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Environment for Corporate Fund Raising in India

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The pace of economic growth has been slowing in India. As per the first advance estimates of the national income released by the National Statistical Office (NSO) in early January, the real GDP growth for Fiscal Year 2019 (April 2019 -March 2020) will slow-down to 5.0% (6.8% for FY2018), the lowest in the past 11 years. In addition to a stagnant rise in employment and income, declining financial intermediation function, associated with tight liquidity triggered by the issue of Non-Performing Assets (NPAs) in the commercial banks and the credit crunch problems of non-bank financial institutions, seems to have contributed to suppressing activities of the private sector. The government has introduced since last year a series of measures like tax cuts and infrastructure investment programs to prop up its economy while the Reserve Bank of India (RBI) implemented five interest-rate cuts (135 basis points in total) between February 2019 and October 2019. To improve financial intermediation function, the government has been promoting capital injection to and integration of the state-owned banks, together with improvement of framework for quick disposal of NPAs.

Some of the major monthly indicators have shown a sign of bottoming out of the economic slow-down since the closing days of 2019, as industrial production for November 2019 increased 1.8% year on year, picking up for the first time in the previous four months, and business confidence described in PMI exceeded in December the expansion-or-contraction line of 50%, for the second straight month. Yet, the NPA ratio of commercial banks remained high at 9.3% as of end-September with a rising trend of that for non-bank financial institutions at 6.3%. Bank loans continued to grow at a slower pace. These show that the recovery of financial intermediation function is still half way through and we have to be cautious about the future of the Indian economy.

In such circumstances, it is noteworthy that the companies in India have been increasing their funding from overseas. While the bank borrowings that used to be mainstream means of fund raising of companies remain stagnant, inflows of foreign capital in the form of foreign direct

investments (FDI) and external commercial borrowings (ECB)[1] tend to support business activities of the Indian companies (Figures 1 and 2). It is likely that in addition to positive growth prospect expected in the medium-to long-term, deregulation of FDI and ECB and lowered borrowing costs reflecting the prevailing low interest rates also have contributed to an increase in their external borrowing. As for ECB, deregulation has been promoted since 2018 like expansion of business sectors of eligible borrowers, easing of application conditions for lenders, and shortening of minimum average maturity period on a certain condition. In March 2019, restrictions were removed on the residual maturity requirement and investment limit regarding foreign portfolio investments (FPI) through voluntary retention route (VRR).

By economic sector of borrowers, manufacturing and finance stand out (Figure 3). Their use of funds includes a high share of "refinancing" and "on-lending /sub-lending" in addition to "investment" (Figure 4). Since the middle of 2018 when the problems of non-bank financial institutions were brought to light, housing finance companies accelerated their fund raising for the purpose of refinancing and on-lending/sub-lending. The protruding figure of the borrowings for March 2019 was mainly represented by the local major companies like Export-Import Bank of India (total US$650 million for the purpose of "on-lending" and "working capital"), Indian Railway Finance Corporation Ltd. (US$500 million for "infrastructure development"), National Thermal Power Corporation (NTPC, US$450 million for "infrastructure development"), also swelled by such foreign big players as Xiaomi Technology India Private Limited, a Chinese smartphone giant (US$290 million for "working capital"), and ArcelorMittal India Private Limited, a European steel giant (US$500 million for "other purpose"[2]).

Expansion of ECB is expected to bring such merits as diversification of funding tools to borrowers and to lenders dispersion of risk assets that are unevenly concentrated in domestic banks. However, it is mainly big local companies and multinationals that can make use of these ECB and it is the actual situation that the funding situation is still severe for most of the SMEs in India. It is essential for India to further improve its domestic financial intermediation function before the Indian economy can achieve a full-fledged recovery.

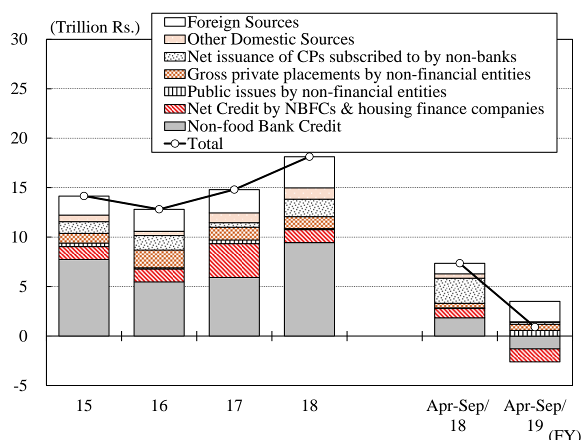
Meanwhile, India's external debt outstanding remains at 20% of GDP in 2019 with short-term debts accounting for about 20% of the total. In addition, debt service ratio and foreign exchange reserves generally show a low risk for its external solvency. However, it should be kept in mind that there is a risk that the debt burdens will increase if the debts increase faster than the economic growth. In its Global Economic Prospects (GEP) published in January this year, the World Bank raised an alarm over the rapid debt accumulation of emerging economies under the slow economic growth and argued that it is essential for them to take "measures to improve business climate, rule of law, debt management, and productivity" to promote a sustained

[1] External Commercial Borrowings (ECB) include commercial loans/ syndicated loans provided by nonresidents, borrowings by buyer's credit, supplier's credit, FCCB, FCEB, non-convertible preference shares, optionally convertible preference shares and securitized instruments (Bonds, CP, FRN, etc.).

[2] It is considered to be a funding intended for the acquisition of Essar Steel India Limited which is in the corporate insolvency resolution process under Insolvency and Bankruptcy Code.

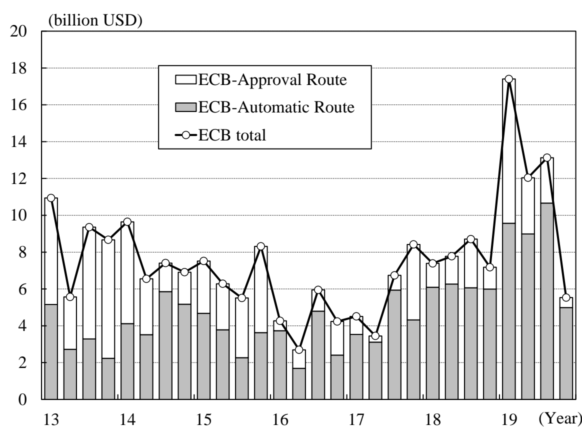
growth. In India, the second Modi administration has been promoting “Make in India” initiative, a program to facilitate investment and build best-in-class manufacturing infrastructure, and making efforts to improve business climate through reforms of law and taxation system, promotion of deregulations so as to achieve its goal to raise India’s economic scale to a level of US$5 trillion in the coming several years. Still, further reforms of its financial and capital markets will be required to attract more funds that play a key role for an expansion of infrastructure investment and private investment.

Figure 1: Flow of Financial Resources to the Commercial Sector



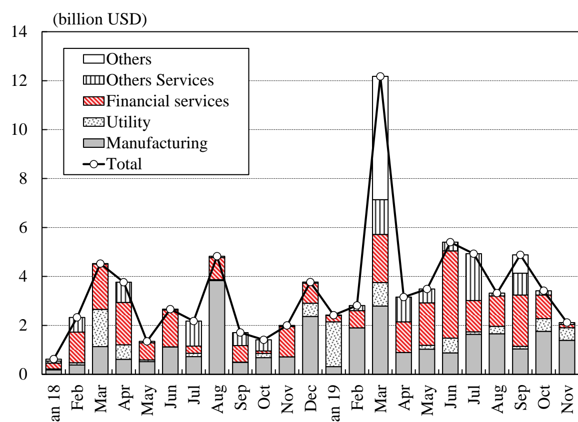
Note: "Foreign Sources" includes ECB, Short-term credit from abroad and FDI.
Source: RBI

Figure 2: External Commercial Borrowings (ECB)



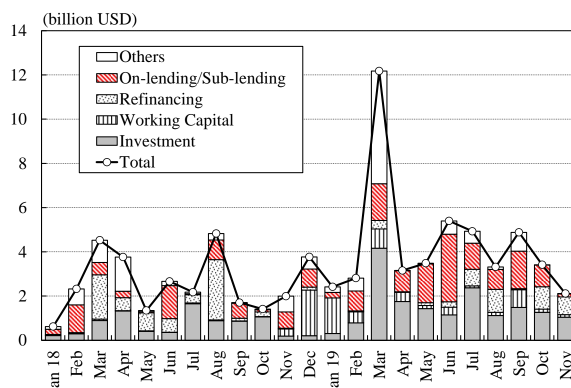
Note: The latest figure is as the sum of amount in October and November 2019.
Source: RBI

Figure 3: ECB by Economic Sector of Borrower



Note: "ECB" includes bank borrowing and foreign currency convertible bonds.
Source: RBI

Figure 4: ECB by Purpose



Note: 1) "Refinancing" includes that of earlier ECB and Rupee loans.
2) "Investment" includes import of capital goods, investments for modernisation, new poject and Infrastructure development.
Source: RBI

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