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Confederation of Indian Industry

Emerging Trends in Corporate Finance

Contents

MESSAGE FROM MD/CEO,
RESURGENT INDIA LIMITED

Over the last one year, India's macro-economic indicators have progressed significantly owing to the overall improvement in the macroeconomic environment such as fall in inflation, rise in forex reserves, softening of global crude oil prices and significant reduction in the current account deficit.

With the resurgence of an improved business environment, corporates are increasingly looking to raise capital to meet their funding requirements. The IPO space is witnessing a surge in activities with growing number of companies looking to raise funds through the IPO route to finance their business expansion / modernization, etc. The recent spurt of reforms by SEBI around faster clearing process, movement towards electronic IPO, favorable norms for listing of SMEs including start-ups is expected to drive greater participation from Indian corporates.

Increased action is being witnessed along other areas as well. The recent launch of the 'Depository Receipts Scheme, 2014' is expected to augment foreign investment and further streamline access to capital for Indian companies. Further, the Government, RBI and SEBI have taken a slew of initiatives to develop the corporate bonds market in India.

The recent introduction of Strategic Debt Restructuring Scheme by RBI, which allows the banks to convert loans into equity, aims to give banks more power to manage their distressed assets. This new scheme is expected to significantly improve the ability of banks to resolve troubled corporate loan exposures.

On the External Commercial Borrowings (ECB) front, overseas borrowings by Indian companies have been on the rise as firms continue to seek advantage of the lower cost of capital in markets like the US and Europe. Indian firms raised USD 30.51 billion via ECBs in 2014.

Going forward, both domestic and international factors are expected to shape the future trends in corporate financing. Some of the key factors are around the much anticipated rate revision by the US Federal Reserve this year, RBI's policy on interest rates and SEBI regulations on driving capital market activities.

Through this report, we have provided a detailed account of the various sources of finance that are available to corporates along with the recent trends and developments.

We hope the report manages to touch upon all emerging trends and topics for the industry, to be taken forward for larger deliberation and action.

Jyoti P Gadia
Managing Director
Resurgent India Limited

Introduction

India's macro-economic indicators have improved remarkably, placing the economy and the stock markets in a much better state than in the past. There are a number of factors that have led to an improvement in the macroeconomic environment such as fall in inflation over the last two years from double-digits to mid-single digits, rise in forex reserves to an all-time high at USD 350 billion, softening of global crude oil prices and significant reduction in the current account deficit.

Majority of the firms resort to raising capital from external sources to meet their funding requirements. These include bank credit, equity markets, corporate bond markets, external commercial borrowings and private equity, etc.

While the banks have been slow in corporate lending recently, the equity and debt markets provide immense opportunities to corporates to raise cost-effective and long term capital. The primary market segment is witnessing flurry of activities with a number of IPOs lined up. Both BSE and NSE are expecting a surge in IPOs indicating a strong revival of the primary market that has remained parched since the 2010 market boom.

Further, it has been observed that increasing number of corporates are utilizing the debt market to fund their borrowing needs given the widening difference between the bank borrowing rates and underlying yields in the debt market. While a better rated company can borrow from banks at base rate, the same company can raise short term and long terms debt up to 150- 200 basis points lower in the debt market. While bigger companies with superior credit ratings have managed to tap the debt market, highly leveraged, capital intensive companies continue to rely on bank financing for their incremental loan requirements.

This report seeks to provide an overview of the various sources of financing in India, looking at the trends for the last few years as well the outlook over the next year.

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Primary and Secondary Market Trends

Before the report deliberates on the crucial component of financing, it is important to highlight key trends in the broader primary and secondary market.

Primary Market

The total resources mobilized by the corporate sector in 2014-15 was INR 4,80,697 crore, up 23% from 2013-14

Exhibit1 – Total Resources mobilized by the Corporate Sector (Amount in INR Crores)

Year	Equity Issues			Debt Issues			Total Resource Mobilization
	Public & Rights	Pvt. Placements	Total	Public	Pvt. Placements	Total	
2010-11	58,157	56,361	114,518	9,451	218,785	228,236	342,754
2011-12	12,857	27,871	40,728	35,611	261,283	296,894	337,622
2012-13	15,473	62,935	78,408	16,892	361,462	378,354	456,762
2013-14	13,269	60,125	73,394	42,382	276,054	318,436	391,830
2014-15	9,789	57,362	67,151	9,410	404,136	413,546	480,697

Source- SEBI Bulletin April 15

- Resource mobilization by Equity and Debt Issue - The total amount mobilized in 2014-15 through equity issue and debt issue was INR 67,151 crore and INR 4,13,546 crore respectively
- Resource mobilization by Mutual Funds – During 2014-15, mutual funds saw a net inflow of INR 1,03,288 crore as compared to a net inflow of INR 53,783 crore in 2013-14

Exhibit 2 - Trends in the Primary Market

S.no	Items	2013-14		2014-15	
		No. of Issues	Amount (INR Crore)	No. of Issues	Amount (INR Crore)
1	Public Issue of Equity -				
1.1	IPOs	38	1,236	46	3,039
1.2	FPOs	2	7,457	-	-
2	Rights Issues	15	42,383	24	9,422
3	Public Issue of Debt	35	4,576	18	6,750
Total Public Issues		**90**	**55,652**	**88**	**19,211**

Source- SEBI Bulletin April 15

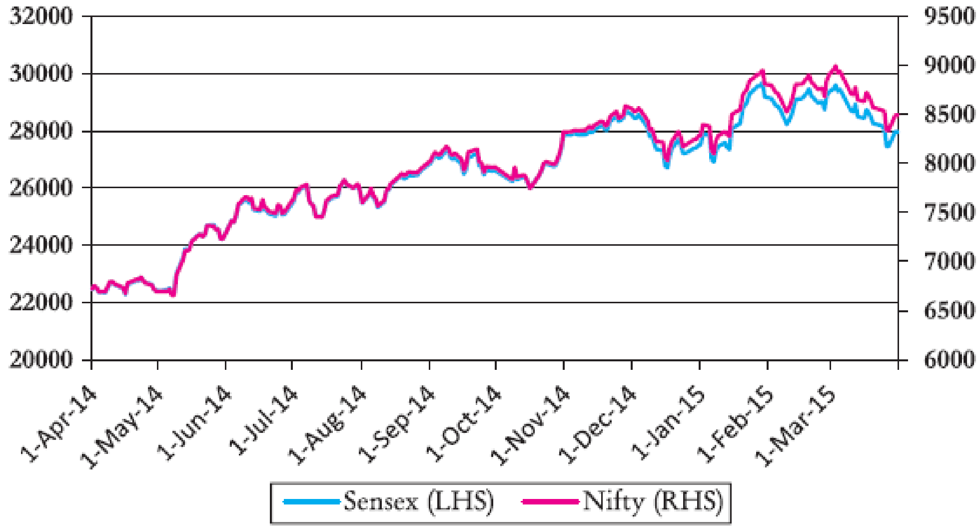
- The cumulative amount mobilized in the primary market (equity and debt issues) for the financial year 2014-15, stood at INR 19,211 crore through 88 issues as against INR 55,652 crore through 90 issues during 2013-14.

- Qualified institutional placement (QIPs) listed at BSE and NSE - The cumulative amount mobilized through QIP route during 2014-15, stood at INR 29,103 crore through 51 issues.
- Preferential Allotments Listed at BSE and NSE - The cumulative amount mobilized through the preferential allotments route during 2014-15 stood at INR 28,260 crore through 419 issues

Secondary Market

S&P BSE Sensex closed at 27,957.5 on March 31, 2015, as against 29,361.5 on February 28, 2015, registering a decrease of 1,404 points (-4.8 percent), while CNX Nifty closed at 8 ,491.0 on March 31, 2015 compared to 8,901.8 on February 28, 2015 indicating a decrease of 410.9 points (-4.6 percent).

Exhibit 3 – Sensex and Nifty Movement



Source- SEBI Bulleting April 15

Exhibit 4– Basic indicators in cash segment

Particulars		2013-14	2014-15
Indices	S&P BSE Sensex	22,836	27,957
	CNX Nifty	6,704	8,491
Market Capitalization (INR Cr)	BSE	7,415,296	10,149,290
	NSE	7,277,720	9,930,122
Gross Turnover (INR Cr)	BSE	521,664	854,845
	NSE	2,808,489	4,329,655

Source – SEBI Bulletin April 15

The market capitalization of BSE and NSE was INR 1,01,49,290 crore and INR 99,30,122 crore, respectively, at the end of March 2015.

Sources of Corporate Financing and Latest Trends

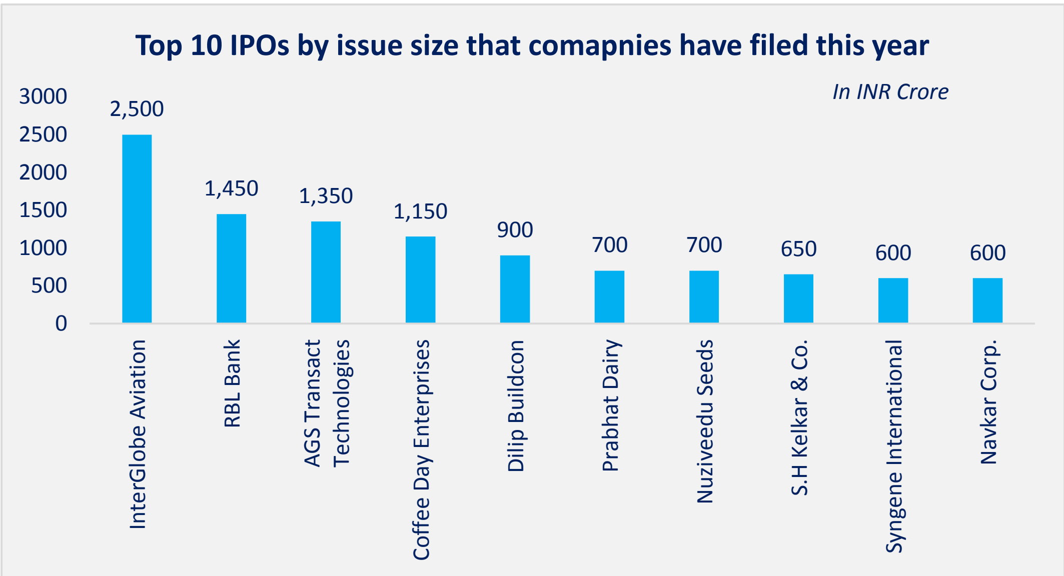
IPO finance for Corporates

There is a flurry of activities in the IPO space following stabilizing trends in the stock markets. Increasing number of companies are looking to raise funds to finance their business expansion and loan repayments and to meet the working capital requirements. BSE expects around 40 IPOs on its main platform and around 100 on the SME platform this fiscal, indicating a strong revival of the primary markets that has remained parched since the 2010 market boom.

Of late, more than 30 companies have approached SEBI to raise funds totaling over INR 20,000 crore through public offers, including big names like IndiGo, Cafe Coffee Day, Matrix Cellular and GVK Airport. At least 20 of these firms have already got the go-ahead from SEBI to launch their respective Initial Public Offers (IPOs), while draft IPO papers of 5 firms are currently under process and may be cleared soon.

A majority of these companies are mid-sized and are looking to raise funds between INR 200 crore to INR 3,000 crore. So far in 2015, 8 companies have already launched their IPOs and have collectively raised nearly 4,000 crore and as many as 19 companies have filed their draft documents with SEBI to float their respective IPOs. In comparison, a total of six IPOs had hit the market in the entire 2014 and together garnered just INR 1,528 crore.

This comes at a time when SEBI has announced a slew of fresh reforms in the IPO space, including reducing the listing period to 6 days and for making the application process for investors entirely cheque-free.



Source: Mint Research

Over the years, SEBI has taken several steps to improve the overall process of listing and raising capital for corporates including SMEs and Start-ups. Some of the initiatives taken by SEBI have been mentioned below-

1. Improving clearing Process
    - SEBI has taken steps to speed up the process of clearing offer documents. SEBI has taken an average 70 days to issue its final observations on the draft Red

Herring Prospectus filed in the first half of 2015. In comparison, it took nearly 120 days to give these on offer documents filed with it a year before.

- So far in 2015, SEBI has cleared close to two dozen IPOs, which cumulatively are looking to raise about INR 8,000 crore. About 8 more filed this year are awaiting a nod for IPOs worth around INR 7,000 crore.
- SEBI has been quick to approve offer documents filed by companies this year as shown by the table below –

Company Name	No. of Days taken by SEBI for approval of Offer Document in 2015	Estd. Issue size (in Cr)
Precision Camshafts	72	250
Navkar Corp	52	600
SSIPL Retail	70	95
AGS Transact Technologies	65	1350
Dilip Buildcon	62	750
Shree Shubham Logistics	102	210
Amar Ujala Publications	68	60
Prabhat Dairy	69	275
Syngene International	51	400
SH Kelkar	86	250

Source: Prime Database

2. Movement towards electronic IPO
   - SEBI plans to do way with cheque payments altogether and move to an electronic process (e-IPO) so as to speed up listing. The e-IPO norms are aimed at reducing the time taken between share sale and listing to 6 days from the current 12 days, enhance the reach of retail investors and reduce costs for issuers. The e-IPO norms are expected to come into effect from January 1, 2016.
   - Currently, applications for IPOs can be uploaded on a real-time basis only through ASBA (application supported by blocked amount), only self-certified syndicate banks are authorized to manage and offer ASBA, which allows application money to stay in an investor's bank account until the shares are allotted. ASBA has been made compulsory for all categories of investors from January 2016

3. Favorable norms for listing of start-ups
   - SEBI recently introduced the listing norms for start-ups aimed at encouraging Indian entrepreneurs to remain within the country, rather than moving to overseas markets for raising capital
   - Hi-tech start-ups in areas such as analytics and biotech can list on the institutional trading platform of exchanges, if at least 25% of their pre-issue capital is held by qualified institutional buyers (QIBs), such as private equity and venture capital firms and NBFCs. Other start-ups can also opt to get listed on

the platform, provided at least 50% of their pre-issue capital is held by QIBs.

- Disclosure norms for start-ups have been made easy. While filing the draft offer document with SEBI, start-ups will only need to disclose broad objectives of a public issue rather than the granular details that are required of regular primary issues
- For start-ups listed on this platform, there will be no cap on the usage of public issue proceeds for general corporate purposes. In conventional IPOs by companies opting to get listed on the main board of exchanges, not more than 25% of the capital raised can be used for general corporate purposes.
- Under the new norms for start-ups, the entire pre-issue capital will be locked-in for a period of six months for all shareholders. In conventional IPOs, there is a lock-in period of three years for (pre-IPO) shareholders holding more than 20% and one year for all other investors.
- Any investing entity registered with SEBI with a minimum net worth of INR500 crore may also be considered as a QIB for investing in shares of start-ups.
- The new rules mandate a minimum investment of INR 10 lakh in such ventures at the time of the IPO and while trading on the special trading platform. Small retail individual investors would not be allowed to invest
- A start-up getting listed on ITP will have the option to migrate to the main board of a stock exchange after three years, subject to compliance with existing eligibility requirements of stock exchanges.

4. Supportive norms for SME listing
    - SEBI has already made it easier for the Small and Medium Enterprises (SMEs) to raise money from capital markets
    - In March 2012, both BSE and NSE launched platforms for SMEs after SEBI announced easier listing and disclosure norms to help smaller companies tap the capital market. At present, 89 firms are listed with the BSE's SME platform while 6 are listed with the NSE platform. The SME platforms are an excellent initiative to pave the way for a large pool of SMEs in India to raise equity capital and attain listing status
    - SEBI allows easy disclosure norms for SMEs, that is, SMEs that want to be listed on the SME platform can file a draft document only with the stock exchange and not with SEBI. Moreover, SMEs also enjoy more liberal requirements for disclosure of financial numbers compared to the entities listed on the main bourse.
    - The BSE SME Exchange is targeting to list about 100 SMEs during FY15-16. To achieve the same, BSE is focusing on tier-2 and tier-3 towns. Recently, BSE SME exchange has tightened the eligibility criteria for listing of SMEs so as to enhance the quality of new issuers. Under the new listing norms, SMEs will require higher post-issue paid up capital at INR 3 crore against the previous requirement of INR 1 crore. Also, the net worth requirement and tangible assets requirement has been increased to INR 3 crore from INR 1 crore.

5. SEBI introduced norms for SME Listing without an IPO
    - In June 2013, SEBI approved listing of SMEs on ITP without an IPO. This was aimed to provide an easier exit option for informed investors, provide better visibility, wide investor base and greater fund raising capabilities to start-ups and SMEs.
    - The objective of framing ITP Regulations was to provide easier exit options for the informed investors who risk their capital to support SMEs.
    - As per the norms, SMEs that are younger than 10 years and whose revenues haven't exceeded INR100 crore in any year can list on the ITP. The paid-up capital of such SMEs and start-up firms must be below INR25 crore.
    - Only those SMEs and early-stage companies that have received investments of at least INR50 lakh from an alternative investment fund, VC fund, an angel investor or similar investors can list on the ITP. SMEs that have received money from a scheduled bank for their project financing or working capital needs can also opt for listing on the ITP after 3 years of such financing and full utilization of such funds.
    - The ITP will also differ from usual share-trading platforms. It will be accessible only to a certain set of individuals and institutions that can trade in a minimum lot of INR 10 lakh
    - The SMEs being listed on the ITP may raise capital through private placement or rights issues.
    - Companies listed on the ITP can exit the platform and choose to be listed on any of the main bourses only after receiving approval to do so from at least 90% of their shareholders

As per industry sources, SEBI is expected to review norms related to trading and listing SMEs as part of its attempts to further boost a segment that has seen impressive growth since its launch nearly three years ago. It is believed that the concerned stakeholders have requested SEBI to lower the minimum trading lot size of INR1 lakh post listing and review the minimum 25% equity dilution, which is required at the time of listing for SMEs. Exchanges are also suggesting that the class of investors allowed to invest in SME issues be widened to include wealthy individuals, non-institutional investors, corporate bodies and merchant bankers. Currently only institutional investors like mutual funds, private equity and venture funds are allowed to invest and trade in companies listed on the SME platforms.

Depository Receipts (ADRs/ GDRs)

Since 1992, Indian companies have been listing abroad through American Depository Receipts (ADRs) and Global Depository Receipts (GDRs).

Depository receipts (DRs) are foreign currency denominated instruments issued by a foreign depository on the back of permissible securities of Indian corporates. DRs are beneficial for Indian companies as they offer new possibilities to raise capital in foreign countries. The importance of DR's lies in the fact, that, they enable the Indian companies to tap capital from overseas locations that have been otherwise difficult to access in the past.

However, it has been witnessed in the past, that investment through the DR route has not able to garner significant investor interest, primarily on account of investor preference for investments in the home country and local currency. As a result, over the last decade, the DR investment route has failed to secure the expected traction, thus requiring significant revisions to India's existing DR scheme.

Last year, the 'Depository Receipts Scheme, 2014' was announced to address this issue and revive investment through the DR route. The scheme came into effect from December 2014. This new scheme has replaced the issue of foreign currency convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993. The 2014 scheme is designed to augment foreign investment and further streamline access to capital for Indian companies.

This new scheme expands the range of permissible asset classes of underlying securities, allows unlisted companies to issue DRs and also permits DRs to be issued for non-capital raising purposes. DRs issued under the 2014 scheme will be available to investors in 34 jurisdictions, subject to the conditions under the foreign investment regime, including the conditions in relation to sector specific caps and pricing. Under the 2014 scheme, Indian companies (whether private or public, listed or unlisted) as well as holders of permissible securities can issue DRs. As per the scheme, the aggregate of permissible securities which may be issued or transferred to foreign depositories for issue of depository receipts, along with permissible securities already held by persons resident outside India, shall not exceed the limit on foreign holding of such permissible securities under FEMA. The scope of permissible securities has been expanded to include equity, equity derivatives, debt securities, government bonds and corporate bonds, which can be acquired by a person resident outside India and are in de-materialized (non-physical) form. Further, the 2014 scheme introduces a new concept of unsponsored DRs which are issued without the permission of the issuer company for DRs that are listed on international exchanges and give the holder the right to issue voting instructions.

Driven by renewed foreign investor interest, several growth initiatives by the government, and a stable regulatory environment, the 2014 scheme is expected to be more successful than the earlier schemes.

Corporate Bond Market

Corporate Bonds are Bonds issued by private or public sector companies in order to borrow funds from the market. As for the current size, the outstanding issues which were at 12,155 as at end March 2011 increased to 18,664 by end Dec 2014. During the same period, the amount outstanding increased from 8,895 billion to 16,485 billion. Even though the numbers indicate a growth in corporate bond market, it remains little enough in comparison to the government bonds.

A comparison to other Asian countries provided below:

Government and Corporate Bonds as % of GDP March 2013

Debt as % of GDP	Government	Corporate	Total
Peoples Republic of China	33.1	13.0	46.2
Hong Kong	37.8	31.4	69.2
Republic of Korea	48.7	77.5	126.2
Malaysia	62.4	43.1	105.5
Singapore	53.1	37.0	90.1
Thailand	58.6	15.9	74.4
Vietnam	19.8	0.7	20.5
India	49.1	5.4	54.4

Source: RBI

The above comparison reflects upon the small corporate bond market in India. The absence of an adequately sized corporate debt market leads to an oversized banking system in any economy, also resulting in excessively regulated lending market on one side and crony capitalism on the other.

Financing through the corporate bonds route ensures greater credit discipline among the borrowers. The disclosure requirements act as a big disincentive for default or delayed payment. Thus there are many advantages of an efficient, well developed and liquid corporate debt market.

Challenges for the Corporate Debt Market

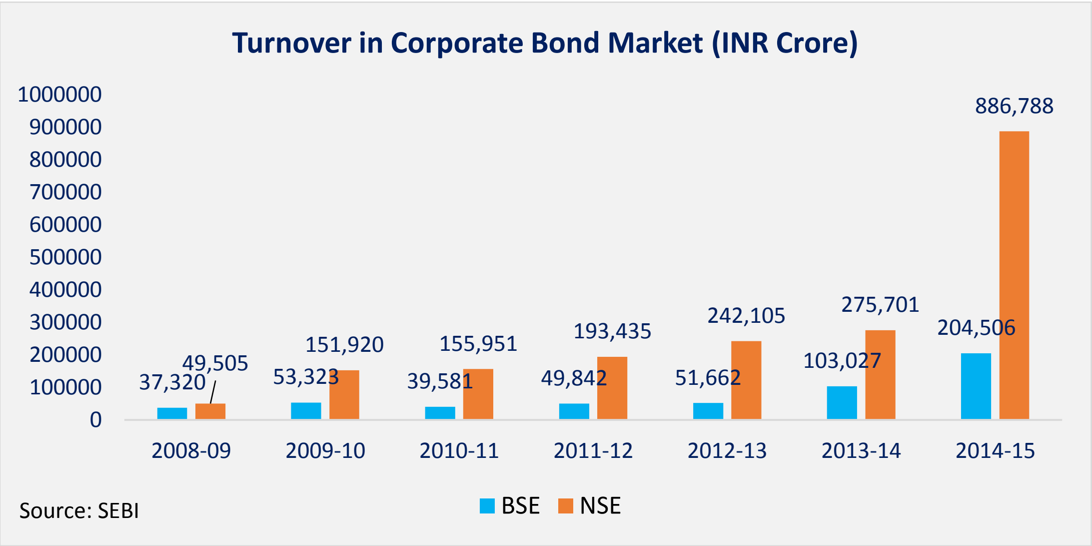
The challenges need be tackled to facilitate improvement and growth of the Corporate Debt Market. Foremost among these are as follows:

- **Low Liquidity** - Trading being limited to certain maturities and tendency of investors to ‘buy and hold’ instruments impacts liquidity. The institutional investors need to be aggressive in actively managing their portfolios with investment horizon not confined to AA and above only. This will add a lot of buoyancy to the market.
- **Low investor base** - Retail participation remains low due to absence of knowledge and understanding of bonds as an asset class. It is imperative to consider innovative ways for expanding the investor base.
- **Public debt preference**- The huge supply of government papers in the country is one of the major impediments to growth of the corporate bond markets.
- **Market Infrastructure** - Infrastructure facilities such as screen based automated order matching, central clearing and settlement, negotiated dealing system, etc. on the lines available to the government securities market would certainly facilitate and encourage secondary market trading, enhance market transparency and liquidity as well as develop scientific risk pricing.

- **Complex issuance**– The listing and disclosure requirements and procedures have to be simple. The size, scale and tenure of issues must improve and need to be made more attractive. The consolidation of bond issues through reissuance/s could improve liquidity and encourage secondary market transactions, with due caveats and cautions.
- **Market making** – Market makers have a big role in growth of any market – they not only assume risk but also add diversity. There is thus a need to develop underwriters and market makers in the corporate debt bonds similar to PDs in the government securities market.
- Corporate Bonds issued by private sector Companies do not qualify for meeting the Statutory Liquidity Requirement(SLR) of the Banks which refrains the Banks from investing in Bonds issued by private Sector Companies.
- The secondary market for Corporate Bonds is also not much developed as Institutional Investors like Insurance Companies, Provident Fund authorities and Banks hold the Corporate Bonds till their maturity which reduces their supply in the secondary market.

Policy Initiatives

Corporate Bonds market in India is at a growing stage and measures are being taken by the regulatory bodies to boost the growth of Corporate Bonds market in India by making necessary amendment in the rules and regulations. During FY15, there were 17,710 trades with a value of INR 2,04,506 crore reported on BSE as compared to 58,073 trades with a trading value of INR 8,86,788 crore reported in NSE.



Some of the recent initiatives by Government, RBI, SEBI and other agencies with the intent of developing the corporate debt market are as follows:

- **Pooling account**: Clearing houses of the stock exchanges have been permitted to have a pooling fund account with RBI.
- **Trade reporting platform**: Towards improving transparency, reporting platforms for OTC trades in corporate bonds amongst others has been set up.

- **Repo in corporate bond**: Since 2010, guidelines in terms of reduction of minimum haircut requirements and expanding the list of eligible collaterals have been relaxed.
- **Credit Default Swaps (CDS)** on corporate bonds: CDS on corporate bonds has been permitted to facilitate hedging of credit risk associated with holding corporate bonds. Based on market feedback, short term instruments like CP, CD & NCDs and unlisted but rated corporate bonds have also been permitted as eligible reference obligations.
- **Encouraging participation of banks and PDs in corporate bonds**: Key initiatives under this include: a) Banks permitted to issue long-term bonds with a minimum maturity of seven years to raise resources for lending to pre-specified sectors. b) Banks to consider raising Tier II capital through public issuance to retail investors c) Investment norms have been relaxed to allow for investing in funds borrowed from call money market subject to certain limits d) Banks and standalone PDs have been allowed to become direct members of stock exchanges for undertaking proprietary trades in corporate bonds e) It is proposed to permit banks to offer partial credit enhancement to corporate bonds by way of providing funded and un-funded credit facilities for infrastructure projects but not by way of guarantee.

- **Foreign Portfolio Investors (FPIs):**
  - Rationalization of investment limits: FPI investment limits have been rationalized and subdivisions have been merged in two broad categories - government securities and corporate bonds. In case of corporate bonds, the ceiling of $1 billion for qualified foreign investors (QFIs), $25 billion for FPIs and $25 billion for FPIs in long-term infra bonds, have been merged - retaining the overall cap for corporate bonds at $51 billion.
  - Rationalization of allocation of debt limits: FIIs can now invest in Corporate Debt without purchasing debt limits till the overall investment reaches 90% after which the auction mechanism would be initiated for allocation of the remaining limits.
  - Withholding tax rate: The rate of withholding tax on interest payments on the borrowings of Infrastructure Debt Funds (IDF), investments by a non-resident in rupee denominated long-term infrastructure bonds and interest on FIIs' investment in bonds issued by Indian companies have been reduced from 20 per cent to 5 per cent.
  - New Foreign Portfolio Investor (FPI) Regulations: Recently, SEBI has notified new FPI regulations to put in place an easier registration process and operating framework for overseas entities seeking to invest in Indian capital markets.
  - The Budget for 2015-16 has proposed to extend the period of applicability of reduced rate of tax at 5% in respect of income of foreign investors (FIIs and QFIs) from corporate bonds and government securities, from 31.5.2015 to 30.06.2017.

- **Credit enhancement by IIFCL**: IIFCL will provide partial credit guarantee to enhance ratings of bond issues, enabling channelization of long-term funds for infrastructure projects. IIFCL is presently undertaking pilot transactions under its Credit Enhancement initiative.
- **Introduction of Rupee linked offshore bonds** by IFC: With an objective to signal confidence in the Indian economy and encourage inflows of USD in India, IFC was permitted to float a rupee linked bond overseas for an amount of USD 1 billion which has been fully utilized by IFC.
- **Domestic Issuance of bonds by IFC**: IFC has the approval now to issue bonds worth 15000 crore for infrastructure financing.

External Commercial Borrowing

An External Commercial Borrowing (ECB), is a type of financing used in India to help companies access overseas funds. It can include foreign-currency commercial loans, as well as other instruments like fixed- and floating-rate bonds, whose interest rates are capped by the Indian central bank. Typically, ECBs are raised for import of capital goods, working capital, refinancing of earlier ECBs, new projects, modernization/expansion, general corporate purposes, etc. ECBs can be accessed under two routes - (I) Automatic Route and (II) Approval Route

Borrowers can raise ECB from internationally recognized sources, such as (a) international banks, (b) international capital markets, (c) multilateral financial institutions (such as IFC, ADB, CDC, etc.) / regional financial institutions and Government owned development financial institutions, (d) export credit agencies, (e) suppliers of equipment's, (f) foreign collaborators and (g) foreign equity holders

The maximum amount of ECB which can be raised by a corporate other than those in the hotel, hospital and software sectors, and corporates in miscellaneous services sector is USD 750 million during a financial year. Corporates in the services sector hotels, hospitals and software sector and miscellaneous services sector are allowed to avail of ECB up to USD 200 million during a financial year.

All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee, and fees are payable in Indian Rupees. The payment of withholding tax in Indian Rupees is excluded for calculating the all-in cost. The existing all-in-cost ceilings for ECB are as under: -

Average Maturity Period	All-in-cost Ceilings over 6 month LIBOR
3 years and up to 5 years	350 basis points
More than 5 years	500 basis points

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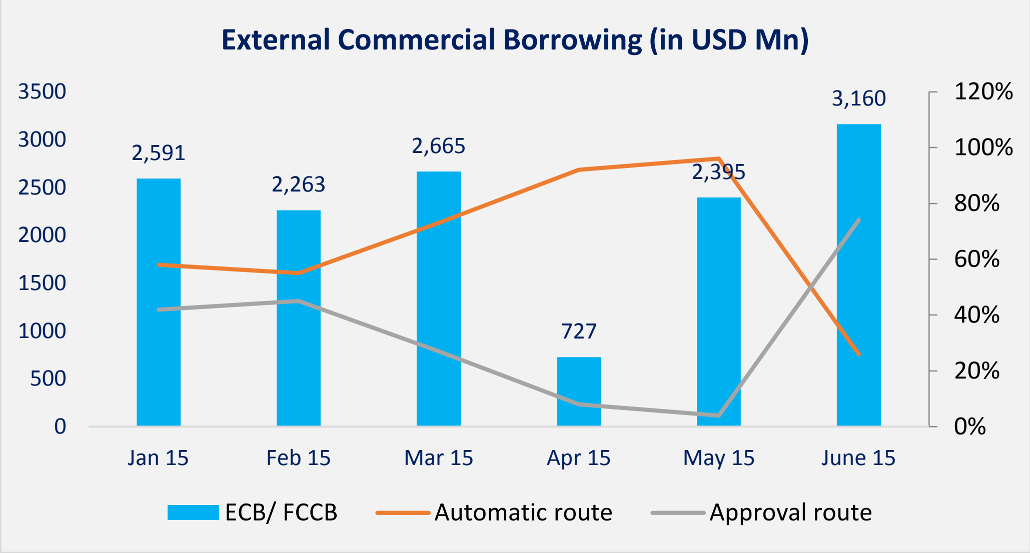


Source: RBI

Figures released by the RBI show that the companies based in India raised USD 3,160 million in ECBs / FCCBs in June 2015, up 22 % compared to USD 2,591 million they had raised in January 2015. In 2014, Indian firms raised USD 30.51 billion via ECBs, which is close to the USD 34.53 billion raised in 2013.

54 companies borrowed a total of USD 806 million under the ECB automatic route in June whilst 8 companies borrowed a total of USD 2,353 million through the approval route bringing the total to USD 3,160 million for the month of June, 2015. The figures released by the RBI show that among the highest borrowers through the automatic route were Reliance Utilities and Power Pvt. Ltd, at USD 300 million for new projects followed by IDFC Ltd at USD 200 million for refinancing an earlier ECB and Reliance Industries Ltd USD 166 million also for refinancing an earlier ECB.

Overseas borrowings by Indian companies have been on the rise as firms sought to take advantage of the lower cost of capital in markets like the US and Europe. Foreign investors continue to be positive on Indian markets, due to prospects of growth under a stable government. As a result, companies do not find it difficult to secure loans from foreign investors.

Some of the recent developments in the ECB space have been detailed below -

- Over the last few months, driven by lower interest rates in the global market, Indian companies are increasingly borrowing by way of ECBs. Further, during this period, the interest rates also remained stable due to the easing of the global crude prices and slow global growth. However, this trend may change soon once the US Federal Reserve raises policy rates, which is expected in either September or December 2015.
- Recently, RBI allowed banks more power to restructure ECBs of companies. Banks can now modify the draw-down and repayment schedules of the ECBs, including change in the average maturity period and changes in the all-in-cost. Banks are now allowed to change the ECB loan from one company to another in case of reorganization or merger. For this, earlier the companies had to approach the RBI but now with banks having the power to make these changes, companies will find it easy to restructure and transfer their ECB loans.

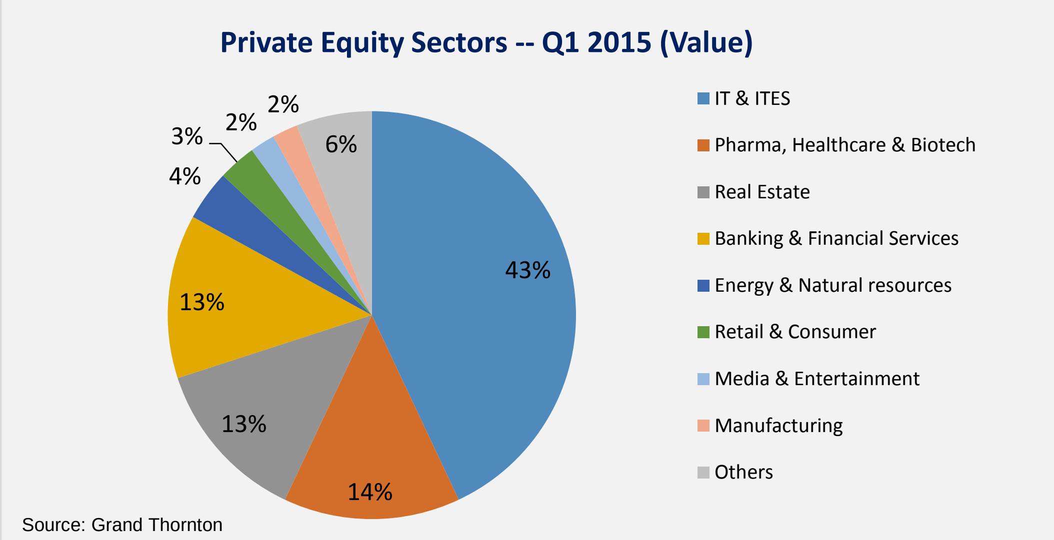
- Recently, in an attempt to relax norms to raise money via ECBs, the RBI has allowed firms in the manufacturing, hospitals, infrastructure, hotels, and software sectors to raise foreign capital from foreign/indirect equity holders without its approval. As per the existing policy, ECBs from direct foreign equity holders (FEHs) are considered both under the automatic and the approval routes. However, ECBs from indirect equity holders and group companies and ECBs from direct FEH for general corporate purpose are allowed under the approval route.
- Recently, the RBI issued a draft framework on issuance of Rupee linked bonds overseas. As per the new proposal, the Indian corporates eligible for raising ECBs will also be able to raise funds overseas by issuing Rupee linked bonds. By allowing firms to sell rupee-denominated bonds overseas will open up another avenue for fund raising by Indian companies and help them raise debt without taking on the currency risk typically associated with borrowings abroad. The cost of hedging the currency risk involved in foreign currency borrowings takes away part of the advantage of lower borrowing costs. Allowing companies to issue rupee-denominated bonds will transfer any currency risk to the investor rather than the seller. While the move could potentially open up a new pool of investors for Indian companies to tap, the benefits may initially be restricted to large high-rated corporate entities that have an established track record in overseas bond markets.

Private Equity

Private Equity recorded highest number of deals and second highest in terms of value for a decade in the year 2014 -- 604 deals worth USD 12 billion. 2014 was also marked by 22 PE investments worth over USD 100 million each. The IT & ITES sector emerged as the leading sector attracting significant PE funding to the tune of USD 4 billion from over 100 deals, contributing over 30% of overall private equity deal value. Other notable sectors were real estate and infrastructure, with over USD 2.4 billion, and banking & financial services, contributing over USD 1.4 billion. 2014 also witnessed several private equity players cashing in on exits from old investments – specifically the Bain-Hero Motocorp, ChryCapital-HCL and Intas.

The momentum continued through 2015 Q1:

- Private equity investment witnessed a 30% increase in deal value and 67% increase in deal volume in Q1 ‘15 vs Q1 ‘14.
- There were four deals each worth over US$100 million and over eight deals each worth more than US$50 million.
- PE deal volumes now contribute to more than 50% to overall deal volumes, surpassing M&A.
- There were also 40 private equity exits during the quarter.
- Over the first quarter of 2015, the IT & ITES sector attracted the highest share of private equity investments followed by pharma, healthcare & biotech, real estate, banking & financial services and energy & natural resources.



- Recently, the Indian government allowed 100% FDI under the automatic route in the medical devices sector in order to encourage manufacturing of equipment, including diagnostic kits and other devices. This could result in increased foreign investment in companies with niche technology

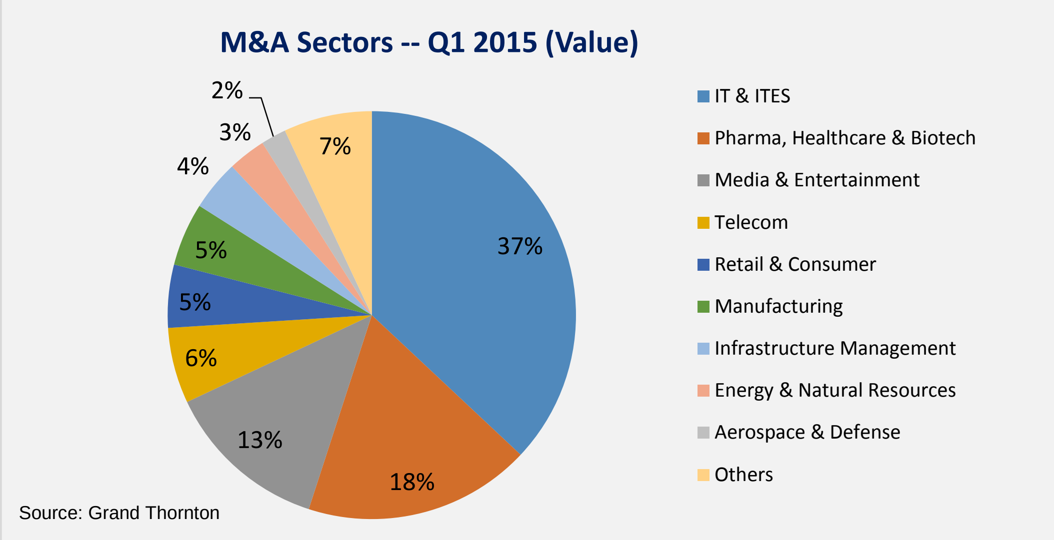
Merger & Acquisition

In 2014, corporate M&A activity contributed close to USD 38 billion from 573 deals. There were eight M&A deals that graced the billion-dollar club, while 54 deals were valued at over US$100 million each. Domestic and inbound deals provided the highlights of 2014 as global players consolidating their existing holding. Key domestic deals included Sun Pharma acquiring Ranbaxy, Kotak acquiring ING Vysya, Flipkart looping in Myntra and a few large power sector mergers and acquisitions.

Key factors driving M&A activity include decisive election results for a stable government, significant reforms, falling commodity prices and other factors such as intrinsic business strengths and the underlying drivers of consolidation and unlocking value. Overall 2014 saw one of the lowest levels of outbound M&A by deal values although volumes remained robust at 117 deals. Like PE, the IT and ITES sector contributed most by deal value in 2014, followed by the pharma & healthcare sector and telecom.

The start of Q1'15 proved vital with an increase in deal activity. The period saw 131 deals worth US$5.6 billion, showing a 26% increase in the deal values compared to 126 deals worth US$4.4 billion over the same period in 2014.

- Domestic deal values rose by 73% and volumes by 30% compared to Q1 2014.
- Total cross border deal values increased by 66%, largely due to big ticket inbound deals. Inbound deals alone contributed 63% of the overall M&A deal values with eight deals valued over US$100 million.
- The IT & ITES sector led the M&A sector pack – both in terms of volume (31%) and values (37%).



Alternative Investment Funds

Alternate Investment Funds (AIFs) were set up in 2012 by SEBI as a new class of investment entity. AIFs are basically funds established or incorporated in India for the purpose of pooling in capital from Indian and foreign investors for investing as per a pre-decided policy.

There are around 135 AIFs registered with SEBI at present, which have, till date, collectively raised investment commitments totaling over INR 22,600 crore, while over INR 9,500 crore worth funds have already been raised by them. Their total investment stood at INR 7,350 crore. AIFs, which include private equity, venture capital and hedge funds are regulated by SEBI, but the Foreign Exchange Management regulations are governed by the RBI.

AIFs are primarily aimed at high net worth individuals, and as per SEBI (Alternative Investment Funds) Regulations, 2012, the overall corpus of the AIF should be at least INR20 crore and there should not be more than 1,000 investors at any point in time. The minimum investment from an individual should be INR1 crore and the fund manager / promoter should have contributed at least 2.5% or INR5 crore, whichever is less, to the initial capital.

There are three categories of AIFs depending upon on their effect on the economy. Categories-I AIFs have a positive spillover on the economy and may get concessions from the regulator or the government. These include venture funds, social venture funds and infrastructure funds, among others. Category-II includes private equity funds and debt funds and do not get any concessions. These cannot raise debt for investment purposes, but can do so to meet their day-to-day operational requirements. Category-III includes hedge funds, and is usually traded to make short-term returns.

Recently, the Union Cabinet cleared a proposal allowing foreign entities to invest in AIFs, which are set up under SEBI regulations, so as to attract more overseas investment into the country especially from NRIs and overseas institutions. Besides increasing the availability of funds for startups, early stage ventures and SMEs, which are generally considered as high risk investments, this move is also expected to reduce the pressure on banking system.

Till now, in India, pooling of capital was allowed only for Indian investors, and investment was done according to a pre-determined policy. However, selectively approval route for investment was used by overseas investors and non-resident Indians (NRIs).

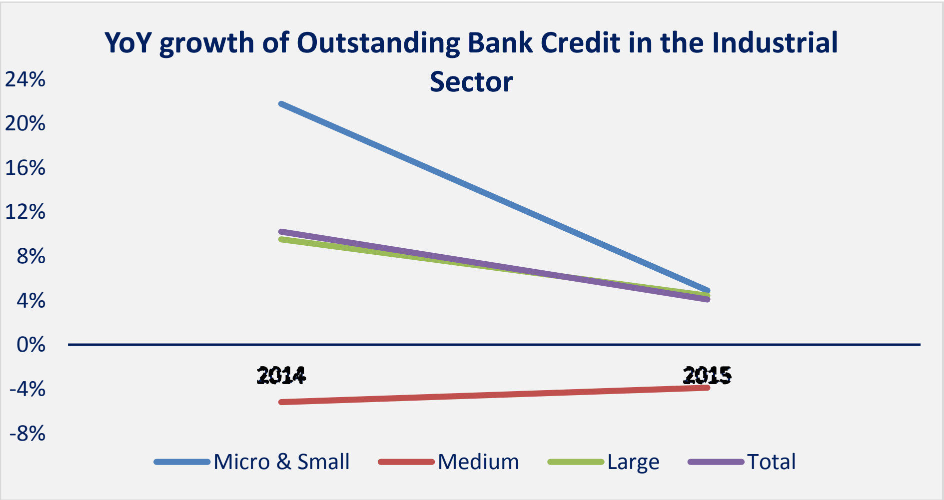
Bank credit to Indian Corporate Sector

The growing volume of stressed assets has made banks go slow on corporate lending in recent years. The primary reasons for increase in stressed assets in recent times are macro economical and global factors, economic slowdown, delays in statutory and other approvals, especially for projects under implementation, aggressive lending practices during upturn and delays in resolution of NPAs through legal proceedings.

Some companies are stressed as the economic cycle has not yet turned round and the demand has not picked up. The large companies are struggling with stretched balance sheets owing to high borrowing and higher risk. Till a few years ago, large companies used to be banks' big clients. But the trend seems to have reversed now, with banks wary of lending to them in this volatile environment.

With the corporate sector slowing down, banks have been shifting focus on lending to SMEs. However, the prolonged slowdown in the economy has led to slow growth in bank lending even for the SME business. Major reason for the slowdown was the downturn in the mid- and large-corporate segments. As the growth in the SME segment depends on the cash flows from the large- and mid-corporates, a prolonged slowdown in the larger businesses impacted the cash flows of SMEs and as a result the banks have become cautious on over lending to this segment.

As of June 15, the total outstanding loan to the industrial sector was INR 26,30,146 crore. The segment wise break-up of this is - Micro and Small – INR 3,74,011 crore, Medium – INR 1,20,403 crore and Large- INR 21,35,733 crore. The total outstanding loan to the services sector as on June 15 was INR 14,33,131 crore



Source – RBI

In a recent move, RBI has proposed to lower the ceiling of how much a bank can lend to a single company or corporate group. Under this new proposal, large exposures of banks to companies or a corporate group would be capped at 25% of the bank's available capital base. Currently, bank's exposure limit is a maximum of 55% of a banking group's capital. The change has been made to align India's exposure limits to the global benchmark and will be implemented by 1st January 2019.The proposed changes will force companies to seek alternative sources of funding such as corporate bonds and commercial paper markets for meeting their financing needs.

Corporate Debt Restructuring and Recent developments

Under a corporate debt restructuring plan, the lenders give the company, the benefit of reduced interest rates and a moratorium period for repayment, and in some cases, lender even sacrifice a part of the principal amount. Such restructuring is facilitated by the corporate debt restructuring (CDR) mechanism initiated by the RBI in 2001.

Performance of CDR scheme till date (As of June 30th 2015)

S.no	Overall Status	Number	Amount in INR Crore
1	Total Cases Referred to CDR cell till date	655	474,002
2	Cases Rejected	125	70,998
3	Cases Approved	530	403,004
3.1	Cases Withdrawn on account of Package Failure	178	67,667
3.2	Cases Exited Successfully	83	61,311
3.3	Live cases in CDR	269	274,026

Source – CDR cell

Till date, more than 655 cases have been referred to the CDR cell, of which 125 were out rightly rejected and 530 were approved. Of the approved cases, 83 have existed successfully and 269 cases amounting to INR 2,74,026 are still live in the system

Earlier, under the CDR mechanism, once the debt of a borrower is restructured, the lender need not classify it as a non-performing asset (so longer as no further default occurs), and, therefore, can put aside much less than otherwise required to provide for any likely loss, with much less damage of profitability. However, from 1st April 2015, new norms around treatment of restructured assets are applicable. The new norms and their impact have been detailed below-

Expiry of RBIs regulatory forbearance towards restructured assets from 1st April 2015

- RBI's regulatory forbearance towards restructured assets came to an end on 31st March 15, that is, starting April 15, banks were required to treat restructured loans as non-performing assets (NPAs) and were required to set aside a minimum provision of 15% of loan value to cover the risk of default. Earlier, banks were allowed to treat restructured assets as standard and set aside 5% of loan value as provision to cover default risk.
- Further, under RBI's new stressed asset management framework, which took effect on 1 April, a joint lenders forums (JLFs) is required to be set up for overdue accounts. It has been observed, that Increasing numbers of such forums are recommending restructuring directly, without routing such accounts via the CDR cell.

Impact of recent changes introduced by the RBI-

- On account of the expiry of RBIs regulatory forbearance on 31st March 15, majority of banks rushed to restructure their distressed assets. As a result, the number of cases approved by the CDR cell witnessed a sharp rise during the Jan – March period. During the full financial year 2014-15, loans worth INR 65,000-70,000 crore have been restructured at the CDR cell—lower than the INR1 trillion approved for restructuring in fiscal 2014
- Banks are now recognizing stress in their accounts earlier and are more hands-on in approaching other modes of restructuring accounts, rather than depending on the CDR cell. Of late, banks have become tougher with defaulting borrowers, often insisting on asset sales and a change in business plans to deal with the stress.

- The pace of restructuring is expected to slow down further in the next financial year, partly due to the change in rules, which will mean that bankers will be more cautious and selective in restructuring high-value cases since it will attract higher provisions
- Since, as per the new norms, the restructured assets will be classified as a NPA, this will lead to a surge in NPAs for banks and it will become difficult for public sector banks to raise additional capital as per Basel III norms.

Issues / Challenges faced in CDR

- Of late it has been witnessed, that the corporates are not very keen to approach the CDR cell since the success ratio is low and operational restrictions imposed by the banks are high
- Another issue faced around the CDR mechanism is, that it is prone to delays. Since most corporate debt is through consortium lending, all agreements among lenders and borrowers facilitated by the CDR cell go to their respective boards for sanctions which delay the overall process.
- Further, CDR proposals have also witnessed high failure rate. As of June 30, 2015, 178 cases with aggregate debt of over INR 67,000 crore had failed either because the promoters could not bring in more money through equity, the industry deteriorated, or interest rates didn't reduce as per plan.
- It has been noted, that Government agencies are increasingly demanding that the companies bidding for new projects not be in CDR, a condition that has made recovery tougher for many companies especially in the infrastructure sector. It is estimated, that debt-laden infrastructure companies have been barred from bidding for projects worth over INR 25,000 crore by government agencies in seven states - Tamil Nadu, Karnataka, Andhra Pradesh, Rajasthan, Gujarat, Uttar Pradesh and Delhi, igniting fear in the industry that the practice may become widespread.

Strategic Debt Restructuring Scheme (SDRS) -RBI recently announced the SDR scheme to address some of the gaps in the CDR scheme, with the objective of revitalizing the distressed assets in the economy.

Factors leading to the introduction of SDR scheme –

- RBI's new norms in the form of SDRS come in the backdrop of a huge surge in bad loans in the banking system. Further, it was becoming increasingly difficult to deal with financially distressed companies mainly on account of the many tools available to the existing management of a company to prevent an external creditor from taking control over the company.
- In June 2015, RBI issued a circular introducing new measures that should provide help to lenders struggling to cope with the mountain of bad debt owed by Indian corporates
- As per the new norms under SDRS, the lenders will have the right to convert their outstanding loans into a majority equity stake in a defaulting company if the company fails to honor its debt commitments agreed under a restructuring plan. It is expected the SDRS will enhance the bargaining power of banks during debt restructuring negotiations and ensure better compliance among borrowers with their restructuring plans

New Norms under SDR –

- The SDRS allows loans to be converted into shares. In fact, this will now be a precondition in all debt restructuring deals / agreements in India. If a borrower is unable to achieve the viability milestones stipulated in the restructuring package, the Joint Lenders Forum (a committee formed by all the lenders of a borrower) will be required to review the accounts of the borrower and decide, within 30 days after reviewing the account, whether to invoke the SDRS. The SDRS needs to be approved by 75 percent of lenders by value and 60 percent of lenders in number.
- Post the decision to SDRS is taken and after loans are converted into equity, the Joint Lenders Forum must collectively hold at least 51 percent of the shares issued by the borrower. Any conversion of shares due to the execution of the SDRS will not be subject to the provisions laid down by SEBI. The Joint Lenders Forum will closely monitor the company, and if needed, replace the existing management with new independent management.
- The circular provides that the Joint Lenders Forum should divest their new equity stake to a new promoter as soon as possible. The new promoter must acquire at least 51 percent of the shares. In sectors where a ceiling is imposed on foreign investment, the foreign new promoter must acquire at least 26 percent of the equity capital or up to the applicable foreign investment limit, whichever is higher.

Probable Issues in SDRS -

- As per the scheme, the lenders may choose to use their powers of conversion subject to the approval of 75% of lenders in value and 60% in number. This may be a difficult threshold to meet in a distressed debt situation with multiple lenders especially where the largest lender holds a significant share of the borrower's debt and the balance is held across other lenders.
- As per the SDRS, the lenders will have the option to divest their stake to a new promoter. It may be noted that there will be significant number of challenges that new promoters may face on acquiring a financially-distressed company. Bringing the financially troubled company out of its present situation and achieving a new successful strategic turnaround could prove to be a difficult task for the new directors. It will also be difficult for the new promoters to build and sustain operating cash flow in such troubled entities. Another difficulty that such companies could face is paying off the creditors of the newly acquired entity. The company may also not be in a position to satisfy any post-completion indemnification claims that may arise. Non-compliance by distressed companies with applicable laws and the consequent statutory liabilities can pose problems for the new directors

Significance and success potential of SDRS -

- On the brighter side, the option to replace the existing management with new management could act as a strong deterrent for willful defaulters and create a sense of fear amongst borrowers, possibly resulting in better credit compliance and responsible management.
- The SDRS is a remarkable improvement over the existing debt restructuring process in India which currently favors the promoters. Traditionally, it has been very difficult for external creditors to take control of a defaulting company. SDRS is expected to send a strong message to willful defaulters by instilling a real sense of fear among them that

they risk losing control over their company if they fail to meet the milestones in their restructuring plan.

- Majority of the banks in India have lauded the introduction of the SDRS and regard it as an effective measure to deal with willful defaulters. The new guidelines have the potential to significantly improve the ability of Indian banks to resolve troubled corporate loan exposures. This scheme will benefit all banks especially those with large corporate exposures such as SBI and IDBI. However, there may be some initial reluctance on the part of the banks to step in and take over control of a company until they have developed the internal expertise and technical know-how to manage large enterprises.

Foreign Currency Hedging

Foreign currency hedging is an important tool leveraged by corporates to overcome the negative impact of price volatility in the global financial markets. Hedging helps corporates with foreign currency exposure to protect themselves from unfavorable fluctuations in exchange rates.

The impact of the movement in the USD-INR currencies affects both the importing firms and the exporting firms. In other words, an importer will benefit when the rupee appreciates, while the exporter will gain when the rupee depreciates against the US dollar. This is because, the cost of import reduces when the rupee gains strength, thus benefiting an importer, and at the same time creating a loss for the exporter, since a stronger rupee will reduce the export remittances when converted to Indian rupees.

In order to reduce the risks associated with these uncertain movements in the financial markets, both importers and exporters create a hedge.

An importer hedging his foreign currency payment obligations would typically execute a contract to buy dollars on a future date at an agreed rate by paying a certain premium to the spot rate. In the case of an exporter, the contract will be executed to sell dollars at a future date at an agreed rate. Hedging is typically done by buying or selling currency forwards and options. The objective of hedging is not to make profits, but to mitigate losses incurred due to currency price fluctuation.

As per RBI, the hedge ratio for ECBs/FCCBs declined sharply from about 34 per cent in FY 13-14 to 15 per cent in FY 14-15. In other words, 85 percent of the forex loans are vulnerable to a sudden depreciation in the rupee, and could pose a systemic risk as well.

Some of the reasons responsible for low hedging among Indian corporates are–

- Majority of the Indian corporates are increasingly keeping their foreign currency exposure unhedged, deterred by the high cost of hedging and lulled into complacence by the rupee's relative stability in recent months.
- Indian companies are assuming that the rupee will not weaken beyond 62-62.50 a dollar due to the build-up in foreign exchange reserves and the strong inflow of capital into India. There are high expectations that the rupee will sustain its strength in the longer run and thus it gives an opportunity to companies to cut down on their hedging cost
- The cost of hedging has remained high because of RBI's intervention in both the spot and forward currency markets. RBI has been intervening in currency markets to stabilize the rupee after it depreciated to a record low of 68.85 a dollar in August 2013
- Many corporates expect that RBI will continue intervening to keep the currency stable. Since a stable currency reduces the risk of unforeseen losses, the companies are reluctant to incur high costs on hedging; the cost for which is currently around 8.5% per annum for both currency and interest rate risk
- Typically, big companies prefer to keep a large part of their exposures unhedged, since they feel they can absorb any losses that arise out of currency fluctuations. Also, there are few companies which enjoy a natural hedge by way of an export advantage which helps offset currency risks on imports
- Most companies that take financial hedge usually do it for their short-term loans such as ECBs, and not for long-term loans. This is due to the fact, that the advantage of a cheaper foreign loan gets negated to some extent when the firms take a hedge on the exposure

RBI has taken a slew of initiatives in order to promote hedging among Indian corporates. RBI is seeking to bring down the cost of currency protection by reducing its own dollar buying in forward markets, making it more affordable for companies to buy forward cover. Further, RBI has also told banks to regularly report quarterly data for corporate customers' positions, including estimates of unhedged foreign currency exposure. However, this has achieved limited success as the banks have found it tough to calculate the quantum of such exposures and report them to the central bank. RBI can only regulate the banks and can glean only so much information that a corporate firm voluntarily gives to the banks.

Conclusion

The various sources of corporate financing highlighted in this report show great potential for augmenting corporate investment in the coming years.

Going forward, there are various factors, both domestic and international which will play an extremely important role in shaping the trends in corporate funding for the coming years like global market movements, strengthening of US dollar, RBI's action on interest rates, SEBI regulations on driving capital market activities and visible improvement in corporate earnings at the domestic level.

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