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A STUDY ON GROWTH OF EXTERNAL COMMERCIAL BORROWINGS IN INDIA

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Introduction

The rising access of the emerging market firms to international capital markets reflects the transformation of corporate financing led by cross-border movement of capital, deepening of global financial markets, and strong inters linkage across markets and institutional developments, particularly the mechanisms for risk assessment. Large access to international borrowings is also indicative of greater trade linkages and an enhanced exposure of firms to foreign currency transactions. Liberalization of capital controls by developing countries coupled with a rising appetite for asset diversification by international investors has also created an environment for firms from developing countries to increasingly access the international capital markets. The above mentioned developments seem to have enabled them to circumvent the credit constraint imposed by the underdeveloped local capital markets, widened their choices of financing and facilitated borrowings at a reasonable cost.

A firm’s choice between borrowings from the overseas markets and the domestic capital market is done typically after a deliberate process of long term financial planning. Thus, a firm’s decision to raise borrowings from international capital markets can be a complex interaction of a host of factors.

One, a firms potential demand for domestic investment, which in turn is a function of the expectations about future growth.Two, the credit constraint a firm might be facing in the domestic market due to underdeveloped and less liquid bond markets, which, on the one hand may hamper borrowings by smaller firms and on the other may not facilitate large sized bond issuances as well as offerings of long maturity horizon. International capital markets due to their highly liquid nature and capacity to absorb long maturity bonds, help firms from underdeveloped markets to raise adequate resources, reduce dependence on the narrow local markets and diversify the sources of funds.

Three, firms persistently attempt to minimize the cost of capital with the progressive opening up of the trade and investment regime. Persistence of interest rate differential above a threshold level between the domestic and the international markets for similar financial assets together with the expectations about exchange rate movements, may lead to substitution of domestic liabilities with international liabilities by firms.

Four, raising loans by the domestic firms from international markets may help firms acquire credibility and reputation, which in turn, may facilitate greater access to domestic markets. It is contended that firms that participate in international markets tend to obtain better financing opportunities and leverage for longer debt maturity.

Five, a firm achieving global scale of operations and having exposure to receivables and borrowings in foreign currency may provide a natural hedge to its balance sheet. In addition, firms may take recourse to international markets to finance their global operations.

Six, foreign currency borrowings may also enable firms in managing risks through more sophisticated financial instruments.

The rationale for this study has been developed from the historical fact that ECBs, which are used as an additional source of funding by Indian corporate’ to augment resources available domestically, have suddenly become a major component of total capital flows to India.

Review of Literature

Mora Sowjana and D. Satish (2014) observed through the case study named Tata Steel’s ECB- the payoffs that, with the initiation of liberalization policies, the Indian financial markets had experienced remarkable changes and Indian companies started borrowing and investing abroad. Many Indian companies have raised substantial amounts of external borrowings through ECB for their long term requirements.

Kumud Malviya (2013) This paper examines the role of Foreign Currency Convertible Bonds (FCCBs), its nature, problems and relevant current issues in relation to foreign investment in India. FCCBs play a pivotal role in foreign investment in India. It is an important instrument to raise funds from the International financial institution outside India.

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Himanshu Yadav (2012) the paper studies the External Commercial Borrowing policy being followed by the Government of India in order to let the Indian entities access the foreign funds. The law governing foreign exchange is Foreign Exchange Management Act, 1999 but no express mention of the ECB instruments is there, though they involve foreign funds. The paper establishes the source of law for ECB and the relevant provisions of the act from where the RBI (Regulator of ECB) derives it powers for the same.

Harpreet Dusanjh (2012) an analytical approach has been made to gauge the aspects of the latest ECB policy (2012) as RBI tends to amend it from time to time via FEMA notifications and A.P. (DIR) and Master Policy circulars. The provisions of law and that of policy have been consolidated to present a framework for the investors where they can categorically relate their proposed ECB to the mode of arising the same within the framework of the extant guidelines.

Verma and Prakash (2011) excogitated the effects of interest rate sensitivity on four components of capital flows using co-integration and causality analysis. The components chosen for this analysis were foreign direct investment (FDI), foreign institutional investments (FII) for the period 1998-2010, external commercial borrowings for the period 2000-2010 and non-resident Indians deposits. It was found that FDI was not interest rate sensitive as it is assumed to be long-term in nature. Also, FIIs are not statistically significant to interest rate sensitivity. On the other hand, as the author expected, ECBs and NRI deposits are found to be statistically significant. 1 percentage point change in interest rate led to around 0.85percentage point change in ECBs and similarly 1 percentage point change in interest rate brought 0.26percentage point change in NRI deposits. Hence, the authors finally interpret that monetary policy takes cognizance of the fact that ECBs and NRI deposits (debt flows) are impacted by the changes in interest rates as well as exchange rates.

Julie Jiang and Jonathan Sinton (2011) in this study the author finds signs of inefficiency in India's financial system, which negatively affects growth differentials of finance intensive industries but this does not quantify the impact of inefficiency on macroeconomic growth. Also, the paper concludes that India's growth has been the fastest in the world despite all the inefficiencies, however, it India could have achieved even higher growth without such burdens. It has been suggested that the future development policy in India should involve developing debt-financing facilities.

Dipen Chatterjee (2010) Indian companies that raised large sums of foreign funds to finance growth and acquisition plans during the bull run in the stock markets are in a Catch 22 situation. The conversion price of their foreign currency convertible bonds is several times higher than their current market prices. This leaves them with two options. One is to reset the price at current market price, a move that could dilute promoter holdings (since it would entail issuing more equity shares). The other is to redeem the bonds, which could increase debt obligations that are already substantial in some cases. The maturity of many of the FCCBs is expected to start in October 2009 and peak in 2010-11. Most analysts say the market is unlikely to recover so significantly over the next two years that market prices will match the conversion prices. The paper would state forth the current conditions of the FCCB market and Bond Holders.

Ankita Chatterjee (2010) noted through the study ECBs and its Growing Importance in India that, External Commercial Borrowings, known as ECBs in common parlance, is a three letter word that is presently ubiquitous in the corporate world as a catena of business activities thrive on ECB transactions taking place in the country on a daily basis. The Indian Corporate Market is one of the most prominent and formidable markets worldwide. As per records, from April 2006 to December 2006, ECB influx into India was a staggering USD 9 billion.

Significance of the Study

It is observed that external commercial borrowings are becoming a pivotal part of capital flows and is rigorously affecting the overall economy. Indian companies had ramped up their overseas borrowings in recent years with a change in the international economic climate to take complete advantage of low interest rates in the global markets. ECBs in India are raised for the purpose of import of capital goods, new projects, modernization/expansion of existing production units in real sector, micro finance, refinancing old loans and on-lending to power sector. The study will try to analyze the trend of ECBs in India over a period of time. It also tries to analyze the factors responsible for the increase or decrease in ECBs in India.

Objectives of the Study

- To identify the trend of ECBs in India
- To ascertain the factors responsible for growth or decline of ECBs in India.

Scope of the Study

- This study will cover the period 2003 to 2015.
- All ECBs are dollar denominated.

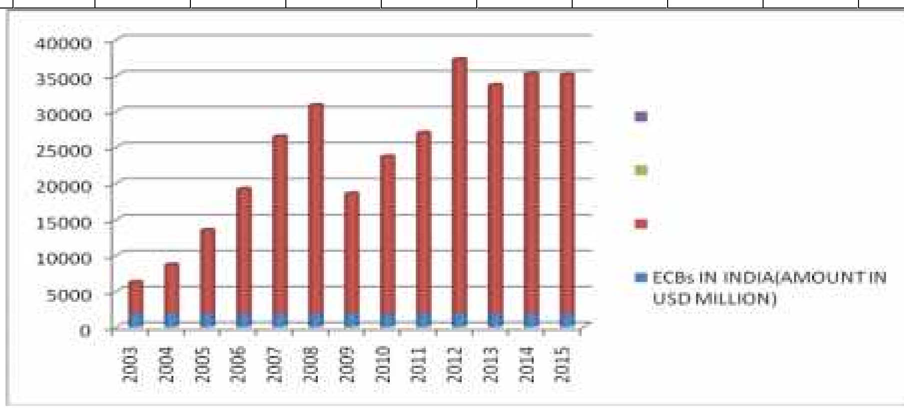
Research Methodology

The research design employs both exploratory and causal research methods. The data are collected from RBI and other relevant sources to extract relevant information. The cause and effect of the outcome is analyzed with the help of the experts through brainstorming and group discussions.

Data Analysis

ECBs RAISED IN INDIA FOR THE YEAR 2003-2015

YEAR	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
AMOUNT IN USD$ MILLION	4235	6671	11490	17175	24492	28842	16517	21703	25012	35240	31670	33218	33121



Interpretation of Data

External Commercial Borrowings (ECBs), which were a preferred source of funds for Indian companies, have fallen out of favour in the recent years. But domestic sources of non-bank finance such as corporate bonds and commercial papers have more than made up for the shortfall. Between April and July this year, $8.4 billion of ECBs were raised by Indian companies. This is around 18 percent lower than the sum raised from this source in the same period in 2014. The intense volatility in global financial markets this calendar is partly responsible for this decline. This has made hedging mandatory for all foreign currency loans and hedging costs have also spiked due to increased uncertainty.

According to Rakesh Valecha, Senior Director and Head – Credit and Market Research, India Ratings & Research, “The decline is a reflection of the domestic cost of borrowing becoming attractive compared to foreign currency borrowings on a fully hedged basis.” According to the RBI, the average rate of interest for fixed-rate foreign loans was in the 0 to 5.25 per cent range this July, much below the 0 to 13.5 per cent range in 2014-15. The fall in interest rates is also indicative of greater supply and falling demand for these funds. The lower off-take of ECBs is also due to the duress on corporate balance sheets and the fact that the better companies are turning to the local bond markets for their funding requirements.

The fall in borrowing can be attributed to excess capacity of Indian corporate sector and currency volatility, said Soumyajit Niyogi, associate director at India Ratings and Research. He also pointed out that smaller companies were also raising money through venture capital and private equity route instead of using the ECB route. Excessive leverage of large companies have also satiated their appetite for further foreign borrowing, he said. Jayesh Mehta, head of treasury at Bank of America-Merril Lynch, said the lower borrowing number was a reflection of the low credit appetite seen in the domestic market. Major borrowers from the foreign market are also absent because of the softening of commodity prices.

Conclusion

From the above anlaysis we could see that the trend of ECBs has witnessed a slight decline from the year 2012, but the decline is very small and their is an increasing trend in the last two years. This trend may continue if the ECBs rates are cheaper and the government liberalizes the rules and procedures for raising funds. As mentioned earlier ECBs are not only

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considered for low interest rates, but due to other factors like liquidity, term of loan and ease of availability. So ECBs are going to be a major source of finance for Indian corporates in the years to come.

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