CHAPTER 4
INSTRUMENTS FOR RAISING PROJECT FINANCE IN FOREIGN CURRENCY

4.0 Introduction

After the conceptualisation of the investment programme and the finalisation of project costs, the next step in the sequence would be to find out a suitable mix for the means of finance. The means of finance plays a vital role in the viability of projects. Over a period of time, a number of sophistications have developed in the funding mechanism leading to financial engineering.

There are very many ways in which the share capital and the debt components are structured. In this chapter, we would describe in detail the various ways in which finance is raised, especially, foreign currency funding as loan or equity or both.

In general, the instruments to raise finance from the capital market can be classified under two categories, viz.,
(a) Short-term funds that last for less than 12 months and
(b) Medium and Long-term funds that last for more than 12 months.

Foreign currency loans for project finance are usually availed for (a) Import of capital equipment; (b) Payment of technical know-how fees to foreign collaborators; and (c)
payment of remuneration and expenses in foreign currency to foreign technicians. Foreign currency loans however, can not normally, be availed for financing any rupee expenditure. But, with the access to Euro funds the Indian corporates are able to obtain permission for the utilization of the issue proceeds for meeting some amount of rupee expenditure and repayment of costly rupee and foreign currency debts.

4.1 Raising Short-term Funds

For the purpose of raising short-term funds, the instruments available are (a) Bankers Acceptance; (b) Commercial Papers; (c) Bridge Loans; (d) Trade Finance; and (e) Note issuance facilities. Generally, short-term fund instruments last for a period of six to twelve months. Corporate entities avail this form of funding mainly because of its cost advantages. We shall briefly discuss each of the above means.

4.1.1 Banker’s Acceptance

This is a type of finance availed for imports or exports. The seller, in order to ensure a customer’s debt, may ask the customer to arrange for a bank to accept a time draft. Thus, the bank guarantees the customer’s debt. These banker’s acceptances have a higher standing and greater negotiability than trade acceptances.
Once a written demand is accepted by a bank, the draft becomes a bank's IOU and it can be bought or sold like any other negotiable security. These are also known as PRIME ACCEPTANCES in US Money Market which has a good secondary market\(^1\).

### 4.1.2 Commercial Paper

Generally, companies obtain their working capital through banks which play an intermediary role by borrowing short-term funds from one group of firms or individuals and lending the same to another group. A lender thus avoids the trouble of assessing the creditworthiness of a borrower since the bank acts as an intermediary to perform the credit rating, assessment etc. But the banks make profits in the deal. However, large and well-known companies can bypass the banking system by issuing their own short-term unsecured notes. These notes are known as Commercial Paper\(^2\).

These commercial papers are in bearer form with fixed maturity of up to one year\(^3\). The instrument can be used to make offerings at different points of time and have a good secondary market. Credit rating of the issuer is compulsory in the Indian markets.

### 4.1.3 Bridge Loans

Even after tying up the means of finance for a project, some formalities like execution of the documents and creation of
charges etc. delay the disbursal of the loan as per project cash flows. Further, it may not be possible to use the proceeds of a public issue or a rights issue pending completion of some legal formalities. In such situations, bridge loans are normally raised. These loans can be raised from any of the financial institutions or the commercial banks. As and when the proposal and the source of finance are finalised, an application can be made to the lender requesting for sanction of funds against the proposed source of finance. These loans are usually available for a period of three months to twelve months.

4.1.4 Trade Finance

This is linked with the imports and the exports and is usually arranged by the supplier by way of credit.

4.1.5 Note Issuance Facilities

In this arrangement, borrowers issue a short-term paper, with a maturity of three to six months and a group of underwriting banks commit to purchase the notes.

4.2 Raising of Medium and Long-term Funds

The instruments generally used for this purpose are -

a. Equity Linked Issues;

b. Joint ventures, collaborations and production sharing contracts;

c. Multilateral loans from World Bank, IFC, and ADB etc.;
d. Commercial Borrowings:
   - fixed and floating rate notes;
   - syndicated loans;
   - instalment sale asset financing;
   - co-financing;

e. Bilateral Loans

f. Grants and mixed credits;

g. Export credits;

4.2.1 **Equity Linked Issues**

There are two broad ways of making equity issues in international market. One is by way of a fresh issue of equity and the other is by way of divestment of existing equity holdings. The premium to be charged on the issue depends on the net worth of the company, existing earnings, discounted present value of future earnings and replacement value of the assets of the company. Market price of the company's share is also a deciding factor. Thus, the pricing of the issue has to be done in such a way that the company can realise its full potential and also offer at the same time, enough incentives to the investors.

Partly convertible bonds/fully convertible bonds, bonds with warrants etc., are also being issued in the international capital markets to raise foreign currency funds. The interest rate in the case of convertible bonds varies based on the conversion price. The bonds may carry Call and Put
options. Bonds with warrants are low coupon bonds which carry a detachable warrant, enabling the holder to purchase equity shares at a predetermined price, at a future date. Global Depository Receipts (GDR), and International Depository Receipts (IDR) are being used by companies in global equity offers. This would facilitate cross border trading and settlement, enhance liquidity, minimize transaction costs and broaden the potential investor base. These American Depository Receipts (ADRs), IDRs and GDRs predominantly represent equity. However, Depository Receipts can also represent shares, convertibles and debts with or without warrants.

4.2.2 Multilateral Loans

For a developing country like India, Multilateral Loans from international financial institutions like World Bank, Asian Development Bank, Manila (ADB), International Finance Corporation, Washington (IFC) etc., are the major sources of foreign currency funding. Generally, these are project-tied loans offering soft repayment terms. However, the currency exchange rate risk element may, prove to be highly costly to the borrower.

4.2.3 Bilateral Loans

Bilateral loans on Government-to-Government basis also offer a cheap method of financing. However, there has been a
steady decline in such loans in recent times. A major disadvantage of this type of loans is that the borrower has to resort to purchasing from the country providing finance, which sometimes reduces competition and results in cost increases.

4.2.4 Grants and Mixed Credits

This consists of grants as well as loans, which also offer a competitive mode of financing. This has a limited availability and the country's experience with this type of loan is not encouraging. Generally, bidders from the countries offering grants/mixed credit tend to increase their prices much to the disadvantage of the organisation availing the grant/mixed credit ⁴.

4.2.5 Export Credits

Export credits are very commonly used to finance import of capital goods and services with a maturity of 5 to 10 years. These are funded and supported by Government Agencies or Banks of exporting countries. Usually, there is a ceiling on the maximum permissible finance which is limited to 85% of the export value.

Export credits are available mainly in two forms, viz., the buyer's credit and the supplier's credit. A few countries like UK also offer project lines of credit with longer maturities. Under a buyer's credit arrangement, a specific
long-term loan is granted by a designated lending agency in the exporter country to the buyer in the importer country normally against a guarantee by an acceptable bank or financial institution. The supplier receives payment for the exports on his delivering as per the relative commercial contract. The lending agency realises the payment from the buyer in instalments as and when they fall due. The period of credit is reckoned as the duration from the date of completion by the supplier of his obligations under the contract to the date of final payment by the buyer under the credit.

Exim Bank of Korea, Exim Bank of Japan, Exim Bank of USA etc. continue to maintain top positions in providing funds through export credits. One major drawback of export credits is the heavy export insurance premium which makes the financing costlier.

4.2.6 Commercial Borrowings
Apart from multilateral credits and export credits, commercial borrowings also form a very important source of funding for foreign currency expenditure. ONGC has raised a substantial amount by way of Samurai bonds in December '90. But India faces stiff competition for raising commercial borrowings from the Republic of CIS, China and the Eastern European countries.
Department of Economic Affairs has announced certain principles (which are revised from time to time) that would guide the future policy on External Commercial Borrowings (ECB) with more than one year maturity.

The various forms of commercial borrowings are discussed below:

1. **International Bonds:**

   International Bond Market is an attractive source for raising medium to long-term foreign currency funds. This market is expanding rapidly compared to that of syndicated loans. Amount raised through traditional and selected new instruments during 1980 to 1989 are given in Annexure III.

   The main advantage of this market is that the borrowing is directly from the investors themselves without any intermediary resulting in lower cost of funds for the borrower.

   The various foreign bonds in use in the international market are (a) Yankee Bonds in US; (b) Samurai bonds in Japan; (c) Bond tyres; (d) Euro bonds; and (e) Zero coupon bonds.

   Euro Bonds are denominated in one or more currencies other than the currency of that country in which they are sold. For example, a Japanese firm will sell in
US bonds denominated in Yen. Euro bonds have accounted for nearly 80 per cent of the total new issues of bonds in recent years\(^5\). The business is conducted mainly in London. Euro Bonds are usually issued in bearer forms.

Foreign bonds on the other hand are denominated in the currency of the country in which they are sold; but the issuer, however, is from another country. These are also called Yankee Bonds in USA, Samurai Bonds in Japan and Bull dogs in UK.

The bonds could be on a fixed rate basis or a floating rate basis. The former are referred to as "Straight" and the latter are known as "Floating Rate Notes (FRNs)".

ii. **Syndicated Loans**

One of the most popular forms of raising finance in the international capital market has been through syndicated loans. A syndicate of banks jointly provide the funds using a common loan agreement at interest spread over London Inter Bank Offer Rate (LIBOR). Spread depends upon the issuer's rating and credit worthiness. The benefit of a LIBOR linked loan is that large long-term funds can be raised at the cost of short term funds. This type of loan
agreements will have special clauses like cross default, event of default, exemption from withholding tax etc. Since here, the interest rate fluctuates, the borrower is exposed to interest rate variations. Syndicated loans are raised from primary markets. However, banks can also provide such loans within the limits prescribed for the region in which that country falls. Such limits are subject to the ratio of assets to capital of each bank.

iii. Instalment sale and lease financing

Leasing is a unique mode of financing through the use of assets. Though, Leasing activity in Rupees is well established in India, it is a relatively new source for Indian entities as far as foreign currencies are concerned. It involves the acquisition of the economic use of an asset through a contractual commitment to make periodic lease payments to a lessor who owns the asset. Thus, a lease separates "use" from "ownership".

There are two parties to a leasing transactions viz., the lessor who owns and finances the purchase of an asset and the lessee who uses the asset for a price i.e. rentals payable at agreed periodic intervals.
iv. **Co-financing**

This can be used to allow countries of lesser creditworthiness to meet their long-term funds requirement. Under such an arrangement, international financial institutions like the World Bank, the ADB etc. take the co-financing role and offer their guarantee beyond the normal maturity acceptable to the investor for a particular borrower. Thus, for example, investors who are presently willing to risk in investing in India for the next three to four years, may be offered a World Bank or ADB guarantee for repayment of principal and interest payments falling due after three to four years till the date of final maturity. Naturally, a fee will be levied by the co-financer.

4.2.7 Joint Ventures and Production Sharing Contract (Oil Exploration Industries)

This can be used as a tool for attracting foreign currency funds. Such contracts are very useful for countries facing resources constraints. While the exploration risk is borne by the bidder, the country offering its blocks for exploration is benefited by way of a share in oil production in case of discovery of commercial quantity of hydrocarbons. This tool is now well established and globally accepted. China has very successfully utilised production sharing contracts to augment its oil production 6.
In addition to the instruments discussed above, swap and option attached transactions are also structured to the needs of the borrower. Dual currency conversion facility, option sell, commodity linked funds etc., are some of the tools, being tried in world trade. There are more and more innovative tools coming up every day.

4.3 Latest Practices in the Indian Context - Euro Issues

As a part of the liberalisation programme, the Government of India had opened up the economy to foreign investors. First, it was opened only to the recognised Institutional Investors who were required to take approval from the Foreign Direct Investment Board and also from the Securities and Exchange Board of India (SEBI). Subsequently, the Government has allowed the Indian corporates to raise foreign currency funding in the international capital markets by way of Euro Issues and also by placing shares on private basis with Foreign Institutional Investors who are registered with the SEBI. There was, thus, a dramatic surge of international investor interest in Indian scrips during the financial year 1993-94.

Euro Issues make available to Indian companies, cheaper funds through international markets. These funds give substantial strength to the financial base of the company.
This also offers substantial scope to companies to improve the viability of their projects and operations.

4.3.1 Euro Issues

The term "Euro" indicates that the issue is listed on a European Stock Exchange. However, subscription can come from any part of the world except India. There are three options available to an Indian company to raise equity or equity linked debt in the international capital market. These are -

* Depository Receipts (DRs)
* Convertible Bonds;
* Bonds with equity warrants;

The choice of the instrument depends on (a) how the company plans to utilise the foreign exchange; (b) whether it wants to take on debt; (c) whether the project is capital or import-intensive; and (d) whether the company merely wants access to more funds taking advantage of the devaluation of the rupee. A brief discussion to identify the key features and the differences between each of the above options is given below.

4.3.2 Depository Receipts

The term "Global Depository Receipt" means any instrument in the form of a depository receipt or certificate created by an Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares.
or Foreign Currency Convertible Bonds of the issuing company. A Depository Receipt (DR) is a certificate, expressed usually in US dollars, representing a specified number of shares of a specified class of a company. They represent convenient marketable blocks of the shares held.

The most important advantages of an issue of DRs by an Indian company are -

a. For the issuer, the immediate issue of equity to a new range of international investors; and

b. For the investor, the opportunities to invest in Indian companies' shares through the euromarket clearing mechanism (thereby enhancing the potential for a liquid secondary market) and not necessarily having to register as a foreign investor with the RBI.

The shares of the issuer could either be issued directly to, or block purchased on the relevant Indian Stock Exchange and lodged with, a local institution which would hold the shares as "Custodian" to the order of a "Depositary".

The GDRs are so named because they may be cleared through Euroclear, CEDEL as well as the Depositary Trust Company (DTC).

Dividend income from GDRs are subject to a concessional rate of withholding tax. The transfer of GDRs outside India is
exempt from Indian capital gains tax.

An alternative structure to the GDRs is the International Depositary Receipts (IDRs) which does not involve the use of the DTC in the US.

Depository Receipts are issued and traded in US dollars. The issuer takes no currency risk as there is no redemption of a DR and any dividend payment due to the holder of the DR is paid to the investor in US dollars at the prevailing exchange rate on the date of the payment.

GDRs are usually listed on the Luxembourg Stock Exchange which gives investors a more enhanced level of protection than is obtained through direct investment. GDRs cannot normally be voted by holders. Like any equity issue, a GDR will potentially dilute the earnings per share.

4.3.3 Convertible Bonds

The term "Foreign Currency Convertible Bonds" means bonds issued in accordance with this scheme and subscribed by a non-resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part, on the basis of any equity related warrants attached to debt instruments. It is a fixed rate debt instrument which may be converted, at the option of the holder, into underlying shares of the issuer of the bond.
a specified conversion price per share and at a fixed exchange rate at any time during the life of the bonds. If the bond is not converted, it is redeemed at par value at final maturity, or earlier, perhaps at a higher value, if the terms of the bonds allow.

The facilities under this instrument to the investor and the issuer are as follows:

(a) The bond gives the holder an option to acquire shares of the issuer at a known effective cost. If the market price of the shares rises sufficiently or the dividend yield on the underlying shares rises to exceed the coupon on the bonds then an investor may wish to exercise the option and covert the bond into shares.

(b) If the company's share price falls sharply the option could become valueless. The bond, however, has a floor value based on its yield as a fixed interest instrument. If the yields available for comparable credit risks are higher than the coupon on the convertible, the value of the bond will fall to the level at which its yield comes into equilibrium with comparable instruments; and

(c) The coupon on a convertible bond will normally be lower than the yield on a straight bond, but higher than the current dividend yield on the shares.
The maturity of a convertible issue in the Eurodollar market is 10 to 15 years, although this can be shortened. Euroconvertible bonds issued by the 10 Indian companies have maturities between 5 to 7 years except in one case where the maturity is 10.5 years.

The currency of the issue has some impact on the overall structure of an issue. An exchange rate is usually fixed at the time of the offering of the bonds for the purpose of exercising the right of conversion. The conversion ratio and price are then adjusted to reflect certain subsequent events such as rights or bonus issues, share splits or consolidation. The ultimate theoretical risk for an issuer is that of a sharp depreciation in the value of its own currency against the US dollar following which investors may redeem the bonds at maturity or exercise an earlier put option and use the proceeds to purchase the issuer’s shares directly in the market on better terms than those available under the bonds.

Unlike the Indian convertible debentures where it has to be converted within 36 months, the conversion period for the euroconvertible bonds begins at the time or within a short period, perhaps a month, of issue and continues till the final maturity specified by the issuer. The important points considered in pricing the Euroconvertible bonds are
(a) the issuer's current share price; (b) the coupon offered in comparison with the present dividend yield on the issuer's shares; (c) expectations of growth in dividends and the volatility of the issuer's share price; (d) the particular characteristics and requirements of investors; and (e) a comparison of the terms and trading performance in the secondary market of other convertibles issued by Indian companies.

In order to appreciate the differences between the Indian Convertible Bonds (FCDs/FCDs) and a Euroconvertible bond the following table is structured:

Table 4.1

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Indian convertible</th>
<th>Euroconvertible</th>
</tr>
</thead>
<tbody>
<tr>
<td>Underlying instrument</td>
<td>Equity</td>
<td>Equity, or GDRs representing equity</td>
</tr>
<tr>
<td>Conversion</td>
<td>Generally mandatory (36 months)</td>
<td>Optional, except in specific instances</td>
</tr>
<tr>
<td>Time of conversion</td>
<td>In predetermined tranches on fixed dates</td>
<td>At any time during the life of the bonds at the option of the investor</td>
</tr>
<tr>
<td>Forced Conversion by Issuer</td>
<td>Not applicable</td>
<td>Call option when the Company's share price meets certain performance targets or in case of tax reasons</td>
</tr>
</tbody>
</table>
Table 4.1 (Contd..)

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Indian convertible</th>
<th>Euroconvertible</th>
</tr>
</thead>
<tbody>
<tr>
<td>Status</td>
<td>Secured by a charge on assets of the issuer</td>
<td>Unsecured and unsubordinated</td>
</tr>
<tr>
<td>Investor Appeal</td>
<td>Not as attractive to the Indian public as straight equity</td>
<td>Quite attractive to international investors as a defensive instrument</td>
</tr>
<tr>
<td>Forex exposure</td>
<td>None</td>
<td>Payment of interest, and possibly, principal in Foreign Currency</td>
</tr>
<tr>
<td>Secondary Market</td>
<td>Quite illiquid</td>
<td>Widely traded over-the-counter</td>
</tr>
</tbody>
</table>

4.3.4 Convertible Bonds with Equity Warrants

An issue of bonds with equity warrants combines a fixed rate bond, with a detachable warrant exercisable into the shares of the issuer at a specified exercise price, and will be outstanding until its final maturity, irrespective of whether the warrants are exercised or not. The warrants, once detached, may be traded separately, but if a holder wishes to exercise the right to acquire the shares he must pay the exercise price specified.

Generally, the warrants issued with the bonds are detachable immediately following payment so that the warrants and the ex-warrant bonds can be traded independently.
Since the bonds carry the detachable warrants, the coupon on the debt element of the issue is less compared to straight bond.

The debt element is separate from the equity element and has a relatively shorter life. Since this has to be definitely repaid on maturity, there is an opportunity for the issuer to swap the proceeds of the issue or hedge specific assets denominated in the currency of issue.

Because a right to buy shares of the issuer - to invest in the future - has been purchased by an investor rather than a full equity exposure, the amount of the exposure is lower in relation to the value of the shares it relates to, which will be attractive to investors.

Equity warrants normally expire at or just before the maturity of the bonds they were issued with. Normally in the euromarkets, the exercise period begins shortly after the issue date of the bond.

If there is a currency mismatch between the currency of the bond and the underlying shares, the normal practice is to fix the exchange rate of the warrants at the time of the issue. This serves to set the value of the equity that can be purchased on the exercise of warrants and to protect the issuer against currency movements. The exercise price is
normally set in the currency of the underlying shares. Thus, for a Eurodollar issue of bonds with equity warrants, the investor will purchase the warrants in US dollars, but to exercise the warrants the investor will have to pay the exercise price in the currency of the shares.

Warrant valuation has traditionally been a rather subjective exercise, with a range of methods and "rules of thumb" being used as valuation aids. However, more sophisticated mathematical option-pricing models, particularly the Black-Scholes formula, are being employed to serve as a guide to the value of the option contained in a warrant.

The theoretical value of the option to purchase the issuer's equity is determined fundamentally by (a) the exercise price compared to the present share price; (b) the remaining life of the option; (c) the volatility of the share price; (d) the expected dividend growth rate of the issuer; and (e) the dilution expected when the warrants are exercised.

In addition to the theoretical valuation of warrants under these methods, the market is concerned with the nature of the warrant package and particularly the effective premium which is the actual exercise price plus the warrant value per share expressed as a percentage of the current share price. The effective premium will be determined by a number of factors such as the expectations of share price growth.
and the current secondary market performance of comparable outstanding issues.

4.3.5 Comparison of Alternatives

The differences, from an issuer’s point of view, between an issue of Depositary Receipts, issue of convertible bonds, and issue of bonds with equity warrants are given in the following table 11:

Table 4.2

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Depositary Receipts (DRs)</th>
<th>Convertible Bonds (CBs)</th>
<th>Bonds with Equity Warrants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nature of funds raised</td>
<td>Permanent equity capital.</td>
<td>Debt only repaid if not converted. Otherwise, permanent equity capital.</td>
<td>Debt must be repaid. Permanent equity capital injected only if warrants are exercised.</td>
</tr>
<tr>
<td>Equity issued/potentially issued as % of funds raised at time of launch</td>
<td>100%</td>
<td>100%</td>
<td>Normally 50%-100%</td>
</tr>
<tr>
<td>Timing of receipt of equity funds</td>
<td>Immediate</td>
<td>At conversion during life of bond.</td>
<td>At exercise of warrants.</td>
</tr>
<tr>
<td>Ability to force injection of new equity</td>
<td>Not applicable</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Currency exposure</td>
<td>No exposure</td>
<td>Exposed on debt issue. Exposure removed on conversion</td>
<td>Exposed on debt issue. Exposure removed on warrant exercise</td>
</tr>
<tr>
<td>Opportunity for Swaps</td>
<td>Not applicable</td>
<td>No (timing of conversion unpredictable)</td>
<td>Yes</td>
</tr>
</tbody>
</table>
Table 4.2 (Contd.)

Differences between DRs, CBs and CBs with Warrants

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Depositary Receipts (DRs)</th>
<th>Convertible Bonds (CBs)</th>
<th>Bonds with Equity Warrants</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Effect on balance sheet</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Permanent equity capital</td>
<td>Long-term debt until converted.</td>
<td>Long-term debt until repaid.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Permanent equity capital after conversion</td>
<td>Addition to shareholders' funds on exercise of warrants</td>
</tr>
<tr>
<td><strong>Effect on balance sheet gearing on issue date</strong></td>
<td>Decrease</td>
<td>Increase</td>
<td>Increase</td>
</tr>
<tr>
<td><strong>Status of debt</strong></td>
<td>Not applicable</td>
<td>Subordinated (normally unsubordinated if put option present)</td>
<td>Ranks with senior unsubordinated debt</td>
</tr>
</tbody>
</table>

After making the issue, the instruments are registered by the company with a depository, which subsequently issues GDRs to the subscribers. The shares are physically held by a custodian appointed by the depository. The depository does all the administrative work and distributes the dividend/interest after deducting 10% of it as withholding tax.

4.3.6 Cost of Euro Issues

The fee for managers, underwriters etc., ranges between 2.5% to 3.5% of the issue size. This fees is subject to market forces. With the underwriters' charges and the expenses incurred on road shows and printing of literature about the company, prospectus and depository and custodian's
commission, the cost of selling an Euro Issue would work out to 5 to 7 per cent of the issue size.

4.3.7 Guidelines for Issue of GDRs

In order to streamline the issue of Depository Receipts, the Government has come out (vide Notification G.S.R No.708 (E), dated 12th November, 1993) with the Global Depository Mechanism Scheme 1993 given effect from 1st April, 1992. The main object of introducing this scheme is to facilitate issue of Foreign Currency Convertible Bonds and Ordinary Shares through Global Depository Mechanism by Indian Companies.

The summary of the Guidelines for issue of convertible bonds or ordinary shares through global depository receipts, as prescribed in the Global Depository Mechanism Scheme 1993, is as under:

a. The issuing company should obtain prior permission from the Department of Economic Affairs, Ministry of Finance, Government of India;

b. The issuing company shall have a consistent track record of good performance for a minimum period of three years, on the basis of which approval for finalising the issue structure would be granted by the Department of Economic Affairs, Ministry of Finance;

131
c. On the completion of the finalisation of issue structure in consultation with the Lead Managers to the issue, the issuing company shall obtain the final approval for proceeding ahead with the issue from the Department of Economic Affairs.

4.3.8 Government Policy on Euro Issues

A number of Indian companies are vying with each other to have access to international markets for funds for supporting their activities.

With the increase in the number of companies approaching for Euro Issues, the Government of India has been rightly concerned -

a. about the end use of funds by the corporates;

b. that too many issues at the same time could adversely affect the demand for Indian scrips;

c. that the inflow of foreign currency funds could add to the inflation.

With the above in view, a circular has been issued on 11th May, 1994 by the Government of India specifying the following requirements to be fulfilled by the corporate entities wishing to tap the Global Capital Markets13.

a. The GDRs are permitted to be used only for five types of expenses that may be incurred within one year from the date of issue. They are (i) Financing capital goods imports; (ii) Financing domestic
purchase/installation of plant, equipment and building; (iii) prepayment or scheduled repayment of earlier external borrowing; (iv) Making investments abroad where these have been approved by competent authorities; and (v) a margin of 15 per cent of the total proceeds of an issue which can be used for other general corporate restructuring.

b. Companies are required to submit quarterly statements of utilisation of funds duly certified by their auditors.

c. Under the new Guidelines FIPB clearance is required for Euro Issues by a company, coming under Annexure III of the New Industrial Policy of 1991, whose direct foreign investment after a proposed Euro Issue is likely to exceed 51 per cent or which is implementing projects not predominantly contained in Annexure III. The final approval will be given by the Ministry of Finance. Annexure III of New Industrial Policy, 1991, contains the list of industries for automatic approval of foreign technology agreements and for 51 per cent foreign equity approvals.

d. In a Financial Year, only one issue will be allowed by a company with a minimum gap of 12 months between two issues by the same company.
e. In a Financial year, not more than two companies will be permitted to float Euro Issues, in a Group of companies.

f. Both in-principle and final approvals will be valid only for three months from the dates of their respective issue.

g. Request for retention of the issue proceeds abroad will be considered on specific application, for import of capital goods, retiring foreign currency debts, capitalising Indian Joint Ventures etc., and projects abroad.

4.4 Private Placement of Shares with FIIs

The Government of India had also allowed the Indian corporates to place their shares on private placement basis with Foreign Institutional Investors to raise foreign currency funds to meet their project costs. The corporates can offer shares to each FII up to a maximum of 5% of the equity capital and the overall offer shall not exceed 15% (earlier 24%) of the paid-up equity capital. This would require the corporates to take prior approval from the Ministry of Finance and also the Reserve Bank of India.

Though, the Ministry of Finance has been giving its approval for placing the shares on private placement basis, the Reserve Bank of India is not according its approval for such
purposes, as the Foreign Exchange Regulation Act has to be amended. However, RBI is according its approval on a case to case basis. Eventhough, this scheme was introduced during the middle of the financial year 1993-94, very few companies have availed of this facility.

4.5 Innovations in Finance

The objective to earn profit has led to many innovations in the field of finance with new instruments and procedures replacing the old ones. The innovations are triggered by a number of causes such as volatile inflation rates and interest rates, taxation and Government policies, technological advances, and the business cycle. Each change motivates the players to find fresh solutions which are more efficient and complete.

4.6 Summary and Conclusions

There are a variety of instruments available for raising short-term, medium term and long-term funds in foreign currency. For the purpose of raising short-term funds, the instruments available are (a) Banker's Acceptance; (b) Commercial Papers; (c) Bridge Loans; (d) Trade Finance; and (e) Note Issuance Facilities. The Indian borrowers are yet to be exposed to these short-term instruments in the international market though instruments like the Bridge Loans and Commercial Papers are popular in the Indian context.
In the area of medium and long-term funds, the instruments generally considered are (a) Equity Linked Issues; (b) Joint ventures, collaborations and production sharing contracts; (c) Multilateral loans from World Bank, IFC, and ADB etc.; (d) Commercial Borrowings like (i) Fixed and Floating Rate Notes; (ii) Syndicated Loans; (iii) Instalment Sale Asset Financing; (iv) Co-financing; (e) Bilateral Loans; (f) Grants and mixed credits; (g) Export credits;

As far as the Euro markets are concerned, India is in the evolution stage, though the volume of money raised till December, 1994, at USD 4.859 billions is substantial in the Indian context. With the ambitious plans for growth with profitability, in an environment of acute competition more and more Indian companies will be having access to the global markets for funds for improving their cost effectiveness and viability\(^\text{15}\). It is a learning period for both the investors and the companies requiring funds. The trend of funds flow in the recent months indicate that there is a greater investor confidence for such investments in India. With a history of high interest rates and a depreciating currency, the Euro funds could be an alternative to costly foreign exchange loans in improving the viability of the projects and operations of the Indian corporates.
Upto December, 1994, 58 Euro Issues have been floated to raise USD 4.859 billions the split figures being USD 3.844 billions by way of GDRs through 48 issues and USD 1.015 billions by way of ECBs through 10 issues\textsuperscript{16}. A sample comparison of these scrips in the international markets vis-a-vis the Indian bourses as of 15th February, 1995 is shown in Annexure IV.

Compared to the international levels of operations the ratio of bonds to the equity is somewhat different in the Indian scenario. These ratios for Indian markets are in an evolving stage and therefore might take some time to fall in line with the international ratios. Perhaps, this could be at a time, when the interest rates and currency behaviour are in line with the international financial markets.
### References:

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Author</th>
<th>Book Title</th>
<th>Publisher</th>
<th>Vol.</th>
<th>Year</th>
<th>PP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Stewart C. Myers</td>
<td></td>
<td>(Third Edition)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Richard A. Brealey</td>
<td>Op. cit</td>
<td></td>
<td></td>
<td></td>
<td>776</td>
</tr>
<tr>
<td></td>
<td>Stewart C. Myers</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Reserve Bank of India</td>
<td>Credit Policy - 1993</td>
<td>Economic Times</td>
<td></td>
<td>1993</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Bombay, 12.10.93</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Nasalkha M C</td>
<td>Mobilisation of International Finance</td>
<td>The Institute of Chartered Accountants of India, 13th All India Conference, Hyderabad</td>
<td></td>
<td>1993</td>
<td>7</td>
</tr>
<tr>
<td>5</td>
<td>Mohinder M Kaura</td>
<td>Globalisation of World Financial Market - Implications and Strategy for India</td>
<td>Administrative Staff College of India, Hyderabad</td>
<td></td>
<td>1994</td>
<td>3</td>
</tr>
<tr>
<td>6</td>
<td>Nasalkha M C</td>
<td>Op. cit</td>
<td></td>
<td></td>
<td></td>
<td>18</td>
</tr>
<tr>
<td>7</td>
<td>Ministry of Finance</td>
<td>Issue of FCDs and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993</td>
<td>Ministry of Finance, Government of India, New Delhi</td>
<td></td>
<td>1993</td>
<td>2</td>
</tr>
<tr>
<td>8</td>
<td>Ministry of Finance</td>
<td>Issue of FCDs and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993</td>
<td>Ministry of Finance, Government of India, New Delhi</td>
<td></td>
<td>1993</td>
<td>1</td>
</tr>
<tr>
<td>9</td>
<td>DSP Financials</td>
<td>Indian Securities Overseas</td>
<td>Economic Times</td>
<td></td>
<td>1995</td>
<td>25</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Bombay, 17.2.95</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Kidder, Peabody</td>
<td>International Equity Financing</td>
<td>Kidder, Peabody</td>
<td></td>
<td>1994</td>
<td>14</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>New York</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Barings</td>
<td>International Equity and Equity Linked Issues</td>
<td>Barings, UK</td>
<td></td>
<td>1994</td>
<td>22</td>
</tr>
</tbody>
</table>
4.7 REFERENCES (Contd..)

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Author</th>
<th>Paper or Book</th>
<th>Publisher</th>
<th>Vol</th>
<th>Year</th>
<th>PP</th>
</tr>
</thead>
<tbody>
<tr>
<td>13</td>
<td>Ministry of Finance</td>
<td>Fresh Guidelines for</td>
<td>The Institute of Co., Secretaries</td>
<td>XXIV</td>
<td>1994</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Euro Issues - 94-95</td>
<td>Secretaries of India, New Delhi</td>
<td>6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>Van Horne C</td>
<td>Financial Management &amp; Policy</td>
<td>Prentice Hall of India (P) Ltd</td>
<td>1991</td>
<td>554</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>New Delhi,(Eighth)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Sampath Kumar D</td>
<td>Euro Issues - A Corporate gold</td>
<td>The Hindu, Hyderabad</td>
<td>1994</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>rush ?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>DSP Financials</td>
<td>Co.cit.</td>
<td></td>
<td>25</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### CHAPTER 5

<table>
<thead>
<tr>
<th>Para No.</th>
<th>Description</th>
<th>Page Nos.</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.1</td>
<td>Questionnaire - Plan and Methodology</td>
<td>140</td>
</tr>
<tr>
<td>5.2</td>
<td>Coverage of the Study</td>
<td>143</td>
</tr>
<tr>
<td>5.3</td>
<td>The Objectives of Exchange Risk Management</td>
<td>144</td>
</tr>
<tr>
<td>5.4</td>
<td>Organisation for Exchange Risk Management</td>
<td>149</td>
</tr>
<tr>
<td>5.5</td>
<td>Exposure Management Review</td>
<td>153</td>
</tr>
<tr>
<td>5.6</td>
<td>Exchange Rate Forecasting</td>
<td>159</td>
</tr>
<tr>
<td>5.7</td>
<td>Evaluation of Exchange Risk</td>
<td>162</td>
</tr>
<tr>
<td>5.8</td>
<td>Exposure Management Techniques</td>
<td>170</td>
</tr>
<tr>
<td>5.9</td>
<td>Opinion Questions on Exchange Risk Management - General</td>
<td>179</td>
</tr>
<tr>
<td>5.10</td>
<td>Opinion Questions - In the Context of LERMS</td>
<td>181</td>
</tr>
<tr>
<td>5.11</td>
<td>Summary and Conclusions</td>
<td>184</td>
</tr>
</tbody>
</table>