General Studies-3; Topic-Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

External Commercial Borrowings

1) Introduction

- External commercial borrowing (ECB) is basically a loan availed by an Indian entity from a non-resident lender.
- They are used widely in India to facilitate access to foreign money by Indian corporations and PSUs (public sector undertakings).
- Most of these loans are provided by foreign commercial banks and other institutions.
- In the post reform period, ECBs have emerged a major form of foreign capital like FDI and FII.

2) ECBs in India

- The DEA (Department of Economic Affairs), Ministry of Finance, along with Reserve Bank of India, monitors and regulates ECB guidelines and policies.
- India has always promoted capital inflows as a part of the development policy.
- Unlike China, most of the Indian foreign debt is mainly owned by the private corporate sector.
- ECBs have emerged as one of the chief conduits for strengthening the Indian corporate debt market.
- According to data on ECBs from RBI, it is found that its quantum has grown during the last decade (financial years 2007–17).
- The chief purpose for accessing funds through ECBs has evolved over time, with refinancing being the primary reason in the recent past.
- The government follows a well-designed ECB policy - government puts ceiling for the total amount of ECBs that can be obtained by all Indian firms through the ECB route during a year.
- There are restrictions with regards to end use of the funds too.
- RBI recently liberalised the norms for ECB by including more sectors in the window.

3) Advantages

- ECBs provide opportunity to borrow large volume of funds.
- The funds are available for relatively long term.
- Interest rates are also lower compared to domestic funds.
- It provides access to international markets for the borrowers and gives good exposure to opportunities globally.
- Corporate can raise ECBs from internationally recognised sources such as banks, export credit agencies, international capital markets etc.
- It is a way of raising capital without giving away any control, as debt holders don't have voting rights, etc.
- Avenues of lower cost funds can improve the profitability of the companies and can aid economic growth.
- Due to rising NPAs there is low credit offtake from banks. So ECBs serve the financial needs of the companies.

4) Disadvantages

- The growing importance of ECBs in the composition of external debt is a cause of concern for the Indian economy.

- Availability of funds at a cheaper rate may bring in lax attitude on the company's side resulting in excessive borrowing.
- This eventually results in higher debt on the balance sheet which may affect many financial ratios adversely.
- Higher debt on the company's balance sheet is usually viewed negatively by the rating agencies.
- This may result in a possible downgrade by rating agencies which eventually might increase the cost of debt.
- Effect on earnings due to interest expense payments.
- Since the repayment of the principal and the interest needs to be made in foreign currency, It exposes the company to interest and currency fluctuations.
- Companies may have to incur hedging costs or assume exchange rate risk which if goes against may end up negative for the borrowers.

5) **The Sahoo Committee report on ECB**

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

6) **Conclusion**

- The companies need to be cautious about the exchange rate risk and impact on balance sheet debt to use ECBs effectively.