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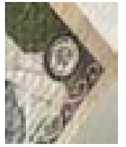
Funding corporate India
Opportunities in international financial markets

An Economist Intelligence Unit briefing paper

Sponsored by Bank of America



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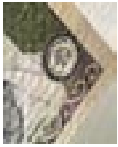

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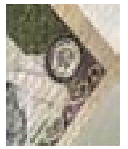

Preface

Funding corporate India: opportunities in international financial markets is a briefing paper by the Economist Intelligence Unit and sponsored by Bank of America. The report is based on a series of interviews with financial experts, government officials and companies involved or interested in the Indian and international financial markets.

The findings and views expressed in this report are those of the Economist Intelligence Unit alone.

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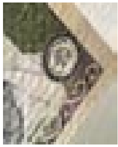

Executive summary

The searing pace of India's economic growth has prompted businesses to go in for revamps or new operations. For this, they need money, which they are seeking in financial markets at home and, increasingly, abroad. Indian companies have traditionally been conservative, relying on their profits and bank loans for funding. But in recent years, they have begun to look outwards, lured by the international financial markets that are cheaper, quicker and nimbler than the old, high-cost domestic ones. The easing of regulations on loans has offered further encouragement.

As a result, India has surged ahead of other Asian emerging markets in terms of growth of private inflows from equity and debt issued and loans raised overseas by Indian companies. Average annual growth over the past five years was 51%, and in fiscal 2005/06, overseas borrowings and equity issues together totalled US$16bn, up 75% from the previous year.

Funding corporate India: opportunities in international financial markets is an Economist Intelligence Unit briefing paper sponsored by Bank of America. It aims to explore the reasons behind corporate India's overseas financial foray, and look at the instruments they favour. It also examines the challenges and benefits for Indian businesses seeking financing overseas. The briefing paper is based on a series of interviews with financial experts, government officials and companies involved or interested in the domestic and international financial markets. The main points of the paper include:

- **Indian companies increasingly are seeking cheaper, quicker loans overseas.** This foray into international financial markets has been made easier by regulatory reform that has provided further opportunities to choose lower-cost international money over old, high-cost domestic loans. Indian companies searching for funds overseas are drawn from a range of industries from automotive to financial, although some sectors like infrastructure clearly have deep funding requirements. For example, Tata Power, India's largest private-sector power producer, raised US$200m in February 2005 with a five-year foreign currency convertible bond (FCCB). State-owned companies directly or indirectly involved in infrastructure have also raised large amounts of external commercial borrowings (ECBs).

- **The usual debt instruments are syndicated loans and bonds, but Reliance has been the first to enter the US private debt placement market.** Indian companies have used a number of instruments to raise pure debt, ranging from various types of bonds to the traditional 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).

- **Overseas equity issues via ADR/GDR have surged.** The start of India's economic reforms in the early 1990s led to a flood of overseas equity issues via American depositary receipts (ADRs) and global depositary r eceipts (GDRs). In fiscal 2005/06, these increased fourfold in amount raised over the previous year. Domestic public issues and private placement deals have also shown healthy growth. Public issues, covering initial public offerings and

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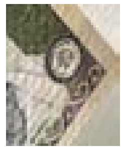

rights issues, swelled by 51% in value between April 2005 and February 2006, compared with the same period the previous year. Private placement funds grew by 38%. However, the surge in overseas ADR/GDR equity issues has resulted in their share of total funds raised via public issues, private placement and overseas equity issues, rising from 4% to 10% over the period. If private placements are not considered, ADR/GDR issues account for a much greater proportion of equity funds raised—28% between April 2005 and February 2006.

- **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 programmes to expand capacity, modernise and/or diversify. Strong export demand has been aided by a 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.

- **An easing of regulations has also facilitated borrowings and equity issues abroad by Indian companies.** The Indian government and its central bank, the Reserve Bank of India (RBI), have streamlined and liberalised 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 liberalised over the past few years and unsurprisingly are much less restrictive than those towards ECBs and FCCBs.

- **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 their balance sheets. In July 2006, further liberalisation 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.

- **Why look overseas?** Not only have interest rates in international financial markets been lower than those in Indian markets, but Indian companies also 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

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increasing in importance as Indian companies conduct more and more business outside the country.

- **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, modernisation, 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.

- **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. Standard & Poor's rates India's foreign-currency debt are below "investment grade" while Fitch raised its rating to investment grade, in August 2006. While 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.

- **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. It is likely that offshore funding will become more prevalent as India's savings-investment gap widens in 2007, and demand for investment funds continues to exceed domestic savings into the foreseeable future.

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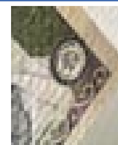


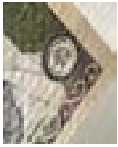
Introduction

What is driving India's corporate lust for overseas financing? 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.

Over the past five 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 Indian 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.

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.

Which are the key corporate players in India looking at accessing financing overseas? What are the most popular instruments with them? What is driving the trend towards borrowing abroad? What are the risks and opportunities in such financing? *Funding corporate India: opportunities in international financial markets,* a briefing paper sponsored by Bank of America, aims to answer these and other questions about corporate India's overseas financial foray.



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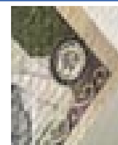


Instruments to go international

When Indian companies began to tap overseas markets in a big way in the 1990s, cost was a major driver in their decision. Regulatory reform has since provided further opportunities to choose lower-cost international money over old, high-cost domestic loans. There are other reasons for going overseas—for example, listing on an international stock exchange gives potential clients a degree of comfort regarding the transparency and overall management quality of a company.

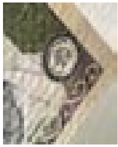
Debt, equity and a bit of both. In terms of overseas financing, official data are separately available for India's external commercial borrowings (ECBs) and overseas equity issues via American depositary receipts and global depositary receipts (ADRs and GDRs, respectively). The ECB figure is not, however, further broken down to reveal the proportion of foreign currency convertible bonds (FCCBs) compared with medium- and long-term borrowings. Unlike straight debt, FCCBs have both debt and equity characteristics since they give the holder the option of converting foreign-currency debt into equity. It is somewhat misleading for them to be included in the "borrowings" figure since, if converted, they will no longer need to be repaid. Thus, an increase in popularity of FCCBs will lead to repayments declining.

As regards pure debt, Indian companies have utilised a number of instruments to raise such debt. The traditional and popular way has been through the syndicated loan market, with a set of banks getting together to finance a company as a group and then syndicating the loan to a number of other banks. Another route to raise pure debt has been through various types of bonds (which differ in terms of documentation, tenor and access to investors). Also, up until now, with the exception of Reliance Industries, Indian corporations have not entered the US private placement debt market where investors selectively consider only "investment grade" companies (based on high credit ratings).

ECBs and FCCBs. In recent years, debt's share (including FCCBs) of overseas financing raised has ranged from 84% in fiscal 2005/06 to 93% in 2004/05. Disbursements, new borrowings and bond issues by Indian companies exceeded repayments in these two years, as well as in 2000/01. The latter, however, was atypical because it was the fiscal year in which a five-year India Millennium Deposit Scheme was launched for non-resident Indians. Had it not been for the US$5.5bn collected under the scheme, introduced to stabilise India's then balance-of-payments position because of hardening crude-oil prices, 2000/01 would have seen repayments exceed disbursements. Between 2001/02 and 2005/06, ECB disbursements climbed by 50% per year to almost US$13.5bn by 2005/06.

ADRs and GDRs. The launch of India's economic liberalisation in the early 1990s triggered a spate of overseas equity issues via ADRs and GDRs, with 2005/06 witnessing a fourfold jump in the amount raised over the previous year. However, the average amount raised per issue has been low, at around US$50m.

Growth in domestic public issues and private placement deals has also been robust. Specifically, public issues, covering initial public offerings and rights issues, grew by 51% in value between April 2005 and February 2006, compared with the corresponding period in the previous fiscal year (the number of such issues rose by almost three times). In the case of private placements, funds raised grew by 38%. However, the faster growth in overseas ADR/GDR equity



issues has resulted in their share of total funds raised via public issues, private placement and overseas equity issues rising from 4% to 10% over the period. If private placements are not considered, ADR/GDR issues account for a much greater proportion of equity funds raised—28% between April 2005 and February 2006.

The Indian companies searching for funds overseas cut across a range of industries from automotive to financial, although some sectors elicit greater government interest. Infrastructure is clearly among the favourites, and has deep funding requirements. Bharti Tele-Ventures, an Indian telecommunications giant, raised a US$225m loan in August 2005. With a final maturity of 4.5 years, the loan was priced at Libor plus 70 basis points. Tata Power, India’s largest private-sector power producer, raised US$200m in February 2005 with a five-year FCCB carrying a 1% coupon, a 3.88% per year yield to maturity, and a conversion premium of 50%. State-owned companies directly or indirectly involved in infrastructure have also raised large amounts of ECBs. These include National Thermal Power Corporation, Power Finance Corporation and the Indian Railway Finance Corporation.

Some sectors have shown more initiative than others in tapping overseas markets—the pharmaceuticals industry, for example. In February 2006, Ranbaxy Laboratories raised US$400m with an issue of zero-coupon FCCBs, which the company claims is the single-largest capital-raising exercise by an Indian healthcare company. The money is being used to fund Ranbaxy’s acquisitions and its capital-expenditure programme. Soon after the issue, the company used a large part of the FCCB proceeds to acquire Terapia, a leading Romanian pharmaceuticals company. Companies in basic industries, like steel and petrochemicals, have also demonstrated a strong hunger for ECBs, given their large investment needs. Tata Steel raised a syndicated seven-year term loan of US$750m in August 2006 to finance capacity expansion as well as future acquisitions. The loan was priced at Libor plus 54 basis points. Reliance Industries, the petrochemicals giant, has been one of the largest Indian borrowers of funds in international markets (*see case study*, Reliance Industries: relying on offshore borrowings).

Financial intermediaries and institutions have also actively raised foreign funds. Housing Development Finance Corporation (HDFC), India's largest housing finance company, placed US$500m worth of five-year, zero-coupon FCCBs in August 2005. HDFC says this represented the largest-ever convertible-bonds offering by an Indian issuer at the time. The Export-Import Bank of India (Exim Bank) has also periodically raised ECBs for on-lending to support Indian exports. The company recently issued ¥23bn Samurai bonds in Tokyo—the first Indian Samurai bond issue in 15 years, according to Exim Bank. The five-year issue was priced at 62 basis points over Yen Libor.

Other companies that have raised substantial ECBs include Mahindra & Mahindra (automotive), Panacea Biotec (biotechnology), Associated Cement Companies (cement), Aditya Birla Nuvo (diversified company), Indian Hotels Company (hospitality), Cranes Software (information technology), Ballarpur Industries (paper), Hindustan Petroleum (petroleum), Great Eastern Shipping (shipping), and Mahavir Spinning Mills (textiles). Many of these companies have also issued ADRs and GDRs, as have Dr Reddy’s Laboratories, Gas Authority of India, Grasim Industries, Gujarat Ambuja Cements, ITC, ICICI Bank, Infosys Technologies, Mahanagar Telephone Nigam, Satyam Computer Services, UTI Bank and Wipro. The list is long and diverse.

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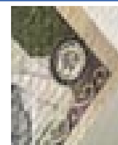


Major sources of funds for Indian industry
Value (Rs bn)

	2004/05	2005/06	% growth
Bank credit to industry	620.1	1,221.7	97.0
New capital issues*	104.7	126.6	21.0
Profit after tax	396.0	607.5	53.4
Depreciation provision	227.0	250.1	10.2
ECBs (disbursements)	384.0	595.6	55.1
ADR & GDR issues	27.5	113.0	310.3

* by non-government public limited companies
Source: Computed from Reserve Bank of India data

Total funds raised by Indian companies through ECBs, ADRs and GDRs*: going up
(US$m)

	ECBs	ADRs/GDRs	Total	% annual growth
2001/02	2,684	477	3,161	
2002/03	3,505	600	4,105	29.9
2003/04	5,228	459	5,687	38.5
2004/05	8,546	613	9,159	61.1
2005/06	13,451	2,552	16,003	74.7

* ECBs = external commercial borrowings ADRs = American depositary receipts GDRs = global depositary receipts
Source: Computed from Reserve Bank of India data

Funds raised by Indian companies through ECBs*
(US$m)

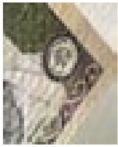
	Disbursements	Repayments	Net
2000/01	9,621	5,313	4,308
2001/02	2,684	4,272	-1,588
2002/03	3,505	5,206	-1,701
2003/04	5,228	8,153	-2,925
2004/05	8,546	3,506	5,040
2005/06	13,451	11,860	1,591

* ECBs = external commercial borrowings
Source: Reserve Bank of India

Funds raised by Indian companies through ADRs and GDRs*
(US$m)

	US$m	Number
2000/01	831	13
2001/02	477	5
2002/03	600	11
2003/04	459	18
2004/05	613	15
2005/06	2,552	43**

* ADRs = American depositary receipts GDRs = global depositary receipts
** relates to the 11-month period Apr 2005 to Feb 2006
Source: Reserve Bank of India



Comparing ADR/GDR issues by Indian companies with domestic equity issues

	Apr 2004 to Feb 2005		Apr 2005 to Feb 2006		% change	
IPOs* & Rights	No of issues	Amount (Rs bn)	No of issues	Amount (Rs bn)	No of issues	Amount (Rs bn)
1 Issues	46	170.38	118	256.49	156.5	50.5
Of which:						
Private sector	43	120.2	111	198.63		
Public sector	3	50.18	7	57.86		
2 Private placement	654	488.88	780	672.88	19.3	37.6
Of which:						
Private sector	533	255.43	672	295.47		
Public sector	121	233.45	108	377.41		
ADR/GDR equity						
3 Issues	11	26.06	43	100.99	290.9	287.5
Share of 3 in 5 (%)	1.5	3.8	4.6	9.8		
Share of 3 in 4 (%)	19.3	13.3	26.7	28.3		
4 Total of 1 & 3	57	196.44	161	357.48		
5 Total of 1, 2 & 3	711	685.32	941	1,030.36		

* Initial public offerings
Source: Computed from Reserve Bank of India data

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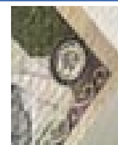


Corporate India's appetite for capital

Dynamic companies in India are hungry—for customers, new markets and growth. This has given them an insatiable appetite for investment funds, and is driving their recent exercises to raise foreign currency. Data from the Reserve Bank of India (RBI) on external commercial borrowings (ECBs) approved during fiscal 2004/05 reveal that 80% of these issues (by value) were to fund new projects, source necessary capital goods and expand/modernise existing capacity. Indeed, many companies are making investments to achieve international competitiveness. And global finance is one stepping stone towards that global goal.

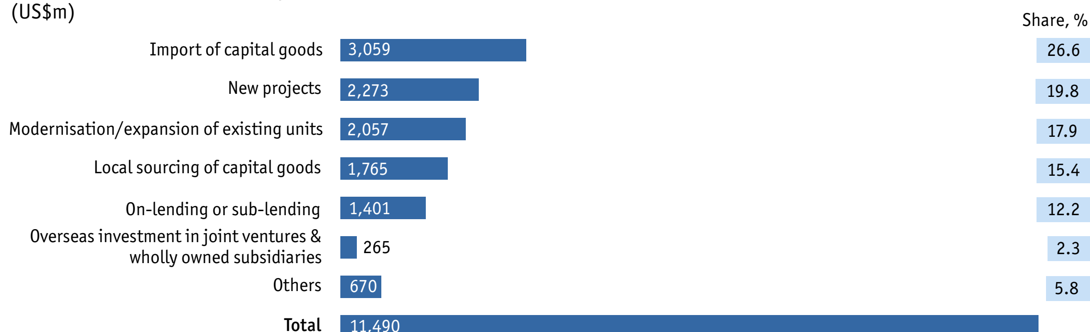
Domestic and export demand

What's driving the dramatic growth in investment activity? One force is undoubtedly the rising domestic and export demand, especially in the industrial and infrastructural sectors. This demand has fuelled business optimism and led to the implementation of investment programmes to expand capacity, modernise and/or diversify. Strong export demand has been aided by the buoyant expansion of world trade and internationally competitive Indian companies have been able to take advantage of the improved trading environment. At the same time, robust economic growth at home has driven domestic demand, with India's GDP expanding by about 8% annually between 2003/04 and 2005/06. 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.

Investment activity in the corporate sector is also robust—imports of capital goods almost tripled to US$14.1bn in 2004/05 from US$5.9bn in 2001/02, reflecting an increase of 34% per year. Growth in imports of capital goods has continued at a heady pace during 2005/06 as well, surging by 48% between April and December 2005 compared with the corresponding period in 2004. Growth in output of the domestic capital goods sector has also been high, indicating buoyant investment activity. During 2002/03 to 2005/06, growth in the index of industrial production of the domestic capital goods sector averaged 14% per year.

To implement the large number of investment programmes requires massive financing, which is coming from home and now increasingly from overseas as well. The use of domestic funding

Approvals of ECBs during 2004/05: where the money is going
(US$m)



Source: Computed from Reserve Bank of India data

Reliance Industries: relying on offshore borrowings

Reliance Industries, the Indian petrochemicals giant, takes its corporate motto "Growth is Life" rather seriously. Over the years, this behemoth—with turnover of US$20bn in 2005/06—has relentlessly pursued a strategy of backwards vertical integration and diversification. As a result, the company has spread its activities from petrochemicals, fibres, yarn and fabrics to include oil-and-gas exploration and production, and petroleum refining and marketing. Frequent raising of resources has been critical to support the company's hectic pace of growth.

Reliance has shown a clear bias towards international financial markets in its fund-raising activities. For example, about 63% of the company's US$3.7bn in long-term debt was foreign-currency-denominated at the end of March 2006. The company also issued global depositary receipts during the 1990s. Besides the relatively low cost of borrowing in offshore markets compared with domestic markets (even on a fully hedged basis), there is another important factor behind Reliance's preference for overseas debt: a large part of both revenues and expenditure are either in foreign currency or linked to international prices. (Reliance is India's largest exporter according to revenues, which totalled US$7bn in 2005/06.) Even domestic prices of petroleum products sold by the company within India are strongly influenced by international prices and exchange rate movements. At the same time, Reliance imports a huge amount of crude oil. Hence, A V Rajwade, an expert on international finance and foreign exchange management (and a former member of the Reserve Bank of India's committee on fuller capital-account convertibility) considers Reliance's major business to be really a "dollar business" and says that it makes more sense for the company to raise money in dollars than in rupees.

Hunger for syndicated loans

In recent years, syndicated-loan markets have been the main source of capital for Reliance. During 2005, for example, an aggregate amount of about US$1.26bn was raised via four-term loans. This financing was both for raising fresh money—primarily for funding capital expenditure—and for refinancing older debt to take advantage of a lowering of spreads, which was brought about by strong offshore market liquidity and the increased level of interest in India attracting newer investors. At the same time, there continues to be a very good appetite for Reliance paper in offshore markets. Spreads for lending (excluding fees) more than halved between March 2004 and September 2005, declining from as much as 90 basis points over Libor for a US$250m loan to 37 basis points over Libor for a US$348m transaction a year and a half later.

Reliance's continued hunger for syndicated term loans is well illustrated by a jumbo-sized fund-raising exercise, totalling US$1.5bn, launched by its subsidiary, Reliance Petroleum, in August 2006. The company claims that this is India's largest ever offshore syndicated loan financing. The proceeds will finance a new 580,000 barrels per day refinery and a polypropylene unit.

A recent departure from borrowings through syndicated loans was Reliance's issuance in March this year of ¥17.5bn (US$150m) worth of Euro-Yen bonds, carrying a coupon of 2.86%. The ten-year tenor of the company's first bond transaction in the offshore markets since the late 1990s was considerably greater than the five-to-seven-year tenor available in the syndicated loan market. Mr Rajwade points out an additional advantage of borrowing in Yen—since the yen interest coupon is low, the withholding tax imposed by the Indian authorities on interest paid is also very low. Another example of a long (9 to 10.5 years) tenor loan was a €116.2m export-credit-agency-backed buyer's credit facility announced in December 2004.

First of its kind

In September 2006, the company raised US$300m of debt in the US private placement market—the first such transaction by an Indian company. This transaction included maturities of 10 and 12 years, considerably longer than those for syndicated loans. The issue was led by Bank of America Securities, ABN Amro and HSBC, and purchased by ten large US insurance companies. Until now, modest Moody's and S&P credit ratings had reduced the attractiveness of this market to Indian issuers. During 2005/06, Reliance's credit rating was upgraded by these two agencies, making the pricing attractive enough for the company to consider raising funds in this market.

Alok Agarwal, chief financial officer of Reliance Industries, says that accessing the US private placement market increases the company's financial flexibility and extends the average maturity of its debt. He also notes that this transaction has provided Reliance with the opportunity to establish partnerships with some of the large institutional investors in the US.

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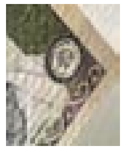

India's index of industrial production of domestic capital goods: robust activity
% growth

Source: Central Statistical Organisation

such as bank credits, new capital issues, internal resources from corporate profits and depreciation provisions has risen substantially over the past year. At the same time, offshore fund-raising has also expanded rapidly, offering advantages in terms of cost, speed and depth of international financial markets. These benefits were strong reasons for Tata Motors, for example, to look to raise funding overseas instead of at home for its expansion plans (*see case study,* Tata Motors: on the road with convertibles).

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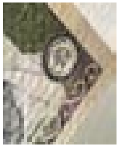

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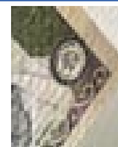

Government policy

Underpinning the surge in fund-raising overseas is government policy. Liberalisation of the regulatory framework has facilitated borrowings and equity issues abroad by Indian companies, which now have better access to international financial markets. The “automatic route” for companies to raise up to US$500m, subject to certain conditions, has stimulated growth in external commercial borrowings (ECBs). K P Krishnan, a joint secretary in the Ministry of Finance, points to the “automatic route” as a major step in the liberalisation of ECB policies. This automatic route applies to all companies—except financial intermediaries, such as banks, financial institutions and housing finance companies.

The government and India’s central bank, the Reserve Bank of India (RBI), have streamlined and liberalised ECB procedures and policies in order to promote companies’ access to international financial markets. At the same time, policies on overseas equity issues have been relaxed and are currently much more liberal than those on ECBs and foreign currency convertible bonds (FCCBs). The finance ministry’s guiding principles have been to keep ECB “borrowing maturities long and costs low”. While facilitating the raising of overseas borrowings, the government has nonetheless sought to maintain prudent limits as ECBs constitute a key component of India’s overall external debt.

ECBs and FCCBs. The easing of government control over ECBs—including FCCBs—has been ongoing since 1999. The situation was very different then. At that time, eligibility to raise relatively large ECBs—of up to US$200m—was restricted to large exporters, those implementing large infrastructure projects and greenfield projects, and development finance institutions/intermediaries. Even they were subject to a number of conditions. For instance, exporters could only raise ECBs up to three times the average amount of annual exports during the last three years. In addition, all companies and institutions were permitted to raise ECBs up to a maximum of only US$5m. All applications needed to be approved by the RBI or Ministry of Finance.

Today, as long as certain conditions are met, companies do not need government approval to raise ECBs of up to US$500m annually for investment in the industrial and infrastructure sectors (*see box*, Major conditions governing external commercial borrowings). The “approval route” applies to cases that fall outside the purview of these limits. It also applies to ECBs of other types of borrowers such as financial institutions, banks and housing finance companies.

ADRs and GDRS. Policies towards American depositary receipts (ADRs) and global depositary receipts (GDRs) have also been continuously liberalised over the past few years and unsurprisingly are much less restrictive than those towards ECBs and FCCBs. As Rakesh Mohan, deputy governor of the RBI, points out, ADRs and GDRs are “risk money”, with all the risk being borne by the portfolio investors rather than the companies. In principle, it makes no difference whether the portfolio investment is in Indian companies listed in India or overseas. From the macro-risk management point of view, foreign portfolio investment is treated the same regardless of where the shares are issued.

Since ADRs and GDRs are considered foreign investment, a basic requirement is that they conform to rules governing sectors where foreign direct investment (FDI) is permitted and to the

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maximum permissible share of foreign equity. These regulations have undergone radical reform in recent years. For example, 100% FDI is permissible in a large number of sectors, and ceilings on foreign equity exist only in a few sectors such as insurance, telecommunications, banking and media. Also, end-use restrictions on GDR/ADR issue proceeds are limited to a ban on stock market and real-estate investments.

Bank instruments. January 2006 saw another major policy liberalisation. From that month onwards, Indian banks have been permitted to issue innovative perpetual debt and debt capital instruments in foreign currency for raising capital funds for capital adequacy purposes. Such expansion in bank capital is needed to meet Basel II capital requirements as well as to support growth in their balance sheets. In July 2006, further liberalisation was introduced by dispensing with the need to obtain prior approval of the RBI for such issues on a case-to-case basis. Indian companies stand to benefit from such raising of capital funds by Indian banks since it improves the capacity of banks to lend to the corporate sector both domestically and overseas. Already, ICICI Bank and UTI bank have taken

Larsen & Toubro: financial engineering

Shankar Raman, executive vice-president (finance) of Larsen & Toubro, states that economics prompted the engineering company to raise funds overseas rather than at home. Besides availing itself of low interest rates, Larsen & Toubro was able to give investors the "upside on stock conversions". This was quite attractive for investors, given the company's healthy order book, strong execution capabilities, robust business and interest in investment for further growth.

Indeed, a November 2004 issue from Larsen & Toubro (L&T) has been almost fully converted. The US$150m issue, one of two tranches of foreign currency convertible bonds (FCCBs) since 2004, carried a 1.25% coupon, a yield to maturity of 4% and a maturity of five years. The bonds, listed on Hong Kong's stock exchange, are redeemable at a premium and convertible at a 35% premium over the market price of Rs831.70 on the date of issue. The share price has moved well ahead of the conversion level and investors who converted gained handsomely from the appreciation in the company's stock prices.

The second FCCB—a yen-denominated bond of US$100m—was issued in early January 2006. L&T claims that it was the first yen-denominated convertible bond issue to be launched in India. The yield to maturity on the zero coupon, five-year bonds was only 0.65%, reflecting low interest rates in Japan. They are convertible at a 35% premium over the price on issue date (Rs1,850.70). By comparison, some Indian companies issued FCCBs at premiums of 50% to 60%. According to Shankar Raman, the company's strategy of pricing deals fairly and sensibly has been an important reason for strong investor support. He says L&T "did not want to squeeze the investors bone dry", leaving "some money on the table" so that whenever the company went back to the market, it would be well received.

It is likely L&T will need to do just that as it expands capacity at its manufacturing plants, develops its information technology and engineering businesses, and makes acquisitions overseas. Given its focus on projects, capital goods and information technology, L&T has benefited considerably from the buoyancy in investment and growth that has characterised the Indian economy in recent years. Between fiscal 2002/03 and 2005/06, revenue has grown at an average annual rate of 27%. Overseas earnings currently account for nearly one-fifth of L&T's total revenue as the company has expanded overseas.

L&T has also raised funds through global depositary receipts listed on the Luxembourg Stock Exchange a decade ago, in 1994 and 1996. According to Shankar Raman, the company gained visibility from these issues and, since its strategy is to increase international business, broadening its shareholder base beyond Indian investors was important. Another advantage is that the company now has a better understanding of what global investors expect in terms of benchmarks and performance parameters. About one-quarter of L&T's stock is held by international investors, although this proportion is likely to increase.

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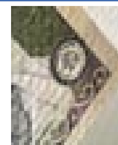


advantage of the RBI's liberalised guidelines, raising resources overseas through perpetual bonds and medium-term notes in August this year. Sanjeev Bajaj, managing director and country treasurer of Bank of America in India, thinks that in coming years there will be more hybrid issuances from corporates in addition to banks. And more innovations in such instruments, especially if there are further changes to the laws and regulations which result in different classes of equity in India (currently, all equity holders are treated on par).

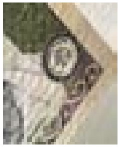
Although most established Indian companies do not seem to have problems with the overall framework and implementation of government policy on ECBs/FCCBs and ADRs/GDRs, there are some reservations. For example:

- The restrictions on interest spreads prevent many second-tier companies from raising ECBs, notes Arvind Sonmale, managing director and chief executive of Global Trade Finance, a trade financing company which focuses on small and medium-sized enterprises.
- Shankar Raman, executive vice-president (finance) of Larsen & Toubro (L&T), believes that there should be greater flexibility for the end-use regulations on a case-by-case basis. He argues that equity investments in companies that L&T has set up specifically for an infrastructure project, for example, should be allowed use of FCCB proceeds. ECB policy permits usage for acquisitions abroad and for investment in acquiring public-sector enterprises being divested domestically, but prohibits any other equity investments in the domestic market. The implicit reasoning is that the latter are speculative and do not add to the productive capacity and/or foreign-exchange earning capability of the economy. This is not necessarily the case. Mr Raman notes that not only are the projects developing badly needed infrastructure, but that L&T is bound by infrastructure concession agreements to hold equity for long periods (of 15 to 30 years).
- Likewise, financial institutions would like more freedom to raise resources. N Shankar, executive director of the Export-Import Bank of India (Exim Bank) notes, for example, that allowing his organisation to raise ECBs under the "automatic route" would save the time it takes to obtain regulatory approval.

A committee set up by the RBI in consultation with the government in March 2006 to look into

Major conditions governing external commercial borrowings

- **Average maturity.** External commercial borrowings (ECBs) of up to US$20m should have a minimum average maturity of three years. ECBs above this value should have a maturity of at least five years.
- **Interest rate spreads.** For average maturities of between three and five years, the spread over six-month Libor (including other costs and expenses) should not exceed 200 basis points (2%). For average maturities over five years, the ceiling is 350 basis points.
- **End-use restrictions.** Domestically, ECBs can only be raised for investment, such as the import of capital goods, new projects, modernisation / expansion of existing production units, in the "real" sector, including the domestic industrial and infrastructure sectors. They cannot be used for acquiring a company in India, except for acquiring shares in enterprises being privatised by the government.
- **Utilisation of ECB proceeds.** It is not permissible to use ECB proceeds for investment in the capital market, for working capital, general corporate purposes, repayment of existing rupee loans, and for investment in real estate. However, refinancing of existing ECBs by raising fresh loans at lower cost is permitted, subject to the condition that the outstanding maturity of the original loan is maintained. As far as raising money offshore for offshore purposes, ECBs can be utilised for overseas direct investment in joint ventures and wholly owned subsidiaries.



fuller capital-account convertibility made several recommendations, which were made public in September 2006. These include:

- Raising the limit for automatic approval to US$750m per year in 2007/08 and 2008/09, and US$1bn per year in 2009/10 and 2010/11
- Removing end-use restrictions on ECBs
- Raising the overall annual limit on ECB authorisations (US$18bn in 2005/06) gradually from 2007/08 onwards
- Omitting ECBs of over 10 years' maturity from the annual maximum, where they do not have call/put options within the first ten years
- Placing ECBs of over seven years' maturity outside of the annual maximum (where they do not have call/put options within the first seven years) from 2007/08 to 2010/11.

The RBI's press release relating to the committee's report stated that it is still to be processed and that measures may be taken from time to time, keeping in view the roadmap suggested by the committee in addition to evolving circumstances, domestically and internationally. It will take some time for the authorities to decide on the committee's recommendations. However, given India's comfortable external-payments position, the possibility of further liberalisation in ECB policy appears bright.

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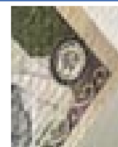

Why look overseas?

Compared with raising funds in the domestic market, international financing is typically cheaper and provides depth in terms of opportunities for larger size transactions and higher tenor. In many cases, it is also easier and faster.

Lower interest rates. In the case of pure borrowings, the compulsion to raise funds overseas is driven by interest rate differentials. In March 2006, short-term interest rates in the US and Japan were 4.77% and 0.04%, respectively, compared with 6.11% in India. In the same month, long-term interest rates in the US and Japan were 4.6% and 1.8% respectively. A comparable rate for India was 7.4%.

Not only have interest rates in international financial markets been low in recent years, but the perception of exchange rate risk has altered among Indian companies, according to Rakesh Mohan, deputy governor of the Reserve Bank of India (RBI). An improved tolerance for such risk has been a further factor encouraging the use of external commercial borrowings (ECBs), which expose issuers to exchange-rate risk since repayment of the principal and interest is in foreign currency. Prior to 2002, the Indian rupee was in an almost continuous decline against the US dollar. Since then, however, the currency has moved in both directions, giving companies greater confidence that it will retain its value. The rupee has even appreciated modestly since 2002. According to Mr Mohan, Indian companies have reduced their assessment of their exposure to exchange-rate risk, thereby lowering the risk premium in the cost of borrowing. Indeed, there are instances where Indian companies can raise money offshore, bring it back to India, hedge it completely and still find that the cost is cheaper than it would be to raise debt domestically.

In the case of foreign currency convertible bonds (FCCBs), the option to convert enables pricing at relatively low yields. The coupon rate for issues by Tata Motors and Larsen & Toubro ranged from zero to 1.25%, for example. The yield to maturity has also been low, mostly below 4% and even negative in a couple of cases. Such good terms are on offer because investors have been strongly attracted by the upside in conversion to equity, in addition to the protection available up until conversion—which can occur once the shares have significantly exceeded the conversion price.

Hedging benefits. As Indian companies become increasingly global, many have large exports or foreign-currency receivables. A number have also set up operations in foreign countries, either on their own or by acquiring foreign firms. Hence, it makes sense for them to borrow in a variety of currencies, acting as a hedge in terms of revenues and expenditures.

Less documentation, faster approval. Additionally, the documentation and regulatory approval processes for overseas financing are often quicker and easier than they are for raising funds domestically. Tata Motors was able to raise US$400m within three-and-a-half weeks in April 2004 on international markets. The same exercise would have taken at least three months on the domestic market, according to Praveen Kadle, executive director (finance) at Tata Motors.

Indeed, the convenience factor is a major reason for companies to tap the overseas equity and debt markets. This has caught the attention of the Securities and Exchange Board of India (SEBI), the country's watchdog agency for the capital market. It is taking measures to enable companies to raise money speedily at home. It is likely that these changes will some time.

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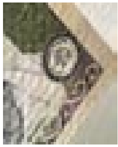

Greater flexibility. Depending upon their needs and financial strategy, companies have been able to structure issues appropriately, with FCCBs offering enormous flexibility in terms of structuring the issues. The widely varying nature of the FCCB issues of Tata Motors and Larsen & Toubro are proof.

Greater visibility. Moreover, just as international investors seek to diversify by investing outside their home markets, Indian companies gain from diversifying their sources of funding. 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 gaining in importance as Indian companies conduct more business outside the country. For Tata Motors and Larsen & Toubro, raising their profile overseas was an important benefit of their issues of American and global depositary receipts (ADRs and GDRs). Fortunately for India's ambitious companies, growing domestic competition has nudged them towards better governance and efficiency. This has made it easier for them to attract overseas interest in international markets.

Tata Motors: on the road with convertibles

Historically, Tata Motors' bread and butter have been commercial vehicles. The Indian automotive company's rugged, reliable trucks and buses dominate Indian roads. They've also become increasingly prevalent overseas, with 11% of Tata Motors' total output being exported in the year ended March 31st 2006. As the company broadens the market for heavy vehicles overseas, however, it has been diversifying its product range at home by offering compact cars that are value for money.

To enhance capacity, develop new models and buy capacity overseas, Tata Motors has introduced nimbler financing techniques. Since 2003, the automaker has issued US$600m worth of foreign currency convertible bonds (FCCBs). A large share of the proceeds from an April 2004 issue, for example, went towards financing the acquisition of Daewoo Commercial Vehicles, the second-largest manufacturer of trucks in South Korea.

Tata Motors' FCCB issues have had several unique features, says Praveen Kadle, the company's Mumbai-based executive director for finance. For example, the second tranche of the April 2004 US$30m FCCB issue was the first in India with a maturity of seven years (the usual maturity was five years or less). Moreover, the conversion premium for this issue—of 60% over market price on the day of issue—was the highest in the Asian market at that time. The second tranche's yield to maturity was 3.75% compared with the first tranche, which was geared towards conversion into equity with a modest conversion premium of only 17.5%. The conversion premium for the most recent issue was 30%.

Tata Motors' FCCB issues: several unique features

	July 2003	April 2004 (Tranche 1)	Apri l 2004 (Tranche 2)	Feb 2006
Size of issue	US$100m	US$100m	US$300m	¥11.76 bn (i.e. US$100m)
Coupon rate (% p.a.)	1	0	1	0
Conversion rate per share (Rs)	250.75	573.11	780.40	1001.39
Redemption period	5	5	7	5
Redemption amount (compared with principal)	Premium of 16.82%	Discount of 4.89%	Premium of 21.78%	Discount of 0.15%
Stock exchange listing	Luxembourg	Singapore	Singapore	Singapore

Source: Tata Motors

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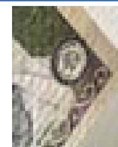

The search for alpha

For many foreign portfolio investors, India is a market with potential for high returns but one that also carries risks. Now that Indian companies are increasingly listing on stock exchanges overseas, foreign portfolio investors are much less worried. The prospect of earning alpha—or returns in excess of those expected, given the perceived risk of an investment—has proved enticing.

India, like other emerging markets, has witnessed rising portfolio investor interest in recent years, due to its strong economic performance and high returns. Indeed, private external flows to emerging markets have grown at an extremely high rate, averaging 40% per year between 2003 and 2005. Flows through equity issuances have been the most buoyant, averaging 69% per year over the same period. With its sound fundamentals and potential for high returns, India's story has been one of the most interesting among the emerging markets. Between 2003 and 2005, private external flows to India grew by 158% per year, nearly four times the rate for all emerging markets. This rapid influx of foreign capital resulted in overseas institutional investors

Low cost of borrowing

The cost of borrowing with these FCCB issues has been extremely low. Coupon rates have either been zero or 1%, and the yield to maturity for both the first tranche of the April 2004 issue and a February 2006 issue has been negative. The cost of debt has been minimised, thanks to the strong demand from investors attracted by the prospects of capital appreciation from shares they obtain through conversion.

Good timing has been an additional factor in the success of Tata Motors' FCCB issues. For example, the company issued FCCBs in April 2004, three weeks before the Indian parliamentary election results were announced. After the results were known, the Indian stock market crashed and took about six months to recover. During this period, Indian FCCB issues almost completely dried up.

According to Mr Kadle, several factors prompted Tata Motors to raise funds in the international market rather than at home. Most important was the low overall cost of these overseas instruments. So far, average borrowing costs have been at least 200 to 300 basis points lower than domestically raised funds would have been at those times, says Mr Kadle. The documentation process and regulatory approvals have also been much easier in the international market compared with the domestic, saving a company 30 to 60 days, in his opinion. Moreover, the international market provides greater depth than the domestic market, and much greater flexibility in pricing and structuring of instruments.

Following through with its penchant for overseas funding, Tata Motors in September 2004 decided to convert all outstanding GDRs (global depositary receipts) it had issued in 1996 into ADRs (American depositary receipts) by listing on the New York Stock Exchange. The conversion was a secondary listing and did not result in any fresh finance being raised. For Tata Motors, the main reasons for the New York bourse listing were to provide better opportunities for overseas investors to put their money in the company, enhance the company's presence in global securities markets, gain a broader capital market access through the listing, and adopt more comprehensive governance practices and standards.

So what are Tata Motors' fund-raising plans for the future? All Mr Kadle will say is that as a growing company planning to introduce new products and expand manufacture of old ones, Tata Motors will continuously explore financing options, either through internal accruals or external resources.

Like Tata Motors, India's other automakers are likely to be hankering for funds for capacity expansion, product development and overseas acquisitions. There is enormous potential for growth in India's automotive sector, given the low penetration rate of vehicles. The size of these investments, the cost and timing of fund-raising will be critical to corporate profitability. The indications are that the international markets are likely to play a significant role in meeting the auto industry's financing needs.

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becoming the driving force behind the Indian capital market.

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, modernisation, and mergers and acquisitions at home and abroad. As a result, the BSE Sensitive Index of share prices surged from a high of 3,513 points during fiscal 2002/03 to a high of 11,307 points during 2005/06.

The booming capital markets have greatly enhanced foreign investors' interest in foreign currency convertible bonds (FCCBs), American depositary receipts and global depositary receipts issued by Indian companies. Investors were willing to take a call on the buoyant Indian stock market. Initial FCCB issues saw investors who had converted their bonds into equity gain handsomely from the appreciation

Genpact: financing independence

Funding the leveraged buy-out (LBO) of the largest Indian business process outsourcing (BPO) firm represents a new trend in international financing for India's corporate sector. From its establishment in 1997 to 2004, Genpact was fully owned by General Electric and was known as GE Capital International Services (Gecis)—which was a captive firm for GE servicing the BPO requirements of GE's 11 business units.

As Gecis grew in size, experience and capabilities, GE's management realised that as an independent company it could obtain business from companies other than GE and thus increase its value. In late 2004, GE sold 60% of its stake for US$500m to two US private-equity firms, General Atlantic Partners and Oak Hill Capital Partners. The deal was completed in December 2004.

Some debt liability on Genpact

A substantial part of the private-equity firms' acquisition cost was met through an LBO debt transaction of US$180m. An unusual feature of the transaction was that the debt raised by the two firms was placed in the books of Genpact rather than that of the shareholder. Thus, some of the debt liability falls on GE, which continues to hold 40% of Genpact's equity.

The deal was complicated by the fact that the company has assets in several countries outside of India (including China, Hungary and Mexico), posing financial consolidation issues.

To solve this, the money was borrowed by a special entity outside India. The five-year loan was priced at 132 basis points over Libor. Three banks—Bank of America, Citibank and Goldman Sachs—were involved as book runners and primary underwriters. A number of multinational banks participated in the syndication and the financing was oversubscribed.

Sanjeev Munjal, treasurer of Genpact, says that much of this debt was "back loaded" in that the company could repay most of the principal towards the fourth or fifth years of its duration—freeing up cash flows in the initial years of its independence. The idea being that, as the company grew its business, it would only be able to pay back a smaller portion during the initial years and a greater proportion as it raised more cash through operations. Mr Munjal says that the LBO transaction went off smoothly, though the timing was tight; there were just about 50 days to complete the deal.

On a "pretty strong wicket"

One-and-a-half years after the LBO, in June 2006, Genpact decided to refinance the debt in order to further reduce the interest cost and build a "kitty" for acquisitions. According to Mr Munjal, the company had exceeded the projections presented to the bankers for the earlier deal and was on a "pretty strong wicket" in asking for refinancing. Additionally, the interest rate in the market had declined, enabling the company to shave about 50 basis points off the pricing, constituting a significant saving over the life of the five-year loan. Further, Genpact has increased its funding facility to US$250m via the refinancing. Having repaid part of the earlier debt, Mr Munjal says that there is only US$150m left as principal yet to be repaid, with the rest for financing acquisitions such as the purchase in August 2006 of MoneyLine, a US company that provides outsourced mortgage services.

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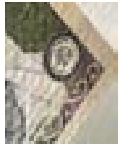

in stock prices. Major investors in Indian FCCBs include specialised convertible bond funds, fund managers, private banking accounts (including high net worth individuals) and banks.

Meanwhile, a large number of international banks from all regions have been eager to lend to Indian companies. India's impeccable record in servicing its external debt has helped to ensure foreign investors' interest in lending to Indian companies at relatively modest spreads.

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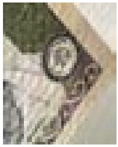

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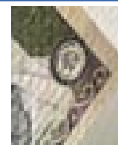


Opportunities and constraints

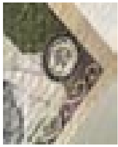
India's high economic growth has emboldened the country's policy makers in formulating future targets. GDP growth during the Tenth Five-Year Plan (fiscal 2002/03 to 2006/07) is expected to average 7% per year, only slightly lower than the target of 8%. An internal paper by India's Planning Commission recommends that the target be revised upwards to 8.5% for the 11th Five-Year Plan (2006/07 to 2011/12). In order to meet the preliminary target, the investment-to-GDP ratio will have to rise from 28% during the tenth plan to 32-35%.

The Economist Intelligence Unit forecasts a savings-investment gap of 3.4 percentage points in 2006/07, widening to 4 percentage points in the next fiscal year before narrowing to 1.9 percentage points in 2010, as growth in savings outpaces that in investment. Nevertheless, the demand for investment funds is expected to continue to exceed domestic savings. This is not the case in other Asian countries, excluding Thailand and Vietnam. As in the latter two countries, India's relatively high savings rates are overwhelmed by a demand for investment that leads to a need for foreign capital.

India's savings rate is expected to rise to 30.7% in 2010, half-way between those of the Philippines (around 20%) and China (just over 40%). And while domestic savings will finance the bulk of India's investment, foreign direct and portfolio investment will play a key role in filling the savings-investment gap.

It is very likely that Indian companies will continue to raise large amounts of resources overseas in the form of both debt and equity. Recent trends also suggest that there are going to be many more large transactions for the bigger Indian companies. Indian companies are growing in size and ambition, and will continue to look at foreign-currency resources to fuel growth, both for capacity expansion and acquisitions. Moreover, given India's good record of prudent external debt management and the potential for high growth, the country is likely to continue to constitute one of the most favoured emerging markets for foreign portfolio investors. But there are nonetheless a few constraining factors.

Credit rating. One of the biggest has been India's sovereign credit rating, which has affected international financing opportunities for many Indian companies. Standard & Poor's (S&P) rates India's foreign-currency debt as below "investment grade" while Fitch recently raised its rating to investment grade, in August 2006. While some Indian companies have been given higher ratings 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. This is why, in terms of pure borrowings, syndicated loans have been much more common than bonds; the latter being more appropriate for a company with a good rating and thus not demanding much credit analysis. Many Indian companies are also relatively small and would not receive a high enough rating to access international financial markets. However, with the improvements in India's sovereign rating in recent months, the constraint posed by the overall sovereign rating has now diminished in importance, at least for the larger companies. Moody's and Fitch have increased India's rating to investment grade already, with S&P's rating just a notch lower. (S&P upgraded its outlook on India in April 2006.) Vishwavir Ahuja, managing director and chief executive of Bank of America in India, thinks that once S&P's rating also is raised to



investment grade, access to international funding for Indian corporations currently constrained by the sovereign rating will increase dramatically, creating a much more broad-based set of issuers.

The narrowing spread. The hardening of interest rates in global markets in recent years has made foreign borrowings more expensive for Indian companies. The Fed funds rate in the US, for example, was raised from 1% in March 2004 to 5.25% in July 2006. As noted earlier, however, there is still a significant interest differential in favour of borrowing abroad. Also, in the case of foreign currency convertible bonds, the yield can remain low if there are prospects of capital gains.

Exchange risk. An inevitable risk of foreign-currency borrowing is exchange risk, especially when maturities are medium- to long-term. As Indian companies become increasingly global, however, exchange risk has become a way of life. There is no longer any escape from managing both interest-rate, as well as currency, risks. Shankar Raman of Larsen & Toubro notes that many larger Indian companies manage such risks all the time due to their substantial exports, imports and operations in foreign countries. They have become adept at hedging exchange risk through the use of instruments such as forward-rate agreements and currency swaps.

Similarly, interest-rate risk can also be hedged through swaps and purchase of interest rate caps/collars. Policy makers have made such transactions easier by dispensing with the need for prior approval by the government or the Reserve Bank of India (RBI).

SOX et al. The demand for relatively high accounting standards has deterred many Indian companies from US equity issues. The requirements of the Sarbanes-Oxley Act (SOX) may also act as a deterrent in future. As such, it is mainly the large, well-governed firms that have opted for raising resources through American depositary receipts (ADRs) and global depositary receipts (GDRs). In fact, companies like Larsen & Toubro and Tata Motors have welcomed the adoption of better accounting standards and corporate governance practices. Indeed, Praveen Kadle, executive director (finance) at Tata Motors, says his company is on the path to becoming SOX-compliant by March 2007. Since ADRs require higher accounting and disclosure standards, it is not surprising that GDRs are more popular with Indian companies.

Volatility. As noted earlier, an important factor in the success of many FCCB issues was the boom in the Indian stock market in fiscal 2003/04 and 2005/06. By the latter year, however, it was clear that Indian equity was overvalued and considerable volatility set in from May 2006, due to the alternating influences of bearish trends and bullish pressures. According to LC Gupta, director of the Society for Capital Market Research & Development, volatility on Indian exchanges is relatively high due to systemic factors which encourage speculation.

In the short run, the recent downturn in the market will affect international fund-raising by Indian companies in equity and/or equity-linked products. Most companies have come to accept such volatility as part of the game. As a result, the right timing of issues, as well as the market and instrument chosen, will continue to be critical in determining their success.

Limits to external indebtedness? For his part, Rakesh Mohan, the RBI's deputy governor, does not believe the recent rapid growth in foreign borrowings by Indian firms is worrying because India has a "pretty comfortable external debt situation". For instance, by end-March 2006, the country's foreign-exchange reserves had exceeded external debt by US$26.4bn, giving a ratio of reserves to total debt of 121%.

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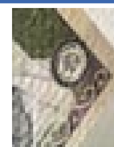


India compared with Asian countries

How does India compare with its Asian neighbours in terms of international financing? IMF data on private external flows can give an idea. These data include private capital flows to both companies and government entities, and therefore are not comparable with official Indian data.

The IMF information, however, illustrates the sudden emergence of Indian companies as leading players in international financial markets. Between 2001 and 2005, private external flows to India through new issuances of bonds, equities and loans grew at a rapid rate of 88% per annum (in US$ terms), the fastest rate of any Asian emerging markets. The comparative growth rate for Asia overall was only 14%. In terms of value, India, with inflows of US$19.3bn in 2005, was third after China and South Korea.

As for funds raised through loan syndication, India led Asia in both 2004 and 2005. It was third behind Russia and Turkey among the world's emerging markets, with inflows of US$8.4bn in 2005. Funds raised through loan syndication by Indian entities grew at an annual rate of 66% during 2001 to 2005, compared with a mere 9% for the region.

As regards external financing through bond issues, inflows into India have been very dynamic, with growth as high as 244% per year during 2001 to 2005—the highest among all Asian countries. This growth was almost ten times the corresponding figure for Asia as a whole (23%). In terms of value, India—with inflows of US$4.2bn in 2005—occupied third spot after South Korea and Hong Kong.

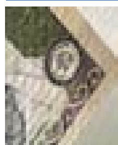
External funds raised through equity issues by Indian entities have also been impressive. During 2001 to 2005, these grew at the average annual rate of 114%, compared with 33% for Asia. In value terms, India, with inflows of US$6.6bn in 2005, ranked fourth in the region, after China, Taiwan and South Korea. However, the gap between India and Taiwan and South Korea was narrow, with inflows to the latter two countries totalling US$7.6bn and US$7.1bn, respectively. (India's ranking remains at No 4 among global emerging markets in terms of overseas equity issues because Asian countries have been the most dynamic.)

That India is a leader among Asian countries in the international equity markets is evident in how active it is in the markets for American depositary receipts (ADRs) and global depositary

Private external flows to emerging markets through new issuances of bonds, equities and loans

	2000	2001	2002	2003	2004	2005	Average 2003-05	Average for India, 2003-05
Bond issuance value (US$m)	80,475	89,037	61,647	98,778	135,513	182,633		
Annual growth (%)		10.6	-30.8	60.2	37.2	34.8	44.1	388.5
Equity issuance value (US$m)	41,773	11,246	16,359	28,296	45,219	78,158		
Annual growth (%)		-73.1	45.5	73.0	59.8	72.8	68.5	220.8
Loan syndication value (US$m)	94,155	61,855	69,389	72,192	106,216	145,907		
Annual growth (%)		-34.3	12.2	4.0	47.1	37.4	29.5	108.9
Total: bonds, equities and loans value (US$m)	216,403	162,138	147,396	199,266	286,948	406,698		
Annual growth (%)		-25.1	-9.1	35.2	44.0	41.7	40.3	158.4

Source: Computed from IMF data



receipts (GDRs). The Bank of New York in its 2005 Yearbook on *The Depositary Receipt Markets* shows that India in end-2005 led its neighbours in terms of the number of ADR and GDR programmes it made available to investors. Indian companies had 185 programmes, followed by the UK (which had 154) and Australia (119). India was also the top country in terms of new programmes in 2005, establishing 36 of 163 new programmes. In terms of capital raised, however, India ranked fourth (with US$4.5bn) behind Taiwan (US$6.8bn), the UK (US$5.5bn) and South Korea (US$4.8bn).

Private external flows to Asian countries through new issuances of bonds, equities and loans
(US$m)

	2000	2001	2002	2003	2004	2005	Average annual growth (%) 2001-05
Asia	**85,881**	**67,483**	**67,201**	**87,968**	**123,719**	**150,388**	**14.3**
China	23,063	5,567	8,892	13,590	24,368	35,797	32.6
South Korea	14,230	17,021	14,694	17,237	24,424	34,463	21.2
India	2,224	2,382	1,381	4,094	13,918	19,316	88.1
Hong Kong	21,046	18,307	12,602	9,056	13,555	15,307	-1.9
Taiwan	6,704	3,794	10,959	18,149	15,309	11,701	34.4
Singapore	6,080	10,384	3,810	6,793	9,170	9,273	24.4
Malaysia	4,506	4,432	5,597	5,729	7,031	6,255	7.7
Philippines	5,022	3,659	5,458	5,454	6,286	5,877	6.1
Indonesia	1,283	965	974	5,110	3,731	5,309	83.2
Thailand	1,573	684	1,927	2,357	4,071	4,548	46.4

Source: Computed from IMF data

Private external flows to Asian countries through loan syndication
(US$m)

	2000	2001	2002	2003	2004	2005
Asia	**29,812**	**22,023**	**32,257**	**27,510**	**36,311**	**38,882**
India	1,208	1,816	963	2,344	5,100	8,449
South Korea	5,793	5,588	6,434	4,483	3,671	7,926
China	1,053	415	5,743	5,142	4,965	5,819
Hong Kong	10,899	7,552	7,793	2,950	4,702	4,025
Malaysia	3,087	2,267	2,826	4,149	4,729	3,217
Singapore	1,544	1,093	2,356	1,287	2,070	2,434
Thailand	1,441	181	1,823	1,019	1,573	1,826
Philippines	2,360	1,816	673	1,654	1,713	1,441
Taiwan	1,054	515	2,421	743	4,699	1,200
Indonesia	1,255	493	318	3,493	1,832	808

Source: IMF

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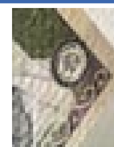

Private external flows to Asian countries through new bond issuances
(US$m)

	2000	2001	2002	2003	2004	2005
Asia	**24,501**	**35,869**	**22,533**	**35,779**	**52,121**	**53,566**
South Korea	7,653	7,756	6,706	11,531	17,529	19,412
Hong Kong	7,059	10,459	1,952	2,626	3,700	6,458
India	100	99	153	450	4,881	4,227
Singapore	2,334	8,665	562	4,337	4,628	4,203
China	1,771	2,342	603	2,034	4,888	3,954
Philippines	2,467	1,842	4,774	3,800	4,458	3,900
Indonesia	n.a.	125	375	609	1,364	3,218
Taiwan	1,698	2,152	5,481	9,130	7,260	2,898
Malaysia	1,420	2,150	1,880	963	1,415	2,303
Thailand	n.a.	279	48	300	1,400	2,243

Source: IMF

Private external flows to Asian countries through new equity issuances
(US$m)

	2000	2001	2002	2003	2004	2005
Asia	**31,568**	**9,592**	**12,411**	**24,680**	**35,287**	**57,940**
China	20,240	2,810	2,546	6,413	14,515	26,024
Taiwan	3,952	1,127	3,058	8,276	3,350	7,603
Korea	785	3,676	1,554	1,223	3,223	7,124
India	917	467	265	1,300	3,938	6,640
Hong Kong	3,089	297	2,858	3,480	5,153	4,824
Singapore	2,202	626	892	1,169	2,473	2,636
Indonesia	28	347	281	1,008	535	1,284
Malaysia	n.a.	15	891	618	887	735
Philippines	195	n.a.	11	n.a.	115	536
Thailand	132	225	56	1,039	1,098	480

Source: IMF

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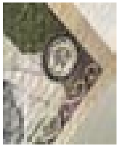

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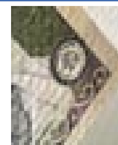

Conclusion

Corporate India's surging demand for funds from abroad is driven by its huge need for investment. An easing of government policy and international investors' buoyant interest in India are facilitating the ability of companies to access these funds. Prospects for further easing in government policy are bright, as a committee appointed by the Reserve Bank of India recently submitted recommendations for a major liberalisation in this area during the next few years. As Indian companies continue to grow at a sizzling pace, a virtuous circle of mutual interest is reinforced.

At the same time, this market is deepening and widening as more companies realise the advantages of overseas financing. International money is relatively low cost, quick to raise and issues are structured innovatively according to precise requirements. Moreover, for many Indian companies, raising money overseas serves to enhance their international profile, an important consideration for burgeoning multinational companies.

Additionally, the recent upgrading of India's rating by international credit rating agencies and the likely further improvements in rating will undoubtedly result in a major opening up in access to international funding for many companies that have been constrained by sovereign rating.

It is likely that offshore funding will become more prevalent as India's savings- investment gap widens in 2007, and demand for investment funds continues to exceed domestic savings into the foreseeable future. This is not the situation in other Asian markets, however, suggesting that India will continue to outpace other Asian markets in new issuances of bonds, equities and loans.

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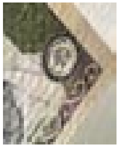

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