External Commercial Borrowings

External commercial borrowing (ECBs) are loans made by non-resident lenders in foreign currency to Indian borrowers. They are used widely in India to facilitate access to foreign money by Indian corporations and PSUs (public sector undertakings).

The debtors can be the government, corporations or citizens of that country. The debt includes money owed to private commercial banks, foreign governments, or international financial institutions such as IMF and World Bank. For telecom sector, infrastructure and Greenfield projects, funding up to 50% (through ECB) is allowed.

Recently, RBI issued a guideline stating that all eligible borrowers can raise ECB up to USD 750 million or equivalent per financial year under the automatic route (earlier it was applicable only to corporate companies). The Department of Economic Affairs, Ministry of Finance, along with RBI, monitors and regulates ECB guidelines and policies. U.S. dollar-denominated debt remains largest component of the external debt.

The Sahoo Committee report on ECB

- The Sahoo Committee was set up in 2013, to develop a framework for access to domestic and overseas capital markets.
- The Committee made an assessment of the currency risk by Indian firms undertaking ECB.
- The Committee noted that the possibility of market failure can be ameliorated, by requiring firms that borrow in foreign currency to hedge their exchange risk exposure.
- The present complex array of controls on foreign currency borrowing should be done away with.
- The Indian domestic rupee debt market is a viable alternative to foreign borrowing for financing Indian firms and does not entail any market failure. The policy should aim at removal of all impediments to the development of the domestic rupee debt market.

Change in ECB norms:

- It has been decided, in consultation with the Government of India, to
liberalize some aspects of the ECB policy including policy on Rupee denominated bonds

- As per the extant norms, ECB up to USD 50 million or its equivalent can be raised by eligible borrowers with minimum average maturity period of 3 years
- It has been now decided to allow eligible ECB borrowers who are into manufacturing sector to raise ECB up to USD 50 million or its equivalent with minimum average maturity period of 1 year itself.
- Presently, Indian banks, subject to applicable prudential norms, can act as arranger and underwriter for RDB (Rupee Denominated Bond) issued overseas and in case of underwriting an issue, their holding cannot be more than 5 per cent of the issue size after 6 months of issue.
- It has now been decided to permit Indian banks to participate as arrangers/underwriters/market makers/traders in RDBs issued overseas subject to applicable prudential norms.
- The minimum average maturity requirement for ECBs (external commercial borrowings) in the infrastructure space raised by eligible borrowers has been reduced to three years from earlier five years.
- Additionally, the average maturity requirement for mandatory hedging (an investment to reduce the risk of adverse price movements in an asset) has been reduced to five years from earlier ten years.

Advantage of ECBs:

- ECBs provide opportunity to borrow large volume of funds
- The funds are available for relatively long term
- Interest rate are also lower compared to domestic funds
- ECBs are in the form of foreign currencies. Hence, they enable the corporate to have foreign currency to meet the import of machineries
- Corporate can raise ECBs from internationally recognized sources such as banks, export credit agencies, international capital markets

Disadvantages

- The growing importance of ECBs in the composition of external debt is a cause of concern for the Indian economy. Availability of funds at a cheaper rate may bring in lax attitude on the company’s side resulting in excessive borrowing.
- This eventually results in higher debt on the balance sheet which may affect many financial ratios adversely.
- Higher debt on the company’s balance sheet is usually viewed negatively by the rating agencies.
• This may result in a possible downgrade by rating agencies which eventually might increase the cost of debt.

• Effect on earnings due to interest expense payments.

• Since the repayment of the principal and the interest needs to be made in foreign currency, it exposes the company to interest and currency fluctuations.

• Companies may have to incur hedging costs or assume exchange rate risk which if goes against may end up negative for the borrowers.

Is it Enough?

• Largely, rupee depreciation is based on a number of external factors which India couldn’t control like U.S Fed rate hike, spiralling trade war between USA and China, and because of election year and the related uncertainty about results in India etc. But, tweaking of ECB norms is a small step in the direction of correcting rupee fall further and also it will help the Indian companies working abroad to attract foreign currency more.