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Advent of International funding options in India

Dr. Monica Sachdeva
Corresponding Author: Dr. Monica Sachdeva

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I. Introduction

Money these days come in all kinds of packages and colors. The challenge for Corporate India now is to get the mix right, given the plethora of funding options. In changing financial market tapping foreign market is no doubt a cheaper way for the Indian companies. Moreover, it creates goodwill of Indian companies in both International and Indian Markets.

Offshore financing instruments have become popular for accessing foreign capital. Obviously, each offshore instrument has positive as well as negative features. In general, smaller issues should probably take the GDR route and the larger explore the ADR alternative, but only if they are willing to shoulder all the ongoing maintenance responsibilities.

Again for instance, a $120 million market capitalization company deciding on a $50 million issue would probably be wise to choose a GDR. On the other hand, a $3 billion company thinking of a $500 million issue should choose an ADR. Meanwhile, Companies with a large equity base and reasonable debt equity ratio may opt for Debt as funding option, which is cheaper than equity alternatives. But the underlying risk in debt is exchange rate. The finance manager of the company should do a proper hedge.

But today, by far most popular means of raising funds in the international markets is external commercial borrowings.

. Even Currency swapping is becoming popular among Indian companies but having risk of exchange rate fluctuations. Covenants also should be considered while issuing particular instruments. As far as Indian government is concerned if the Tara Pore Committee's report of "Fully Convertibility of Rupee" is accepted their will be enormous flow of foreign funds in the Indian market.

In all there are several options available to Indian companies in International market as there are several reasons for Indian companies to tap the wide-open International market.

II. Foreign Institutional Investors And Foreign Investment Banks

2.1 Foreign Institutional Investors (F.I.Is)

a) Meaning of F.I.Is

Foreign Institutional Investors (FIIs) including pension funds, mutual funds, investment funds, etc are permitted to invest in all securities in the primary and secondary markets in India including equity shres/debentures of companies which are listed or to be listed on the recognized stock exchanges and in partly convertible debentures, fully convertible debentures, right renunciations, warrants and units of domestic mutual funds vide the guidelines issued by the Government of India in September, 1992.

In order to be able to invest in the aforesaid manner, the FII would be required to register itself with Securities and Exchange Board of India (SEBI) who will grant such FII registration approval to buy/sell the securities and remit the income/dividend/sale proceeds after payment of applicable taxes through the designated bank branches. The Reserve Bank of India will permit the designated banks to open a foreign currency denominated account and special non-resident rupee account in the name of FII. The designated bank branch will also be permitted to transfer funds from the foreign currency account to the rupees account and vice versa and to make investments of the balance in the rupee account to credit sale proceeds of shares/securities as also dividend/interest earned on the investment of rupee account and to transfer the reportorial proceeds net of taxes from the rupee account to the foreign currency account.

In accordance with the permission granted by Government of India and Reserve Bank of India such FIIs will be permitted to invest up to 24% of the capital of a single Indian company (together with the other non-resident Indians and OCBs etc.). It is further stipulated that the holding of a single FII or the concerned FII group in any company will also be subject to the ceiling of 5% of the total paid-up equity capital. The aforesaid limits however do not include direct foreign investment by foreign collaborators and investments of FIIs through offshore funds, global deposited receipts and Euro convertible bonds.

SEBI has also permitted FIIs to open sub-accounts in favour of their overseas clients, which may include pension funds/investment trust etc. which do not per se qualify for registration as independent FIIs. Foreigners are also permitted to invest in shares or securities subscribed for in foreign currency under the GDR scheme approved by the Government in this behalf. It may be mentioned that there is no ceiling on such investments and in fact the issues are fully for subscription by the foreigners/non-resident. Ministry of finance monitors the issue of such securities.

c) Guidelines for Investment By Foreign Institutional Investors

The liberlisation era budget had announced a decision to allow reputed foreign investors, such as Pension Funds etc. to invest in India capital market. To operationalise this policy announcement, it has become necessary to evolve guidelines for such investments by Foreign Institutional Investors (FIIs). The following guidelines have been formulated in this regard :

1. Foreign Institutional Investors (FIIs) including institutions such as Pension Funds, Mutual Funds, Investment Trusts, Asset Management Companies, Nominee Companies and Incorporated/Institutional Portfolio Managers or their power of attorney holders (providing discretionary and non-discretionary portfolio management services) and non-discretionary portfolio management services) would be welcome to make investments under these guidelines.
2. FIIs would be welcome to invest in all the securities traded on the Primary and Secondary markets, including the equity and other securities/investments of companies which are listed/to be listed on the Stock Exchanges in India including the OTC Exchange of India. These would include shares, debentures, warrants and the scheme floated by domestic Mutual Funds. Government may even like to add further categories of securities later from time to time.
3. FIIs would be required to obtain an initial registration with Securities and Exchange Board of India (SEBI), the total regulatory agency for securities markets, before they make any investment in the Securities of companies listed on the Stock Exchanges in India, in accordance with these guidelines. Nominee companies, affiliates and subsidiary companies of a FII will be treated as separate FIIs for registration, and may seek separate registration with SEBI.
4. Since there are foreign exchange controls also in force, for various permissions under exchange control, along with their application for initial registration, FIIs shall also file with SEBI another application addressed to RBI for seeking various permissions under FEMA, in a format that would be specified by RBI for this purpose. RBI's general permission would be obtained by SEBI before granting initial registration and RBI's FEMA permission together by SEBI, under a single window approach.
5. For granting registration to the FII, SEBI shall take into account the track record of the FII, its professional competence, financial soundness, experience and such other criteria that may be considered by SEBI to be relevant. Besides, FII seeking initial registration with SEBI shall be required to hold a registration from the Securities Commission, or the regulatory organization for the stock market in the country of domicile/incorporation of the FII.
6. SEBI's initial registration would be valid for five years. RBI's general permission under FEMA to the FII will also hold good for five years. Both will be renewable for similar five-year periods later on.
7. RBI's general permission under FEMA would enable the registered FII to buy, sell and realize capital gains on investments made through initial corpus remitted to India, subscribe/renounce rights offerings of shares, invest on all recognized stock exchanges through a designated bank branch, and to appoint a domestic Custodian for custody of investment held.
8. This General Permission from RBI shall also enable the FII to :

a. Open foreign currency denominated accounts in a designated bank. (There can even be more than one account in the same bank branch each designated in different foreign currencies, if it is so required by FII for its operational purpose);
b. Open a special non-resident rupee account to which could be credited all receipts from the capital inflows, sale proceeds of shares, dividends and interests;
c. Transfer sums from the foreign currency accounts to the rupee account and vice-versa, at the market rate of exchange;
d. Make investments in the securities in India out of the balances in the rupee account;
e. Transfer repatriable (after tax) proceeds from the rupees account to the foreign currency account(s);
f. Repatriate the capital, capital gains, dividends, incomes received by way of interest, etc. and any compensation received towards sale/renouncement of rights offerings of shares subject to the designated branch of a bank/the custodian being authorized to deduct with holding tax on capital gains and arranging to pay such tax and remitting the net proceeds at market rates of exchange.
g. Register FII's holdings without any further clearance under FEMA.

9. There would be no restriction on the volume of investment minimum or maximum for the purpose of entry of FIIs, in the primary/secondary market. Also, there would be no lock-in-period prescribed for the purposes of such investments made by FIIs. It is expected that the differential in the rates of taxation of the long-term capital gains and short-term capital gains would automatically induce the FIIs to retain their investments as long-term investments.
10. Portfolio investment in primary or secondary markets will be subject to a ceiling of 30% of issued share capital for the total holdings of all registered FIIs, in any one company. The ceiling would apply to all holdings taking into account the conversions out of the fully and partly convertible debentures issued by the company. The holding of a single FII in any company would also be subject to a ceiling of 10% of total issued capital. For this purpose, the holdings of an FII group will be counted as holdings of a single FII.
11. The maximum holdings of 24% for all non-resident portfolio investments, including those of the registered FIIs, will also include NRI corporate and non-corporate investments, but will not include the following :
a. Foreign investments under financial collaborations (direct foreign investments), which are permitted upto 51% in all priority areas.
b. Investments by FIIs through the following alternative routes :
   i. Offshore single/regional funds;
   ii. Global Depository Receipts;
   iii. Euro convertibles
12. Disinvestments will be allowed only through stock exchange in India, including the OTC Exchange. In exceptional cases, SEBI may permit sales other than through stock exchanges, provided the sale price is not significantly different from the stock market quotations, where available.
13. All secondary market operations would be only through the recognized intermediaries on the Indian Stock Exchange, including OTC Exchange of India. A registered FII would be expected not to engage in any short selling in securities and to take delivery of purchases and give delivery of sold securities.
14. A registered FII can appoint as Custodian an agency approved by SEBI to act as custodian of Securities and for confirmation of transactions in Securities, settlement of purchase and sale, and for information reporting. Such custodian shall establish separate accounts for detailing on a daily basis the investment capital utilization and securities held by each FII for which it is acting as custodian. The custodian will report to the RBI and SEBI semi-annually as part of its disclosure and reporting guidelines.
15. The RBI shall make available to the designated bank branches a list of companies where no investment will be allowed on the basis of the upper prescribed ceiling of 30% having been reached under the portfolio investment scheme.
16. Reserve Bank of India may at any time request by an order a registered FII to submit information regarding the records of utilization of the inward remittances of investment capital and the statement of securities transactions. Reserve Bank of India and/or SEBI may also at any time conduct a direct inspection of the records and accounting books of a registered FII.
17. FIIs investing under this scheme will benefit from a concessional tax regime of a flat rate tax of 20% on dividend and interest income and a tax of 10% on long-term (one year or more) capital gains.

Source: Press Note dated 3rd Sept. 2011 of Department of Economic Affairs, (Investment Division), Ministry of Finance

Till April 2011, FIIs were gross buyers of shares worth Rs 23202.20cr & these net investment was Rs 7106.50 cr. i.e. us $ 1.6 billion (as per SEBI)

Foreign fund managers have reposed their faith in the Indian market despite several headwinds-—from the unusually sticky inflation to slowing growth to deteriorating fiscal situation. Although the sensex had lost a little over 3% during the three month ended June 2011, and the BSE 500 shed 2.3%, the aggregate PH holding in companies that constitute BSE 500 index remained nearly unchanged at 12.5% from 12.6% as of March 2011. And if one compares the corresponding figures between June 2009 and June 2011, FUs have increased their holding in these 500 companies by 2.3 percentage points, from 10.2% to 12.5%, an analysis by domestic brokerage major ICICI Securities showed.

"The optimism displayed by FTIs in the Indian corporate growth story arises from the fact that the Indian economy remained relatively insulated from the global economic meltdown mostly on account of the strong domestic consumption, thrust on infrastructure development and a strong banking system," the I-Sec report noted. "The resilience of the Indian economy reaffirmed the faith of FTI investors who have increased their holding in Indian companies," the report added. After pulling out Rs 63,052 crore in 2008 during the economic meltdown, FIIs invested Rs 85,368 crore in 2009 and Rs 1,34,294 crore in 2010. In the first three months of 2011, during the pre-budget sell off, net FIIs outflow was about Rs 3,100 crore but the April-June quarter witnessed a reverse flow with net FH inflow at Rs5,171 crore.

FIIs holding has declined by just 0.1 percentage point during April-June, the report noted. Between June2009 and June 2011, while total FH holding has remained nearly unchanged, aggregate holding by the promoters in BSE 500 companies have gone down from 61.1% to 58.6%. During the same period ownership by mutual funds too has dipped from3.5% to3.1%. Retail holding, on the other hand, has remained almost unchanged at 10.1%, while holdings by others, which include insurance companies and banks, increased from 15% to 15.6%.

Foreign Invesment Banks

There is little doubt that the advent of foreign investment bank; has had a profound effect on the Indian capital markets both domestically and externally.

The external impetus has arisen in essence from the gradual realization that the size of the capital market in India is insufficient to accommodate the funding requirements and capital raising aspirations of the larger and better known Indian companies. Notwithstanding the fact that the Indian capital market itself has grown considerably in size during the last several years. The capital needs of Indian companies have undoubtedly grown even faster. This is certainly for the growth of Indian GDR market, with companies actively exploring the external options of raising funds. This is where the foreign investment banks have played their greatest role to date.

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