ECB path constricted: What it means for the aam company
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With the recent RBI circular revising External Commercial Borrowing (ECB) norms, Indian companies which so far enjoyed a privileged slot under the automatic route of ECB scheme of things, have lost their ground considerably. So far Indian companies were allowed to borrow in foreign exchange, whether in tranches or otherwise, sums of up to US$ 500,000,000 under the automatic route in a single financial year. With the arrival of the latest circular, it's now been made that not more than US$ 20,000,000 can be infused into companies in India in a given financial year, that too under the approval route for end-uses arising in India.

It follows from the above, that borrowings in excess of US$ 20,000,000 can only be for foreign currency spendings and here the RBI has been careful in not just cutting elements that contribute to higher levels of inflation (by providing for parking of such sums with an Authorised Dealer abroad) but also in leaving an indicator for companies to expand operations to territories outside of India.

On a slightly different note, it may be worthwhile revisiting some of the important restrictions laid down on India specific end-uses of moneys raised under the ECB regime. ECBs can be raised only for investment in real and industrial sector which includes SMEs (Small and Medium Enterprises) and Infrastructure sector. Infrastructure sector has been defined to cover industries like power, railways, roadways and telecommunications amongst others. The term 'Investment' has been defined to include investments on import of capital goods, fresh project financing, modernisation and expansion of existing units. The natural bent is to understand as to what the impact would be on real and infrastructure companies, in particular.

The message is clear for companies in the Real and Infrastructure sectors - their dependency levels on external borrowings would have to come down, while foreign stakes in these sectors are consolidated. Earlier this year, the cap applicable for foreign investments in the Telecom sector was increased from 49 to 74 percent (under the automatic route) . Taking a clue, what might follow, could be the further opening up of sectors such as railways and roadways, power, airport and seaport to foreign players, even as the much awaited revisions to the FDI policy are expected to be notified soon.

Also, going by what has transpired in the last few days, with the RBI (by a notification) deciding to liberalise overseas direct investment norms - by allowing Indian parties to now invest up to 400 percent of their net worth in JVs and Wholly Owned Subsidiaries abroad, it can safely be concluded that the banker's bank has grown keener in not just urging Indian companies to operate from foreign territories but also in flushing out excess money from the domestic market.

In support of the above, by another notification which came on the same day, the RBI also decided to catalyse pre-payment of ECBs by raising pre-payment limits from US$ 400,000,000 to US$ 500,000,000. Given the fact that there already exist some grey areas, especially in arriving at the average maturity period for multiple loans borrowed in a single year, this would come as an incentive for companies wishing to expedite activities on the repayment front.

On the one side, while keeping a tab on external borrowings of Indian companies and also thinning down the roles of third parties like foreign collaborators, international banks and multilateral financial institutions, the RBI is fostering a new wave at the other end for 'aam companies' to diversify operations beyond India.

domestic credits to come easy?

With the US Fed rate cut of 50 bps now in place, what India Inc. would next wait to see will be a possible reduction in the domestic interest rates. Starting from that day in last month, which saw the Fed Reserve reducing both the benchmark nominal rate as well as the discount rate, it could only be a matter of few months before the dollar flow in U.S really picks up. This would in turn stimulate an increased flow of money into India also in the form of ECBs, which would then come at lower all-in-cost ceiling rates. If the RBI pressured by this cut in Fed rates, follows the trend by reducing local interest rates - then that would result in even local loans coming easy into the corporate kitty.

However, considering that the Fed rate cut was largely expected, it could be inferred that the RBI had drawn the ECB plot in anticipation – the decision to bring the US$ 20,000,000 allowed for Rupee expenditure under the approval route particularly evokes some interest. That be the case, it wouldn't be surprising if the RBI's scrutiny of ECB Applications becomes more stringent in the months to come. Perceiving it from that context, would RBI reduce interest rates for the domestic market and even if it doesn't, how long would it want to resist such a move? It all remains to be seen.