

Impact of Masala Bonds in Corporate Financing

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Abstract

The introduction of Off-shore Rupee Denominated Bonds popularly known as **Masala Bonds** to raise debt fund from NRIs and Foreigners for empowering Indian Rupee was a great move in respect of the response received from the end of investors. The first issue of Masala Bond is made by International Finance Corporation (IFC), an investment arm of World Bank in November 2014. HDFC is the first Indian Corporate issued Masala Bonds in 12th July 2016 by listing in London Stock Exchange. Since the data are insufficient to make a quantitative analysis over ongoing Masala Bond issues, most of the analyses are in qualitative nature on the basis of secondary data available. This paper is an attempt to analyse experiences of international issuers, to analyse the scope of Indian issues and to analyse various upcoming news in this regard to have a meaningful check on pulses favouring Masala Bond issue for financing Indian Corporate. This paper concludes Indian Masala Bonds are highly competitive with any other domestic currency denominated bonds with respect of interest yields but subject to the condition of stability or appreciation of Indian Rupee.

Key Words: Masala Bond (Off-shore Rupee Denominated Bond), IFC, HDFC, Corporate Financing.

Introduction:

Bonds are instruments of debt - typically used by corporate to raise money from investors.

External Commercial Borrowings (ECBs) are the avenues to raise fund from offshore.

The challenge with the ECBs is the entity raising money is faced with a currency risk - they have to be raised and repaid in dollar terms. A year is a long time in forex markets. ECBs are exposed to higher degree of currency risk. The **rupee-denominated bonds** or **masala bonds** are instruments through which Indian entities can raise funds as well as repay in Rupee value from overseas capital markets, while the bond investors hold the currency risk.

For eg: With a Masala Bond, a corporate could issue Rs. 100 billion worth of bonds with the promise of paying back Rs. 110 billion (Principal Amount + 10% annual interest on Principal Amount) in one year. The investors will lend the dollar equivalent of the Rs. 100 billion.

After one year, the Indian corporate needs to pay back the dollar equivalent of Rs. 110 billion. The currency risk is with the investor. Since Masala Bonds act as new source for diversification of financial structure of Indian Corporate, various analysis about its impact on corporate financial structure as well as attractiveness is to be made by researchers.

Research Methodology

- This study is only on the basis of secondary data by the means of published statistics and news updates as of this day.
- Since the numerical data available is insufficient to draw meaningful conclusion, conceptual analysis (except quantitative analysis to test competitiveness of Masala Bond with equitable domestic currency denominated bond of China) is made to draw conclusion and findings.

Objectives of study

- 1) To analyse the competitiveness of Masala Bonds Issued by International Financial Corporation.
- 2) To analyse the scope of Masala Bond Issued by Indian Corporate Entities.
- 3) To analyse latest news related to issue of masala bonds to know its pulses in Indian Corporate world.

Analysis of the Competitiveness of Masala Bond Issued by International Financial Corporation:

The first issue of Masala Bond is done by International Financial Corporation in **November 2014** and the first Indian Corporate issued Masala Bond is HDFC in **July 2016**. The details are as given below.

International Issuers of Masala Bond

- Rs1,000 crore (\$150 million) issued in **November 2014** by IFC to fund infrastructure projects in India.

- Rs1,800 crore (\$ 270 million) issue in **April 2015** by IFC to support private sector investment in India.
- Rs315 crore (\$47.25 million) issue in **August 2015** by IFC to be used for private sector investments in India.
- Other issuers of masala bonds include European Bank for Reconstruction and Development (EBRD), Inter-American Development Bank (IDB), and The Province of British Columbia.

FY15 Borrowings in International Markets

Currency	Amount (\$ Equivalent),	Percentage
U S Dollar	8,621,527,000	54.5%
Australlian Dollar	2,381,909,500	15.1
Brazilian real	1,247,752,840.45	7.9
Japanese yen	6,90,844,961	4.4
Rupee	6,46,237,823.36	4.1
Renminbi	6,11,959,012.97	3.9
Euro	3,40,150,000	2.2
Other	1,278,496,063.62	8.1
Total	15,818,877,201.40	100

FY13 Borrowings in International Markets

Currency	Amount (\$ Equivalent),	Percentage
U S Dollar	6,597,029,098	55.80
Australlian Dollar	1,377,411,350	11.60
Brazilian real	8,91,776,917	7.50
Japanese yen	6,05,262,000	5.10
Russian ruble	4,88,293,678	4.10

Source: Statistics by London Stock Exchange

The above data clearly indicates the role of issues of Masala Bonds by International Organisations. In the year 2015, 4.1% of total Borrowing in International Markets done in Rupee Denomination compared to absence of any notable role in 2013. The fifth position achieved in 2015 in above said aspect is just because of Masala Bond Issues which popularised Indian Rupee among foreign investors.

Comparison with Similar Bonds

- ▶ ‘Dim Sum Bonds’ denominated in the Chinese Renminbi (RMB), were issued in 2007 by the China Development Bank overseas.
- ▶ According to a Citibank July 2016 report, at present there are about 110 Dim Sum Bond issues trading in the market with a par value of RMB 183.10 billion (\$27.61 billion) and a market value of RMB 185.22 billion (\$27.92 billion)
- ▶ The average coupon is 4.10%, the yield to maturity (YTM) is 4.05% and the average life is 3.34 years, with over 75% bonds being of the investment grade.
- ▶ In case of Masala Bond, the average coupon 5y maturity (active bonds) is 6.45% and Average coupon 3y maturity (active bonds) is 6%.
- ▶ Since China has been showing rapid growth in its gross domestic product (GDP) for past years; Dim Sum Bonds have become very attractive and popular, with stock exchanges of Luxembourg, London and Hong Kong being the home of trade for these bonds.

Comparative analysis on behalf of investor:

For Comparative analysis purpose Let us combine interest payable and Depreciation in Rupee Value by assuming Chinese Yuan is stable. The analysis is made an impact reflects as of today.

Let us assume

- 1) \$ 100 is invested by the investor.
- 2) Average yield of Dim Sum Bond is 4.05%
- 3) Current exchange rate is 66.93

Date of Issue	Currency Exchange rate on date of issue	Initial Investment	Equivalent Re value	Average interest yield by Masala Bond	Equivalent Rupee yield as of today (October 2016 *)	Total in \$ value (\$1= Rs 66.93)	Net Benefit (Composition of interest and Decrease in Rupee Value)	Comparative result
November 2014(IFSC)	61.56	\$ 100	Rs 6156	7.25%	Rs 855.43	104.75	2.48%	Weaker
April 2015	62.66	\$ 100	Rs 6266	7.00 %	Rs 681.43	103.8	2.53%	Weaker
August 2015	65.11	\$ 100	Rs 6511	7.25%	Rs 550.72	105.5	4.71%	Stronger
July 2016 (HDFC)	67.13	\$ 100	Rs 6713	7.875%	Rs 131.74	102.27	8.8 %	Stronger

Examples of Calculations

- 1) First line: Total Interest: $6156 * 0.0725 * \frac{23}{12}$ Net benefit: $4.75 * \frac{12}{23}$
- 2) Total Interest: $6266 * 0.0725 * \frac{18}{12}$

From the above analysis it is clear that first two issues of Masala Bond are not competitive with Dim Sum Bonds issued by China. But later it became highly competitive in the international market on a later stage issued by HDFC.

Analysis on milestones achieved and growth potential:

▶ **RBI guidelines regarding issue of masala bond by Indian corporate**

- ▶ The issuance of rupee denominated bonds overseas (Masala Bonds) was permitted by RBI's circular dated 29 September 2015.
- ▶ April 2016 Circular reduced minimum maturity period from 5 years to 3 years
- ▶ The interest payments (coupon payment) for the rupee denominated bonds should not be more than 500 basis points above the sovereign yield of the Government of India security of corresponding maturity.
- ▶ This means if the interest rate of a five-year G Sec is 7%, the interest rate for rupee denominated bond should not be above 12%.
- ▶ On 12th July 2016, HDFC seeks to raise at least Rs2,000 crore from masala bonds sale, which is likely to launch Tuesday and close on Friday.
- ▶ HDFC will have the option of raising Rs.1,000 crore more from the sale in case of excess demand.
- ▶ This was a hot sale in the market and oversubscribed by **4.3 times** of issue.

▶ HDFC has done issuance of Masala Bonds in four separate tranches, Rs3,000 crore on 14 July 2016; Rs500 crore on 1 September 2016 and Rs1,000 crore on 2 September 2016 and Rs 500 crores on 1s October.

▶ It has a maturity of three years and an annual yield of 8.33%.

Interpretation : HDFC (Housing Development Financial Corporation) received a positive response regarding issue of Masala Bonds in LSE and influenced Indian Corporate World to think on the same line.

Initiativeness by Ministry

▶ **November 2015:** On a visit to the UK the Indian Prime Minister Narendra Modi announced that a railway rupee bond would be issued in London to finance the upgrading of India's railway network.

▶ **April 2016:** Piyush Goyal, Indian Power Minister, announced that \$1 billion USD of rupee bonds would be listed in London by Indian public sector corporates.

Analyse latest news related to issue of masala bonds to know its pulses in Indian Corporate world.

▶ **22/08/2016:** HDFC decided to raise issue of Masala Bonds immediately after the reports on 38% rise in standalone net profit to Rs 1,871 crore for the June quarter.

Bond yields and prices move in opposite direction. With limited supply of securities in the market, investors' demand for the paper goes up, creating scarcity premium.

▶ **13/09/2016:** An article in Economic Times states Non-resident Indians (NRIs) living in financial centers such as Hong Kong and Singapore are ideal target investors as they are comfortable with Rupee debt.

▶ So far four Indian issuers have sold a combined 78 billion rupees (\$1.18 billion) of the debt.

▶ **26/09/2016:** Singapore Exchange aims to host global masala bonds with nearly 8 per cent of debt securities listed on SGX issued by Indian companies, and about \$66 billion raised, SGX accounts for about 80 per cent of overseas bond listings by Indian companies.

▶ **14/10/2016:** The 4th issue of Masala bonds by HDFC carries a coupon rate of 7.25 per cent per annum payable semi-annually. The bonds will mature on January 9, 2020.

▶ **17/10/2016:** Fullerton raises Rs 500 crore through the issue of masala bonds and said the bonds were priced at a coupon of 8.12%, cheaper than the rate firm pays for bank loans in India.

▶ Anand Natarajan CEO of Fullerton opined that NBFCs are largely reliant on institutional funds for working capital as a raw material and continuously look for alternate sources of money.

▶ Diversification of funding sources and looking for uncorrelated funding options is a key priority. The masala bonds offer such an opportunity.

Findings

▶ The issue of Masala Bonds made Indian Rupee familiar among Global investors.

▶ Masala Bonds strengthened India-UK financial partnership.

▶ FY 2015 witnessed 4.1% of total international borrowings is Indian Rupee denominated bonds due to issue of Masala Bonds.

▶ In comparison with similar bonds, Masala bonds promise better interest to investors but depreciation of Indian Rupee compared to other Currencies leads into less net returns.

▶ The first Indian Corporate (HDFC) issued Masala Bonds received very warm welcome by investors by 4.3 times oversubscription.

▶ HDFC better utilised the market condition by the total issue of Rs 5000 crore within a short span of time.

▶ The cost of issue of Masala Bond by HDFC is 8.33% which is attractive compared to its last domestic bond issue in the month of June @ 8.46%.

- ▶ The first two issues of Masal Bonds are not competitive with Chinese Dim Sum Bond but the third issue is competitive at present.
- ▶ The Masala Bonds issued by HDFC is highly competitive with any other currency denominated bonds as well ECBs as of today.
- ▶ The better experience of HDFC will be inspiring Indian Corporate World soon.

Limitations

- ▶ Analytical data is not yet evolved.
- ▶ Review of literature mainly consisting of newspapers reading.
- ▶ The study is mainly on the basis of analysis of opinions of CEOs and disclosed proposed activities.

Scope for further study

- ▶ This study can be continued in a later stage with more data.
- ▶ In a later stage it will be easy to analyse interest rate cut by RBI and its effects on Indian Rupee value as well as attractiveness Masala Bonds.

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