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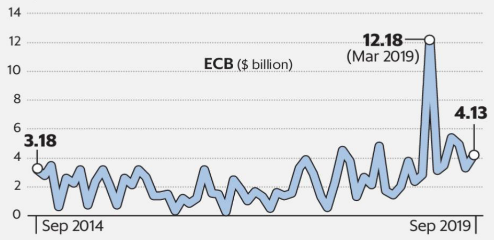
Funding route

Businesses in India have started tapping the ECB market as global interest rates decline. In the first six months of FY20, they raised over $24 billion.



Source: Bloomberg

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External commercial borrowings of firms jump 50% in Apr-Sep

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External commercial borrowings (ECB) of Indian companies jumped nearly 50% in the six months ended 30 September from a year ago, thanks to cheaper overseas funds, easier overseas borrowing norms and weakened local banks.

Corporates borrowed $24.3 billion from overseas markets in the first six months of FY20, showed data from the Reserve Bank of India (RBI) compiled by *Bloomberg*. This compares with $16.46 billion and $9.68 billion raised in the first six months of FY19 and FY18, respectively.

To be sure, despite this shift, banks are still the single-largest source of funds for businesses, and ECBs made up just 12% of their total borrowings in FY19. However, bank credit growth has been subdued so far this year, with outstanding non-food credit growing 8.8% year-on-year (y-o-y) to ₹97.68 trillion in the fortnight ended 25 October.

According to a 6 November report by CARE Ratings, it needs to be seen if bank credit picks up in the rest of FY20 when economic activity generally tends to be higher, to ascertain the extent of substitution, if any, in the sources of external funds of businesses.

"The constrained and relatively high-cost lending of domestic banks and financial institutions on account of stressed asset quality, heightened risk aversion and strained liquidity conditions has, in part, been counterbalanced by the low interest rate regime in the international markets," said Kavita Chacko, senior economist, CARE Ratings.

The CARE report said companies from the financial services sector continue to dominate external borrowings, accounting for nearly 47% of the value of ECB in the first six months of the current fiscal, up from 35% a year ago.

Recent instances include HDB Financial Services Ltd ($300 million), L&T Housing Finance Ltd ($60 million), Bajaj Finance Ltd ($575 million) and Home Credit India Finance Pvt. Ltd ($112 million) in September 2019.

Another interesting trend is that companies are mostly using this route for their working capital requirements. In September alone, of the 117 entities that raised money, 45 needed working capital.

"The primary reason for corporates to seek funding from ECB is the better pricing they are getting. With the currency becoming slightly strong and the hedging costs becoming cheaper, the all-inclusive cost is still lower than raising money in India," said Ajay Manglunia, managing director and head of institutional fixed income at JM Financial.

The CARE report said that of the total ECBs raised during April-September 2019, nearly 65% fell in the 3-5 years maturity bracket and less than 10% of borrowings were for tenures of over 10 years, indicating ECBs are not relied upon for financing longer duration projects.

Banks are still the source of funds for firms, and ECBs made up just 12% of their total borrowings in fiscal 2019

Others believe that an RBI regulation that aims to de-risk the banking sector for concentrated corporate exposure could be limiting banks' ability to fund large businesses.

According to Soumya Kanti Ghosh, group chief economic adviser, State Bank of India (SBI), the large exposure framework may be acting as a constraining factor in bank lending to such entities and hence they are tapping the ECB route. The RBI regulations, which came into effect on 1 April, mandate that banks limit their exposure to 25% of their capital for connected parties.

"As far as the non-banking financial companies (NBFC) sector is concerned, though the banks expanded their lending in the first half of FY20, the markets seemed to have lost appetite in funding of NBFCs, even the commercial papers (CPs). Subsequently, a large part of NBFCs are tapping the ECB route mostly for onlending," Ghosh wrote in a report on 16 October.