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Funding Foreign Subsidiaries In India Through External Commercial Borrowings

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It is needless to say that the largest democracy in the world presents itself as a great business opportunity for global economies write Krrishan Singhania, Managing Partner and Founder, K. Singhania & Co.and Mr. Rohan Tyagi, Associate, K. Singhania & Co.

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Funding Foreign Subsidiaries In India Through External Commercial Borrowings

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Introduction

Since the liberalisation of Foreign Direct Investment (FDI) during 1980-91, India has seen sharp increase in investments through a bundle of funding instruments, both- equity and debt-based. An Indian entity has a variety of debt and equity options available today for funding its operations through offshore investors. One such debt instrument that has captured traction recently is External Commercial Borrowing ("ECB"). ECB are commercial loans that an eligible entity in India can raise from foreign investors. In light of the recent relaxation issued by Reserve Bank of India ("RBI"), ECB has positioned itself as an attractive option for Indian entities seeking funding from foreign investors. This article aims to give a brief about the Indian legal framework regulating ECBs. It further argues why debt-based funding option such as ECB should be preferred over other financing options as it provides a win-win situation for both, the investor and the investee.

Framework of ECB

All the transactions in foreign currency are regularised by the central bank of India, the RBI. RBI's Master Direction[1] issued in March 2019 (and updated till June 9, 2022) entails a series of norms that must be complied with by an eligible entity to raise ECB. ECB can be raised both in Foreign Currency ("FYC") and Indian Rupees ("INR"). We have listed below a few important factors that must be taken care of by the Indian entities and the foreign investors who seek to raise ECB:

1. Eligibility and recognition of the foreign investors

Investors based in the member states of The International Organization of Securities Commissions ("IOSCO") or residents of Financial Action Task Force ("FATF") member states are recognised by the Reserve Bank of India (RBI) as an eligible lender. For instance, USA, UK and EU are member states of both, the IOSCO and the FATF.

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2. Eligibility of the Indian entities

Any entity eligible to receive Foreign Direct Investment ("FDI") under the FDI Policy of 2020 is also eligible to raise ECB addition to this, all the registered entities engaged in micro-finance activities, viz., registered Not for Profit companies, registe societies/trusts/ cooperatives and Non-Government Organisations, are eligible to raise ECB.

3. Forms of ECB

ECB can be raised in the form of a Bank loan, floating/ fixed rate notes/ bonds/ debentures (other than fully and compulsorily convertible instruments like Compulsorily Convertible Debentures (CCD) and Compulsorily Convertible Preference Shares (CCPS); Trade credits beyond 3 years; FCCBs; FCEBs and Financial Lease.

4. Limitation on capital of ECB

All eligible Indian entities can raise ECB up to US$ 750 million or equivalent per financial year. The liability-equity ratio of 7:1 has to be maintained by the Indian entity raising ECB. However, this ratio will not be applicable if the outstanding amount of all ECB, including the new one, is up to US$ 5 million or its equivalent. RBI in its recent press release has temporarily altered the ECB framework to increase the supply of foreign exchange reserves in India. Applicable till December 31, 2022, the foreign investors can issue an ECB equivalent to US$ 1.5 billion instead of US$ 750 million as long as they abide by the guidelines issued by the RBI.

5. Change of currency of ECB

The change of currency of ECB from one freely convertible foreign currency to any other freely convertible foreign currency as well as to INR is freely permitted. However, the inverse is not true. Change of currency of ECB from INR to any freely convertible foreign currency is not permitted.

6. Interest and all-in-cost of ECB

The all-in-cost or the sum of all fee payable to raise an ECB in Foreign currency is benchmark rate plus 500 base points spread. Whereas, it is benchmark rate plus 450 base points for ECB that are raised in INR. As part of the recent relaxations offered by RBI, the all-in cost has also been raised by 100 basis points but this is subject to the investment grade rating of the Indian entity.

7. Minimum maturity for ECB

The Minimum Average Maturity Period (MAMP) of an ECB is 3 years. However, the MAMP would differ based on the specific object of raising ECB.

Why should you choose ECB?

The ECB structure has a number of innate advantages coupled with recent relaxations offered by RBI. For instance, there are many economies with lower interest rates and if Indian businesses and organisations raise ECB from countries based in Europe and the US at lower interest rates, they indisputably stand to gain. They also enable Indian entities to raise large amount of capital for a considerable period of time making it a preferred option for businesses in India.

By raising ECBs, a company's stake does not diminish unlike investing through equity route. Since debtors won't have any voting rights in the Indian entity, the borrowers may raise money without giving up control. However, the foreign investor and the Indian entity can even convert the ECB into equity if they so desire. RBI's master direction provides a framework for the conversion of matured but unpaid debt into equity.

It is advantageous for raising funds through ECB for a company who is either going to import machinery for tools for setting up their operations in India or is earning in foreign exchange. Such a company can meet its liability of repayment of ECB without taking the risk of the fluctuating rate of foreign exchange.

ECBs also give borrowers the ability to diversify their investor base. They also provide borrowers with better access to global markets.

Why ECB over equity route?

ECB structure is far more flexible than funding through equity. It enables the lender and the borrower to decide the terms a conditions of repayment, interest, maturity and other factors like a regular loan agreement. Once investments are ma through equity, the capital remains invested without an assurance of a return whereas by raising ECB, the schedule repayment and its mode and methods can be worked out between the investor and the investee.

As the share capital attracts stamp duty and other government taxes, in a case where large capital is invested in the form equity then the cost of setting up operations in India goes up. However, if a balance between ECB and equity is maintained, th substantial savings can be made on the cost of incorporating a company in India.

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Conclusion

It is needless to say that the largest democracy in the world presents itself as a great business opportunity for global economies. In a landscape where financing of the operations could be overwhelming, ECBs can help Indian entities to raise funds from foreign investors with peace of mind.

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[1] https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11510

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