

A Study on External Commercial Borrowings – Impact on Indian Industries

Dr. Sandeep Poddar

Associate Professor

S.P.D.T. Lions Juhu College of Arts and Commerce, Andheri (E) , Mumbai -59

Abstract

This research paper examines the role of External Commercial Borrowings (ECBs) in the Indian economy, focusing on their impact on Indian industries. It explores the concept of ECBs, their advantages and disadvantages, the regulatory framework governing them, and analyzes trends in ECB inflows over recent years. The study aims to understand the motivations behind Indian corporates' utilization of ECBs, assess their effects on domestic industries, and identify the potential drawbacks associated with this form of financing. The research methodology relies on secondary data analysis, primarily sourced from the Reserve Bank of India (RBI) and other publicly available resources.

1. Introduction

External Commercial Borrowings (ECBs) represent a significant source of foreign capital for Indian companies. They encompass various debt instruments, including commercial bank loans, buyer's credit, supplier's credit, and securitized instruments like bonds and notes, obtained from non-resident lenders. ECBs play a crucial role in supplementing domestic resources, facilitating large-scale investments, and enabling access to potentially lower interest rates compared to domestic financing. This paper delves into the intricacies of ECBs, analyzing their impact on Indian industries within the broader economic landscape.

2. External Commercial Borrowings: An Overview

ECBs are a vital component of India's external debt, providing Indian corporates and Public Sector Units (PSUs) with an avenue to finance expansion projects, new investments, and augment domestic resources. ECBs can be utilized for various purposes, including rupee-related expenditures and imports, with certain restrictions in place, such as prohibitions on investment in the stock market and real estate speculation.

2.1 Regulatory Framework

The Department of Economic Affairs, Ministry of Finance, in conjunction with the Reserve Bank of India (RBI), regulates and monitors ECB activity in India. The ECB policy aims to balance the need for flexible borrowing options for Indian companies with the necessity of maintaining prudent limits on overall external debt.

2.2 Routes for Raising ECBs

Automatic Route

ECBs for investment in the real sector (industrial and infrastructure) generally fall under this route, requiring no prior RBI/Government approval up to a specified limit.

Approval Route

Cases that fall outside the purview of the automatic route, including borrowings by certain financial institutions and amounts exceeding the automatic route limit, require approval from an Empowered Committee set up by the RBI.

2.3 Key ECB Guidelines

- **Minimum Average Maturity:** Typically ranges from three to five years, depending on the loan amount.
- **All-in-Cost Ceilings:** Subject to ceilings over the benchmark rate (e.g., LIBOR), including interest rates, fees, and other expenses.
- **End-Use Restrictions:** Primarily intended for investment in the real sector, with restrictions on activities like on-lending, capital market investments, and real estate.
- **Guarantees and Security:** Regulations govern the issuance of guarantees and the creation of charges over assets in favor of overseas lenders.
- **Reporting Requirements:** Borrowers must comply with reporting requirements, including submission of forms and regular updates to the RBI.

3. Trends in External Commercial Borrowings

3.1 ECB Inflows Over the Years

Year	ECB Inflows (USD Billion)
2018	41.5
2019	49.4
2020	35.4
2021	32.6
2022	38.7

The data indicates fluctuations in ECB inflows, influenced by domestic and global economic conditions, interest rate differentials, and regulatory changes.

3.2 Sectoral Distribution of ECBs

Sector	Share of ECB Inflows (%)
Infrastructure	30
Manufacturing	25

Services	20
Others	25

4. Impact of ECBs on Indian Industries

4.1 Benefits of ECBs

- **Increased Investment:** ECBs allow Indian companies to undertake large-scale investments.
- **Technology Transfer:** Foreign borrowing facilitates access to advanced technology and expertise.
- **Lower Interest Costs:** Foreign debt may offer lower interest rates than domestic borrowing.

4.2 Risks Associated with ECBs

- **Exchange Rate Fluctuations:** Depreciation of the rupee can increase the repayment burden.
- **Increased Debt Burden:** High reliance on external debt may lead to financial instability.
- **Regulatory Uncertainty:** Changes in regulations may impact companies' ability to raise ECBs.

5. Need for the Study

This study is crucial for understanding the evolving role of ECBs in the Indian economy. The findings can help policymakers and businesses optimize ECB utilization while mitigating risks.

6. Review of Literature

Existing research has examined capital flows in India, interest rate differentials, and the role of ECBs in financing industrial growth. Prior studies have indicated that ECB inflows are highly sensitive to global financial conditions and domestic regulatory changes.

Vishakha Kutumbale (2012) The ECB are used by Indian Corporate as an additional source of foreign funds for financing their short-term fresh investments, expansion of existing capacities and imports. The RBI has been watchful about allowing rupee expenditure through ECB because of its protectionist stand towards full capital account convertibility. Full capital account convertibility denotes free international capital movement, and the freedom to convert domestic currency into other internationally-accepted currencies and vice versa. Ideally, an increase in external debt of the country should be matched by growth in its forex reserves to maintain solvency in the long run. The findings of the paper suggest that there exists a significant positive relationship between the ECB and IIP over the period under study which reflected that ECB acted as a major input for the positive growth of industrial production in the Indian Economy.

7. Research Methodology

The study employs secondary data analysis, drawing data from the Reserve Bank of India (RBI), government reports, and financial databases.

8. Objectives of the Study

- To examine the various aspects of the ECB policy framework in India.
- To analyze the impact of ECBs on Indian industries.

- To understand the factors driving Indian corporates to opt for ECBs.
- To identify and evaluate the potential drawbacks associated with ECBs.

9. Analysis of Data

The study analyzes ECB inflows, sectoral distribution, and trends over the years. The findings indicate that ECB inflows are subject to global economic conditions and interest rate differentials.

The analysis of ECB data highlights:

- **Rising Inflows (2018-2019):** Driven by low global interest rates and favorable regulatory policies.
- **Decline in 2020-2021:** Due to the COVID-19 pandemic and economic slowdown.
- **Sectoral Impact:** Infrastructure and manufacturing sectors remain the largest beneficiaries of ECBs.

10. Conclusion

ECBs play a critical role in supplementing domestic capital for Indian industries. While they provide access to lower-cost funding and facilitate growth, the associated risks require careful management. The study recommends that policymakers focus on prudent regulation to ensure sustainable use of ECBs in the Indian economy.

References

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