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Impact of Masala Bond on Indian Infrastructure Companies

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ABSTRACT

Masala bonds have emerged as a significant financial instrument facilitating capital raising for Indian infrastructure firms in the global market. This abstract examines the effects of Masala bonds on Indian infrastructure firms, focusing on their implications for financing, growth, and risk management. Masala bonds offer Indian infrastructure firms access to international capital markets, diversifying their funding sources beyond domestic avenues. This access enables firms to raise funds dominated in Indian rupees, mitigating currency risks associated with traditional foreign currency borrowing. The issuance of Masala bonds enhances the visibility and credibility of Indian infrastructure firms in the global investment community. By successfully tapping into international markets, these firms signal their financial robustness and attract foreign investors seeking exposure to India's infrastructure sector.

INTRODUCTION

The financing market for infrastructure in India has changed significantly in the last few years, and one important tool for capital raising has been the rise of Masala bonds dominated in rupees. Masala bonds, which are issued in foreign markets and valued in Indian rupees, have attracted interest as a potential way for Indian corporations to reach out to foreign investors while reducing the risk associated with fluctuations in the rupee. Given this, infrastructure companies in particular have been more inclined to use Masala bonds to finance their radical expansion strategies and meet the urgent demand for capital infusion in India's infrastructure sector. The research focuses on these companies' foreign market orientation to better understand how Masala bonds affect Indian infrastructure corporations. By examining the patterns, trends, and factors influencing the issuance of Masala bonds, especially in offshore markets, this research seeks to disentangle the market dynamics and strategic factors influencing infrastructure providers' financing choices. It also seeks to clarify how the issuing of Masala bonds advances the larger goals of capital mobilisation and infrastructure development in India. By issuing Masala Bonds Indian Companies can diversify their funding source beyond the domestic market reducing their dependence on local banks and financial institutions.

OBJECTIVES

1. To understand the working mechanism of Masala Bonds
2. To find Infrastructure projects financed by Masala bonds in India
3. To figure out the advantages and disadvantages of Masala bonds.

METHODOLOGY OF STUDY

This study is mainly based on Secondary data like journals, internet websites, and news articles.

LITERATURE REVIEW

Mrs Vrinda Pandit (2016) Established a research paper titled “Masala Bonds” – A New Debt Instrument in Capital Market. This research paper delves into masala bonds, emphasizing their unique features and potential benefits for Indian enterprises. It discusses transferring currency risk to investors, enabling issuers to streamline obligations and reduce costs. Objectives include distinguishing masala bonds from other financial products, exploring Reserve Bank of India guidelines, and assessing investor attraction. Masala bonds offer access to a broader investor base in offshore markets, lower borrowing rates than domestic bonds, and portfolio diversification. The article underscores masala bonds' appeal to issuers due to their comparatively lower interest rates.

Sarawagi Vineet and Tapan K. Nayak (2018) published a research paper titled Public Private Partnership Contracts: Indian Infrastructure Perspective. This paper shows that in India, the government is a major contributor to the fast growth of the infrastructure sector. Because of their high prices and extended durations, the contracts for these projects are extensive and require careful examination. Although private equity firms participate but face difficulties such as bureaucratic hurdles and problems with land acquisition. Corporate bonds like Masala and Green bonds are seen as potential funding sources for these projects. Finally, it suggests that the evolving landscape of Public-private partnership contracts in the infrastructure sector is expected to attract interest both globally and domestically, contributing to the overall growth of the country.

Renu Kohli, Pravakar Sahoo and M Shuheb Khan (2017) established a research paper titled Developing India's Offshore Local Currency Bond Market: Lessons from Emerging Countries The paper tells that after the 2008 financial crisis, the offshore local-currency bonds of emerging market economies (EMEs) experienced a significant increase, indicating divergent patterns between advanced economies and EMEs. To capitalize on this trend for financing domestic infrastructure while controlling currency concerns, India introduced masala bonds, or bonds denominated in rupees, in the year 2013. Even in the initial phases, investors and issuers have shown significant interest in masala bonds. However, constraints like depth and liquidity slow down the expansion and development of the market. The study finds critical elements for the masala bond market's further expansion and viability as a source of funding for infrastructure through surveys and case studies of EME peers like China and Brazil. Overall, supply-side impulses and investor interest support the masala bond financing channel. However, the market is still in its nascent stages and needs important challenges to be resolved effectively in the long run.

Dr Renu Jatana and **Dr Mehjabeen Barodawala** (2021) published a research paper titled Did IFC's MASALA BONDS TEMPERED INDIAN FOREX MARKET? This paper tells that a major shift in the financial landscape occurred in 2014 when the International Finance Corporation (IFC) introduced Masala bonds, allowing Indian corporations to receive financing from overseas investors in Indian rupees. The global financial markets have taken notice of this endeavour, and academics are delving into its ramifications. Khan (2015) emphasizes how the successful placement of Masala bonds gave Indian regulators more confidence, which resulted in broader issuance approvals for resident corporate businesses and investment trusts. Mishra and Roy (2018) examine Masala bond competitive dynamics with particular attention to how they affect Indian exchange rates. Additionally, Sharma et al. (2019)

investigates the money coming into India via Masala bonds, providing insight into their influence on the development of the nation's financial markets.

Aviral Agrawal and Darshan M Jain (2018) – "MASALA BONDS AND ITS FINANCIAL IMPACT ON ISSUING COMPANIES", Volume 05 Issue 4(1), Pages: 105-111. It says Masala Bonds are a recent development in the bond market that allows the issuer to raise funds from foreign markets in Indian Rupees and transfer the currency hazard to the investor. Masala bonds were first issued by the International Finance Corporation in the time 2014 and listed on the London Stock Exchange. This paper highlights Masala bonds and their impact on the performance of the company and finally tries to find out the relation between the debt component and the cost of capital of the organisation

News reported by **The Hindu Bureau** on September 30, 2022, titled "ED is not probing masala bonds issued by the Central govt. agencies, KIIFB tells HC". It says that the KIIFB instance serves as proof of the research around masala bonds, which highlights their critical role in financing infrastructure projects. The KIIFB made it clear that no investigation is focused on masala bonds issued by government organizations like NTPC and NHAI, stressing their contributions to industries like renewable energy and transportation development. Transparency concerns are raised by the ED's refusal to respond to inquiries regarding the masala bond launches of other entities, even in breach of court orders. The state's progress is impacted by investigation delays and impedes project approvals and infrastructure development. Critics claim that there is a lack of transparency and legal basis for the ongoing investigation, which puts ongoing initiatives in danger. Despite compliance concerns, this case highlights the significance of masala bonds in financing vital infrastructure.

MASALA BONDS

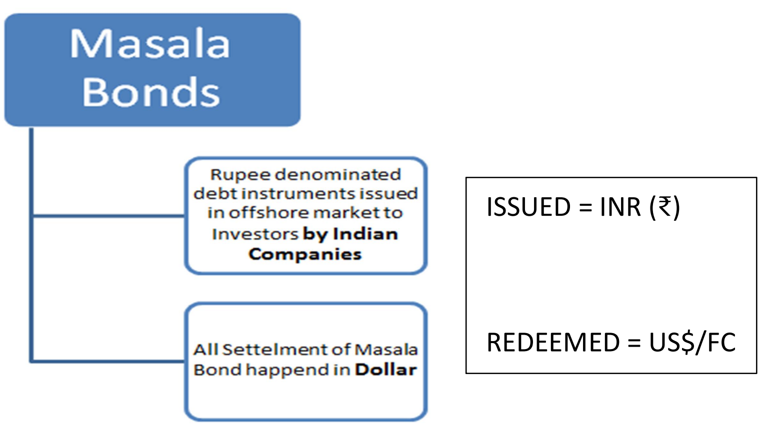
Meaning

Masala bonds are like loans that Indian companies take from people outside India, but they're in Indian rupees instead of foreign currency. This means foreign investors lend money to Indian companies in rupees. The International Finance Corporation (IFC) started this trend in 2014 by launching these bonds on the London Stock Exchange. These bonds are special because even though they're in rupees, they're settled in US dollars, and their value depends on how the Indian rupee is doing against the dollar. This helps Indian companies borrow money from overseas investors while keeping their loans in rupees. For

Indian companies, masala bonds are a good way to manage their debts, reduce costs, and show off the strength of the Indian rupee to foreign investors. These bonds also open up opportunities for a wider range of investors, not just big institutions, because they're listed on stock exchanges. Overall, masala bonds make it easier for Indian companies to borrow money globally and for foreign investors to invest in India's growth.

WORKING MODEL OF MASALA BONDS

A Company wants to build an infrastructure in India, but they need a lot of money to do it. Instead of borrowing money from Indian banks, they decide to issue masala bonds to raise funds from foreign investors. So, the company decided to issue a Masala bond worth ₹100 crore. These bonds are dominated by Indian rupees, which means they're in rupees, not in foreign currency like dollars or euros. However, these bonds will be traded and settled in US dollars. Now, let's say a foreign investor, wants to invest in these masala bonds. The investor agrees to lend ₹1 crore to the Company by buying their masala bonds. The Company promises to pay the investor back with interest in rupees. When the investor buys the masala bond, the investor pays ₹1 crore to the Company. This money goes towards funding the construction of the infrastructure. In return, the Company gives the investor a bond certificate, confirming their investment.



Over time, the Company pays back the loan to the investor in rupees, including interest. If the Indian rupee strengthens against the US dollar during this time, the investor will get more dollars when they convert their rupee earnings back into dollars. On the other hand, if the rupee weakens against the dollar, the investor might get fewer dollars when converting their rupee earnings back. This means there's a currency risk involved for the investor, as the value of the investment depends on the exchange rate between the rupee and the dollar. In this way, masala bonds allow Indian companies to raise funds from foreign investors in rupees while shifting the currency risk to the investors. It also offers investors the chance to participate in India's growth and gain returns on their investments.

INFRASTRUCTURES FINANCED BY MASALA BONDS

NHAI - The National Highways Authority of India, has raised Rs 3,000 crore by selling the rupee-denominated masala bonds that are now listed on the London Stock Exchange. The initial benchmarked issue of INR 1500 crore was upsized to INR 3000 crore at a price yielding 7.30% annually. The transaction marks the largest ever 5-year issuance and the largest inaugural transaction in the Masala Bond market.

IRFC - Indian Railway Finance Corporation, the finance arm of Indian Railways, is planning to raise Rs 1,000–2,000 crore through an issue of rupee-denominated offshore or masala bonds. The instruments will have a tenure of three to five years, and the company is optimistic about getting a coupon of around 7% or below. S&P Global Ratings recently affirmed the 'BBB-issuer' rating on IRFC.

NTPC – National Thermal Power Corporation lists the world's first Indian green masala bond and the first masala bond by a Quasi-sovereign issuer. The listing raises INR 20 billion ($ 300 million) with a 7.48 per cent annual yield, attracting global investor support to the Indian Government's target to generate 175GW of renewable energy by 2022. The bond has been independently certified by the Climate Bonds Initiative and will be listed on the London Stock Exchange's green bonds segment.

KIIFB - Kerala Infrastructure Investment Fund Board's debut Masala bond is the first sub-sovereign entity in India to tap the offshore rupee international bond market. The INR 21.5 billion ($312 million equivalent) senior secured fixed-rate bond has a five-year tenor with a 9.723% coupon. The band has been admitted to the London Stock Exchanges.

HDFC - Housing Development Finance Corporation Ltd has been the first corporation in India to issue Rupee Denominated Bonds. The INR 30 billion issue bears a fixed semi-annual coupon of 7.875% per annum and has a tenure of 37 months. The bonds have been issued for 99.24% of their par value, and the annualised yield to the investors is 8.33% per annum.

Advantages For investors

- Less documentation as there is no need to register as a foreign portfolio investment [FPI] in India.
- Masala bonds will provide diversification from the relatively shallow domestic bond market.
- Masala bond offers 9% for investors
- Capital gains arising from rupee appreciation are exempted from tax.
- The bond can be settled in foreign currency through international custodians.

For issuer's

- Cheaper cost of funds as masala bonds often issued below 7% interest rate.
- No currency risk as the companies issuing bonds do not have to worry about rupee depreciation

The proceeds can be used for

1. Refinance of rupee loan and NCDs
2. Development of integrated townships/affordable housing projects
3. Working capital to corporate

Disadvantages

For issuers

- Regulatory requirements: Issuers must comply with regulatory requirements set by both Indian and international authorities, which can add complexity and cost to the issuance process.
- Non-performance of bond due to high interest

For investors

- Liquidity risk: Masala bonds may have lower liquidity compared to bonds issued in more established markets, making it difficult to buy or sell large quantities without affecting the market price.
- Currency risk: Fluctuations in the exchange rate between the Indian rupee and the currency in which the bond is denominated can affect the returns for foreign investors.

Conclusion

Masala Bonds are a type of financial instrument that allows Indian companies to raise capital in foreign markets using their currency, the Indian Rupee. By providing investors with an entry point into Indian assets, these bonds help issuers diversify their funding sources. In summary, Masala bonds give Indian businesses a creative way to finance themselves by giving them access to global capital markets and a variety of funding sources. Although their success is dependent on several variables, including the state of the market, the regulatory landscape, and investor interest, they offer a potential possibility to both issuers and investors. Masala bonds are an attractive option for funding infrastructure projects since they mitigate currency risk, give access to global financial markets, allow flexibility in the bond's structure, and support the growth of the Indian capital markets. As a result, they serve as a useful instrument for meeting India's infrastructure development's finance requirements.

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