the lower cost, greater flexibility, speed and depth that international financial markets offer.

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