Raising Foreign Resources: Challenges and Opportunities

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Mr Modi clearly faces an uphill task as he takes charge to fulfill aspirations, expectations and wishes of billion plus Indians, fuelled by the fundamental theme of 'Development' on which the electorate gave such resounding vote of confidence in his leadership.

Coming weeks and months would undoubtedly witness many steps taken by new regime – some big & transformational and many small but extremely effective. These will be in various directions and issues but the ones most closely watched will be those related to development – involving capital investments, taxation and ease of doing business in India.

It is clear that to kick start the economy, create employment and gainfully deploy funds for schemes like MNREGA, massive investments (on lines of Keynesian theory) will have to be made in industry, particularly infrastructure.

It would also mean that while on one hand RBI would have to opt for interest rates to be lowered at the risk of inflation for sometime, on the other, the increase in demand for funds would put enormous pressure on interest rates domestically due to inadequate supply of funds locally.

As a consequence, to meet the massive requirements of funds needed to rejuvenate Indian industry and infrastructure at reasonable cost, we have to necessarily (just as other developing economies did earlier on) look for offshore capital – both equity and debt. An indirect advantage of large inflow of foreign exchange in India would be a strong rupee which would help reduction in inflation due to lower import cost. This would go a long way in meeting the twin objective of balancing growth & inflation.

Needless to say, in anticipation of business friendly steps that the new Government is likely to take, global investors have clearly given a thumbs up indicating their willingness, eagerness and if I may say a bit of an urgency to invest large capital in India. The last one about "urgency" is being fuelled by unambiguous pronouncements by respected and responsible long term investors (like Rakesh Jhunjhunwala & Mark Mobius amongst others) about India being on the threshold of the biggest possible bull run, etc. etc.

The fact that the global investors are indeed in some urgency can be gauged by the following :

1. Sensex has jumped from 22600 to 24200 in May 2014.
2. Total FII inflows during last one month into India was USD 5.7 Bn, highest in last 27 months.
3. The yields for offshore bonds issued by Indian companies have tightened by an average 20 basis points since announcement of election results.
4. Twin bonds issued by Bharti Airtel just before announcement of exit poll results on 13th May, whereby it raised USD 1 Bn in USD denominated bonds and Euros 750 Mn (approx. USD 1 Bn) in Euro Bonds were cumulatively oversubscribed 8 times generating an overall whopping demand of USD 16 Bn. The unsatiated demand and subsequent election results have already resulted in increase in value of those bonds by approx.5% in just a fortnight post issue.

Considering our need and the willingness of global investors to invest large capital in India, the new government in tandem with industry must ensure that all challenges and impediments to raising large foreign resources commensurate with size and potential of our economy are quickly removed. A few thoughts in this regard for all four major sources of foreign capital i.e.

(a) Debt capital
(b) Equity investment under FDI
(c) Equity investment from FIIs
&
(d) NRI repatriations

are given below :

I. Debt Capital : Debt inflow in India (ECBs or External Commercial Borrowings) are currently allowed under following routes :

(a) ECAs (Export Credit Agencies)
(b) FIIs (Foreign Institutional Investors)
(c) Debt Capital Markets
(d) Other ECBs (External Commercial Borrowings)

Debt from global investors would without a doubt be the major source of funding for our development needs going forward. This segment is also the deepest globally in terms of size and if tapped properly would be an endless source of funding for Indian projects.

All the above categories of ECBs are governed by specific schemes and rules of RBI and contain several restrictions. Some of these are as under:

- Eligible Borrowers
- Eligible lenders
- Maximum amount
- Minimum maturity (tenure)
- Maximum interest payable
- End use
- Prepayment

I feel it is about time that most of the restrictions as existing are relaxed in varying degrees to enable Indian corporates to avail of large pools of capital.

Some specific suggestions are as under :

1. **Eligible Borrowers** : Instead of a long list of ineligible borrowers, the only criteria for effective monitoring and to mitigate risk of defaults should be the following :
   (i) Should be a corporate entity
   (ii) Minimum net worth
   &
   (iii) Eligible covenant like net debt : EBITDA & / or net debt : equity.

2. **Eligible Lenders** : Besides existing recognized lenders, any global lender that meets KYC criteria of RBI, should be an eligible lender.

3. **Maximum Amount** : Restriction on maximum absolute amount per borrower be ideally removed (or at least increased to at least USD 3 Bn per borrower per annum) under automatic route and should be replaced by amount eligible based on prudential covenants like maximum net debt : EBITDA and/or net debt : equity.

4. **Minimum Maturity** : General minimum average tenure should be reduced from five to three years to ensure larger participation and to allow Indian Corporates to spread maturities over varied periods.

5. **Maximum Interest Payable** : To begin with, the present general limit of 500 bps over libor need to be relaxed by at least 250 bps to enable smaller companies to get access to foreign funds. Over time of course, rate of interest must be left to borrower & lender as in case of local borrowings.

6. **End Use Restrictions** : By and large, every legitimate & lawful industry & company should have the freedom to have access to foreign capital. The negative list, if necessary from security angle, needs to be small.

7. **Prepayment** : There is absolutely no reason for any restriction on prepayment in general and for at least post minimum maturity in particular. In case of adverse foreign exchange position, RBI can always retain the right to introduce such restriction.

II. Equity Investments under FDI : FDI needs to be liberalized based on the principle that FDI is generally welcome in every sector except for a small negative list (which could primarily be based on security concerns, if any). Elaborate provisions mandating restriction on foreign ownership to prevent control of foreigners and ensure control in Indian hands are futile because majority with Indians does not ensure control of Indians and conversely minority shareholding by foreigners cannot prevent their control if some Indian shareholders are willing to cede it. In addition, restrictions on benign sectors like Retail (which even remotely do not pose any security threat) are uncalled for and send wrong signals about our basic attitude to foreign investment.

III. Equity Investment by FIIs : Registration procedures need to be drastically simplified to attract more FIIs. Also, we need not be too fussy about investments by way of Participatory Notes (P Notes) which are accepted globally, since the investing entity is indeed a registered entity eligible to make such investments.

IV. NRI Repatriations : Huge and unwarranted arbitrage is currently provided on NRI deposits by allowing very high interest rates on foreign currency deposits vis-à-vis interest payable by such NRIs on corresponding borrowings in same currency in their home country. It is common knowledge that virtually all foreign banks indulge in this racket by providing large leverage to NRI borrowers for corresponding deposit with them in India under this scheme. This was clearly being deliberately allowed by RBI to shore up falling FE reserves and supports are no longer required.

I would like to point out that of all the above sources of foreign capital, the one which has maximum potential is the global bond markets. This is the source with tremendous depth across various countries, across various currencies, across various maturities and across varying credit ratings of borrowers.

Unfortunately, this is a path less travelled by Indian corporates. This would be evident by the following facts:

- Only 9 Indian Corporates (excluding PSUs) have outstanding bonds in international markets as of date.

- Total amount raised by such bonds is a mere 18 USD Bn for entire Indian Inc.
- Top 3 Corporates account for 75 percentage of total outstandings (Reliance, Hindalco & Bharti).
- Weighted average remaining period to maturity is only 7.7 years.

As pointed out above, recent bond issues clearly prove deep and strong demand for quality Indian paper across currencies and maturities. All Indian Corporates with good credit must use this source going forward for their funding needs. The fact that only nine Indian Corporate Houses have availed of this source so far is indeed heartening for investment bankers who can expect to be very busy in this market in years to come.