VIVRO FINANCIAL SERVICES

# FINTELLIGENCE

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# FOREWORD

The development and growth of companies is sustained with the availability of capital. Among the several avenues of fund raising available to listed companies, a Rights Issue is an important avenue. Companies pursue Rights Issue as a means to raise funds from existing shareholders for various reasons, ranging from expansion or acquisitions to paring down debts, often at a price less than the prevailing market price. In 2014-15, 18 companies raised around INR 6,750 crores through rights issues. During the current fiscal year (up to December 2015), 9 companies have raised more than INR 8,600 crores by means of rights issue, which is a testament to the fact that while equity bourses have seen some tumultuous movements in recent times, capital is available in the system for companies with effective and efficient management and corporate governance.

While a rights issue is used to raise capital, a buy back is an offer by a company to acquire its own shares from the market. Buy-backs have gained considerable importance in the past 25 years, since the addition of sections 77A, 77AA and 77B in Companies Act, 1956 through the Companies (Amendment) Act, 1999. A buyback carried out through the stock exchange mechanism is more tax efficient and provides a transparent method of returning capital back to its shareholders and reorganising the capital base of the company.

Banks and Financial Institutions rely on information while evaluating the possibility of extending credit to customers. In the mix of information used to appraise credit facilities of customer, Credit Rating of the customer from external credit rating agencies proves to be a valuable input. It not only provides an independent assessment of the financial risk inherent in working with the customer, but also acts as a revalidation of a company's internal credit assessment. From the point of view of customers/companies, an understanding of their perceived risk and measures to be taken to improve their risk rating is quite essential in the modern financial world. As per Basel III norms that will be applicable to banks in the near future, the quality of credit would impact the amount of capital a bank needs to provide for its capital adequacy norms, making credit rating of the borrower company an important determinant for lending and pricing.

The government of India is making several legislative changes in order to bring efficiency in capital markets and the avenues of raising capital, especially with respect to the new changes made in Foreign Direct Investment regulations. Through Press Note 12 dated 24th November, 2015 and recent amendments proposed in the Union Budget 2016-17, the government has eased restrictions on foreign direct investment ("FDI") in India with a view to promote the 'Make in India' and 'Startup India' initiatives. According to the Department of Industrial Policy & Promotion, India has now thrown open 92.5 per cent of FDI through the automatic route, which is certainly a welcome development.

As we advance into a new financial year in India, we are happy to release our March – April, 2016 Issue of Fintelligence. We hope you enjoy this edition of Fintelligence. Please write back to us on fintelligence@vivro.net with your valuable feedback and comments. Wishing you all a Prosperous Financial Year ahead!

Nilesh Vaishnav

Chairman

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# RIGHTS ISSUE
# AN EFFECTIVE MANNER OF RAISING CAPITAL

## Introduction

A rights issue is a seasoned offering in which the issuing company solicits investments from existing shareholders of a company in proportion to their current holding typically at a discount to the current market price. The idea is to offer existing shareholders with an investment opportunity, which is perceived to be attractive.

Companies pursue Rights Issue as an avenue to raise funds for various reasons, ranging from expansion or acquisitions to paring down debts. Since a rights issue results in a higher equity base for the organisation, it also provides it with better leveraging opportunities.  They view a rights issue as a special "by invitation only" opportunity.

The table below shows a comparison of funds raised by Corporates via initial public offer and rights issue in India.

| | 2015-16 (Upto Dec 15) | | 2014-15 | | 2013-14 | | 2012-13 | |
|---|---|---|---|---|---|---|---|---|
| Issue Type | No of Issues | Amount` Crores | No of Issues | Amount` Crores | No of Issues | Amount` Crores | No of Issues | Amount` Crores |
| Public Issues | 50 | 12,259 | 46 | 3,039 | 40 | 8,693 | 33 | 6,528 |
| Rights Issue | 9 | 8,631 | 18 | 6,750 | 15 | 4,576 | 16 | 8,945 |

Source: Internal Research

It is worthwhile to note that the number of companies who accessed capital market were far more than the companies who raised funds through rights issue, however, the average issue size in case of rights issue was much higher. It demonstrates the faith reposed by the existing shareholders in the company and its management.

## Rights Issue – Equity Capital and Market Capitalisation

Rights Issue affects two important elements of a company - capital and market capitalization (M-Cap). The effect on M-Cap depends on the perception of the market. In theory, every new issue has some kind of diluting effect and hence as a result of a fall in the market price in proportion to an increase in the number of shares, the market capitalisation remains unaffected.

However, if the market sentiment believes that the funds are being raised for an extremely positive purpose then price of the stock may just rise resulting in an increase in the market capitalisation. If a shareholder does not want to exercise the right to buy additional shares then he/she can sell the right entitlements as the rights entitlements are usually tradable. Alternatively, investors can let the rights entitlement lapse.

## Regulatory Framework:

Section 62 of Companies Act, 2013 contains provisions on "further issue of capital", and enacts the principle of pre-emptive rights of shareholders of a company to subscribe to new shares of the company. Provisions of Section 62 of Companies Act, 2013 are mandatory for all Private companies, Public Companies, Listed as well as Unlisted companies in relation to further Issue of Capital.

A rights issue by any listed issuer, where the aggregate value of specified securities offered is fifty lakh rupees or more has to comply with Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, as amended ("ICDR Regulations")

As per ICDR Regulations "Rights Issue" means an offer of specified securities by a listed issuer to the shareholders of the issuer as on the record date fixed for the said purpose.

There are no eligibility conditions for Listed Companies to be eligible for making a Rights Issue Offering unlike an Initial Public Offer. As per ICDR Regulations, the following companies are not allowed to raise funds through a Rights Issue:

- Issuer, Promoters/ Promoter Group or Directors or persons in control of the Company debarred from accessing the capital market;
- Promoters, Directors or Persons in control of the Company was or also is a promoter, director or person in control of any other company debarred from accessing capital market;
- If there are any existing partly paid-up equity shares;
- If firm arrangements of finance towards 75% of the stated means of finance, excluding the amount to be raised through the proposed rights Issue is not made;
- if the issuer of convertible debt instruments is in the list of wilful defaulters published by the Reserve Bank of India or it is in default of payment of interest or repayment of principal amount in respect of debt instruments issued by it to the public, if any, for a period of more than six months.

## Points to be considered prior to the Rights Issue

- There shall be no further issue of specified securities during the period between the date of filing the draft offer document with the Board and the listing of the specified securities offered, unless full disclosures are made in the draft offer document.
- If there are any holders of outstanding compulsorily convertible debt instruments, their reservation of equity shares of the same class shall be in proportion to the convertible part thereof.
- Issue price to be decided before determining the record date.

## Record Date

- A listed issuer shall announce a record date for the purpose of determining the shareholders eligible to apply for specified securities in the proposed rights issue.
- The issuer shall not withdraw rights issue after announcement of the record date. However, if the rights issue is withdrawn, the company shall not make an application for listing of any of its specified securities for a period of twelve months from the record date.

## Manner of Disclosures in the Offer Document

As per recent ICDR Regulations, there are two types of disclosure documents – Full Disclosure document as per PART A of the SEBI (ICDR) Regulations, 2009 and a limited disclosure document as per PART E of the SEBI (ICDR) Regulations, 2009 under Schedule VIII. In order to be covered under the limited disclosure document, certain compliance conditions are to be met by the Issuer, as follows:

- The issuer has been filing periodic reports, statements and information in compliance with the listing agreement for the last 3 years;
- The reports, statements and information referred to above are available on the website of any recognised stock exchange with nationwide trading terminals;
- The issuer has investor grievance handling mechanism which includes meeting of the Shareholders' or Investors' Grievance Committee at frequent intervals appropriate delegation of power by the board of directors as regards share transfer and clearly laid down systems and procedures for timely and satisfactory redressal of investor grievances.

However, in Issuers where there is a change in the management post a takeover or an Issuer whose securities are listed pursuant to a Scheme of Arrangement sanctioned by the High Court under section 391 to 394 of the Companies Act, 1956 – no exemption of limited disclosures is available even if the Issuer meets the above mentioned criteria.

The key difference between a limited disclosure and a full disclosure are as under:

| Key Sections | Full Disclosure Document | Limited Disclosure Document |
|---|---|---|
| Business Section | Details of the Business, strategy, Property etc. need to be disclosed | Exempted |
| Industry Section | To be disclosed | Exempted |
| Basis of Issue Price | To be disclosed | Exempted |
| History & Corporate Structures | To be disclosed since inception | To be disclosed only if the Issuer has not come out with any Issue in past 10 years |
| Group Company Information | To be disclosed | Exempted |
| Promoter & Promoter Group | To be disclosed | Exempted |
| Financial Information | Restated Financial Statement needs to be presented for last 5 completed years and for the stub period | Audited Financial Statement for last completed year and Limited Review numbers for the stub period needs to be presented |
| Outstanding Litigations | Material litigations as per board policy needs to be disclosed | Material litigations which may have an impact of more than 1% of the networth (as per latest audited Financial Statements). |

## Pricing Guidelines

There are no laid down procedure or guidelines for determining the price at which the shares can be offered in a right issue. Companies are free to determine the price at which the Rights Issue share may be offered. Typically, securities are offered at a discount to the recent trading price.

## SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (SAST Regulations) And Rights Issue

An acquirer is obliged to make an open offer in terms of SEBI SAST Regulations for:

- Acquisition of Shares or Voting rights in a Company which entitles acquirer to exercise 25% or more voting rights;
- Acquisition of additional 5% shares or voting rights beyond 25%.

SAST Regulations has prescribed certain exemption. One such exemption pertains to change in holding pursuant to acquisition of shares beyond entitlement in a Rights Issue.

Acquisition of shares by any shareholder beyond his entitlement pursuant to a Rights Issue, shall be exempt from open offer obligations subject to fulfillment of the following conditions:

- the acquirer has not renounced any of his entitlements in such rights issue; and
- the price at which the rights issue is made is not higher than the ex-rights price of the shares of the target company, being the sum of:

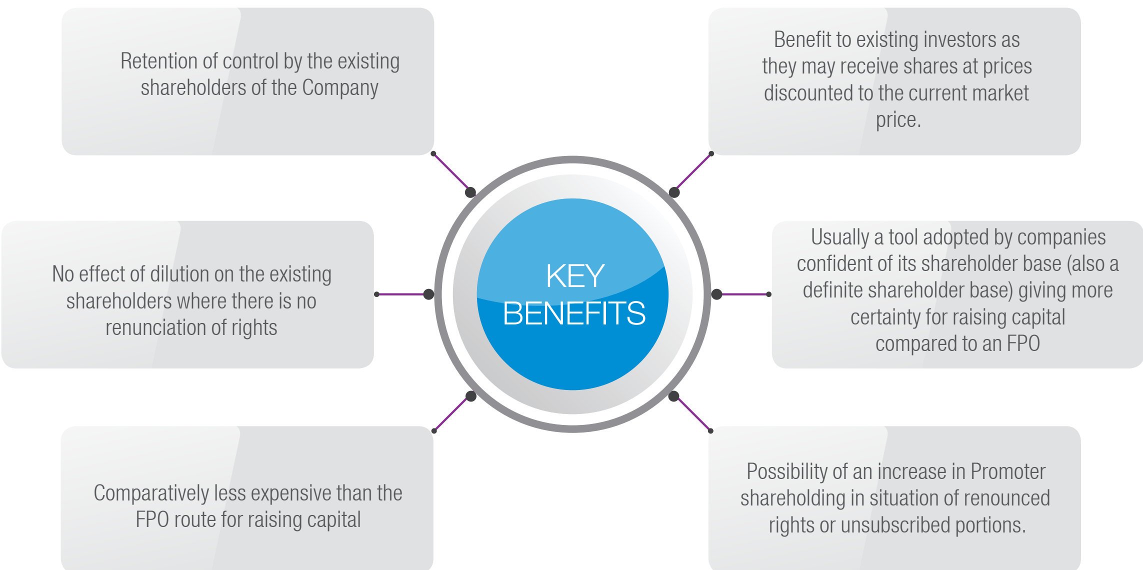
**A** (Volume Weighted Average Market Price during 60 days *Number of shares outstanding)/ Total Number of shares outstanding after allotment under the Rights Issue AND

**AND**

**B** (The Price at which shares are offered in the Rights Issue *Number of shares offered in Rights Issue)/ Total number of shares outstanding after allotment under the Rights Issue

| | | |
|---|---|---|
| *For Example* | Volume Weighted Average Market Price during last 60 days | = Rs.100 |
| | No. of shares outstanding | = 1000 |
| | No. of shares post rights | = 1500 |
| | Rights issue Price | = Rs. 60 |

In the given case, the price at which the rights issue is made shall not be higher than the ex-rights price of the shares of the target company being,
[(100*1000)/1500] + [(60*500)/1500] = Rs. 86.67



## Conclusion

Amongst various forms of capital raising a Rights Issue may be considered as an effective tool to raise funds from existing shareholders without necessarily diluting their shareholding in the Company. A properly structured issue can be used as a cost effective mechanism to fund expansion, and reward existing shareholders.

In 2014-15, 18 companies raised around INR 6,750 crores through rights issue. During the current fiscal year (upto December 2015), 9 companies have raised more than INR 8,600 crores by means of rights issue and many more are likely to follow.

# BUYBACK OF LISTED SHARES
# **AN OVERVIEW**

## Introduction

Buyback of shares is the repurchase of its outstanding shares by a company. Companies generally buyback shares in order to reorganise its capital structure, return cash to shareholders and enhance overall shareholders' value. Buyback leads to reduction in outstanding number of equity shares, which may lead to improvement in earnings per equity share and enhance return on net worth and create long term value for continuing shareholders.

There are generally two ways a company can return cash to its shareholders – declaration of dividend or through a buyback of shares. A buyback represent a more flexible way of returning surplus cash to its shareholders as it is governed by a process laid down by law, it is carried out through the stock exchange mechanism and is more tax efficient as it does not involve the company to make payment of dividend distribution tax and it has the benefits of long term capital gains. This article elucidates the buyback regulations in India, its methods and broad process.

## History

The major objective of the buyback ordinance was to revive the capital markets and protect companies from hostile takeover bids. Prior to the amendment of the Companies Act, 1956, buyback of securities in India was prohibited under Section 77 of the Act which imposed a blanket ban on companies from buying their own securities. The concept of buy-back of securities was introduced in the Companies Act, 1956 by the Companies (Amendment) Act, 1999 by the insertion of Sections 77A, 77AA and 77B. Apart from the above provisions, a company was required to comply with the conditions mentioned in Section 77 of the Companies Act, 1956 as well as Private Limited Company & Unlisted Public Limited Company (Buyback of Securities) Rules, 1999 simultaneously. Under the Companies Act, 2013 buyback is governed by sections 68, 69 and 70.

Once the Companies Act, 1956 was amended in 1999, buybacks started gaining momentum. The practice of buybacks has now spread far and wide across the corporate spectrum, with small and large companies across different sectors. The table below gives an overview of buybacks and money being returned to shareholders in the form of buybacks:

| Year | Amt. Rs. In crores | No. of Issues | Year | Amt. Rs. In crores | No. of Issues | Year | Amt. Rs. In crores | No. of Issues |
|---|---|---|---|---|---|---|---|---|
| 1998-99 | 1 | 1 | 2004-05 | 3600 | 11 | 2010-11 | 4295 | 20 |
| 1999-00 | 300 | 12 | 2005-06 | 363 | 10 | 2011-12 | 13765 | 31 |
| 2000-01 | 1297 | 14 | 2006-07 | 295 | 7 | 2012-13 | 1694 | 21 |
| 2001-02 | 2154 | 27 | 2007-08 | 2004 | 10 | 2013-14 | 11380 | 32 |
| 2002-03 | 1011 | 31 | 2008-09 | 4218 | 46 | 2014-15 | 605 | 10 |
| 2003-04 | 52 | 8 | 2009-10 | 824 | 20 | 2015-16 As on 31 Jan 2016 | 1418 | 12 |

**Source:** Prime Data- The primary market monitor

## International Scenario

In advanced countries, companies utilize their reserves to buyback equity share for the purpose of extinguishing the shares or treasury operations. Under the law of some states in the US, including Delaware and New York, a company that repurchases its own shares has two main options: (1) hold them as treasury shares or (2) retire the re-purchased shares. Internationally, treasury stock is created in the US, UK, China and many other countries. Majority of these countries have specific legislations governing the creation and use of treasury stock. The law and procedures relating to buyback of their own shares by companies vary from country to country. For instance, the legal system in USA and Canada is quite flexible when it comes to treasury stock however in the UK there is elaborate procedure for buyback of shares. In the US buyback of shares by companies is a common business strategy. The board is empowered to decide buyback including price to be offered, number of shares to be repurchased and timing, can repurchase from open market by a tender offer or private negotiations etc., without recourse to shareholders' resolution, whereas in UK a company can repurchase through market purchase and Off Market Purchase which is authorized by members' resolution in General Meeting.

At present, in India, there is no specific law which permits the creation of trust shares or treasury stock, since the Companies Act require shares which are bought back to be extinguished.

## Legal Framework for Buyback:

| | |
|---|---|
| For Unlisted Public and Private Companies | Section 68, 69 and 70 of Companies Act, 2013 Rule 17 of Companies (Share Capital and Debentures) Rules, 2014 |
| For Listed Companies | Section 68, 69 and 70 of Companies Act, 2013 Rule 17 of Companies (Share Capital and Debentures) Rules, 2014<br>Securities and Exchange Board of India (Buy-back of Securities) Regulations, 1998 and Securities and Exchange Board of India (Buy-back of Securities) (Amendment) Regulations, 2013. |

## Sources, Prohibition and Pre-conditions of Buyback

Shares can be purchased by the Company out of :

- Free Reserves;
- Securities' Premium Account;
- Proceeds generated out of Issue of any shares or other specified securities.

No buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

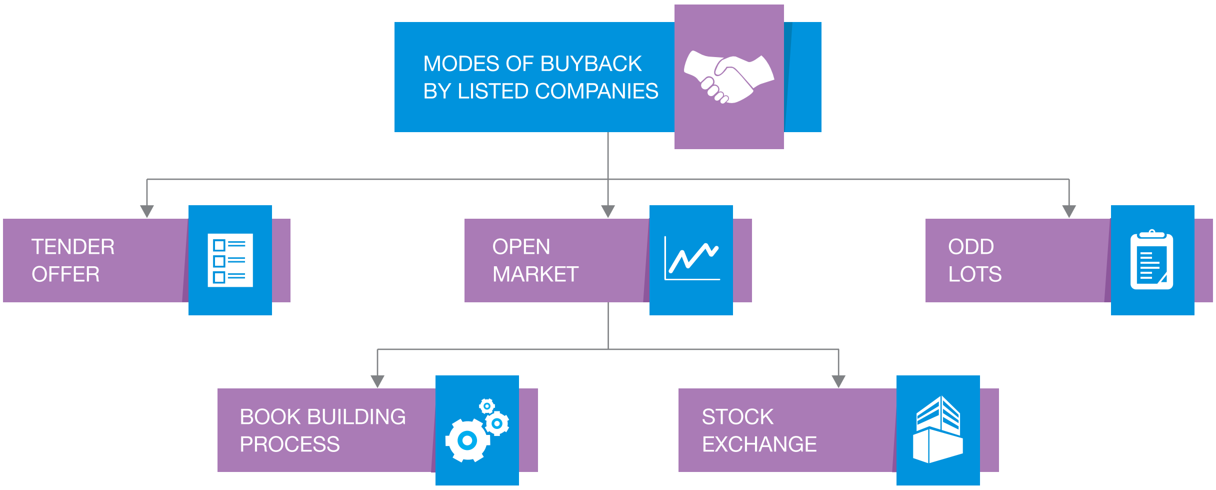
Companies are prohibited to buyback its own shares directly or indirectly through any investment company or group of investment companies or through any subsidiary company including its own subsidiaries. The company should not have defaulted in repayment of deposit, interest, redemption of debentures/preference share, dividend and term loans. Buyback shall not be prohibited if default is remedied and a period of 3 years has lapsed after such default ceased to subsist. Further companies are not allowed to raise further capital for a period of one year except in discharge of its subsisting obligations.

## Pre-conditions

In order to carry out a buyback of shares, the following matters need to be considered to by the company:

- The buyback should be authorized by its Articles of Association;
- It should be approved by the Board or shareholders, as the case may be;[1]
- Buyback should not exceed 25% of its paid up equity share capital in one Financial Year;
- Post Buy-back, the Debt Equity Ratio of the company should not exceed 2:1;
- Equity Shares to be bought back must be fully paid up;
- Buy-back should be completed within 1 year of passing of the resolution;
- Company should ensure that at least 50% of the amount earmarked for buy-back, as specified in resolutions is utilized for buying-back shares;

## Buyback by Listed Companies




## Process of Buyback

A buyback process starts with passing a resolution in the board of meeting or a shareholders resolution through postal ballot which contains the specifics of the buy-back offer and ends with a public announcement in a national daily on the successful completion of the buy back. A broad process of buyback is as under:

1. Shareholders resolution is not required when the buy-back is 10% or less of the total paid-up equity capital and free reserves of the company; and such buy-back has been authorized by the Board by means of a resolution passed at its meeting;


## Tender Method

In addition to the above, following steps /compliances are required to be complied for buyback under Tender Method:

- Approval by Board Resolution / Special Resolution through postal ballot;
- Opening of Escrow Account and depositing cash on or before opening of the buyback;
- File the Draft Letter of Offer (DLOF) along with fees and Declaration of Solvency with SEBI and ROC;
- SEBI to give comments on Draft Letter of Offer;
- Dispatch of Letter of Offer to Shareholders;
- 15% of the shares proposed for buyback are to be reserved for the small shareholders on proportionate basis;
- No offer of buyback for 15% or more of paid up capital and free reserves shall be made from the open market.

## Tax Treatment for Buyback of Shares

SEBI vide circular dated April 13, 2015 provided the facility for acquisition of shares through the stock exchange mechanism pursuant to a buyback. Stock Exchanges having nationwide trading terminals will provide a separate window-"Acquisition Window" which is similar to secondary market transactions. Investors can sell their shares through the respective stock brokers during normal trading hours. Such transactions, where investors pay STT, are eligible for capital gains tax exemptions under the Income Tax Act, 1961 as under:

- In case shares are held for a period of 12 months or above , it shall be treated as Long Term Capital Gains arising from such transaction would be exempt under section 10(38) of the Income Tax Act 1961; and

Dividend Distribution Tax (DDT) under Section 115-O of the Income Tax Act, 1961 will not be applicable in case of buyback.

## Applicability of Stamp Duty

No Stamp Duty is payable in case of buy back of shares as company is buying back its own shares and hence, the same does not result in any transfer.

## Buyback vis-a-vis Compliance under SEBI (SAST) Regulations, 2011 (Regulations)

In case the acquirer's initial shareholding was more than 25% and the increase in shareholding due to buyback is beyond the permissible creeping acquisition limit of 5% per financial year, the acquirer can get an exemption from making an open offer, subject to the following:

- Such acquirer does not vote in favour of the resolution authorising the buy-back of securities under section 68 of the Companies Act, 2013;
- In the case of a shareholders resolution, voting is by way of a postal ballot;
- The increase in voting rights does not result in an acquisition of control by such an acquirer over the target company. In case the above conditions are not fulfilled, the acquirer may, within 90 days from the date of increase, dilute his stake so that his voting rights fall below the threshold which requires an open offer.

## Conclusion

Buybacks aren't without value. It is crucial, however, for directors to understand their real effects when deciding to return cash to shareholders or to pursue other investment options. A buyback's impact on share price comes from changes in a company's capital structure and, more critically, from the signals a buyback sends. Investors are generally relieved to learn that companies don't intend to do something wasteful such as make an unwise acquisition or a poor capital expenditure with the excess cash. In general, markets have applauded such moves, making buybacks an alluring substitute if improvements in operational performance are elusive.


# CREDIT RATING
# IMPROVING FINANCIAL DISCIPLINE

## Introduction

Credit rating is an unbiased, objective and independent opinion of a third party agency as to an issuer's capacity to meet financial obligations. It is a simple and easy to understand symbolic indicator of the opinion of a credit rating agency about the risks involved in a borrowing program of a company/issuer in reference to that company's/issuer's capacity to repay its financial obligations. Globally, the concept of credit rating first emerged in 1940s following the financial crisis of 1937 in New York. Internationally there are three major credit rating agencies – Fitch, Standard and Poor's and Moody's. The concept first came to India in 1987 when CRISIL was established as the first credit rating agency of India. At the moment there are 6 major credit rating agencies in India – CRISIL, ICRA, CARE, India Ratings, SMERA and Brickworks. Securities and Exchange Board of India (SEBI) is the regulator for credit rating agencies in India.

Credit Rating agencies use alphanumeric combinations to denote credit rating of an issuer. Ratings are of several types, however essentially they can broadly be classified into Long Term Rating for Long Term Debt Instruments (Term Loans, Long Term Corporate Bonds etc.) and Short Term Rating for Short Term Debt Instruments (Working Capital Facilities, Commercial Paper etc).

## Long term credit rating and its description:

| D | C | B | BB | BBB | A | AA | AAA |
|---|---|---|---|---|---|---|---|
| In Default | Substantial Risks and Default Imminent Vulnerable to Default | Non-Investment Grade Greater Likelihood of Default | Non Investment Grade Inadequate Degree of Safety | Investment Grade Moderate Degree of Safety | Adequate Degree of Safety | High Degree of Safety | Highest Degree of Safety |

## Short term credit rating and its description:

| D | A4 | A3 | A2 | A1 |
|---|---|---|---|---|
| In Default | High Risk | Moderate Risk | Low Risk | Lowest Risk |

## Process of Credit Rating

The credit rating methodology essentially consists of analyzing the operational and financial characteristics of the company/issuer. Besides quantitative factors, qualitative aspects like assessment of management capabilities play a very important role in arriving at the rating for an instrument. The relative importance of qualitative and quantitative components of the analysis varies with the type of issuer/company.

**STEP 01**
**ECONOMY & INDUSTRY ANALYSIS**

- Determines the degree of operating risk faced by the entity.
- Assesses based on Major Players in the industry, Demand-Supply factors, Price Trends, Changes In Technology, International/Domestic Competitive factors in the industry, Entry Barriers, Capital Intensity, Business Cycles etc.

**STEP 02**
**BUSINESS RISK ANALYSIS**

- Determines the position of the company in respect to the industry it operates in.
- Assesses the company on grounds of Diversification, Seasonality and Cyclicality, Size of the Company, Cost and Efficiency Parameters, Market Share, etc.

**STEP 03**
**FINANCIAL RISK ANALYSIS**

- Involves evaluation of past and future expected financial performance with greater importance on cash flows towards debt servicing.
- Includes a holistic analysis of financial ratios like Debt Equity Ratio, Growth Ratio, Profitability Ratios, Turnover Ratios, Leverage and Coverage Ratios, Liquidity Ratios (In case of short-term rating), etc.
- Financial Flexibility is measured by mapping the alternative sources of liquidity available to the entity, when required.
- Projections and Sensitivity Analysis over the life of the instrument is critically examined and assumptions underlying the projections are validated.

**STEP 04**
**MANAGEMENT EVALUATION**

- Considered to be one of the most important factor supporting the credit rating of the entity.
- Key dimensions for evaluation include Track record of the promoters,/ management, Corporate Strategy including Business Plan, Mission, Vision, etc., interests and Capabilities of the group concers, Organizational Structure, Control Systems, Personnel Policies, Corporate Governance, etc.

The rating process is ultimately an assessment of the fundamentals and the probabilities of change in the fundamentals. Rating determination is a matter of experienced and holistic judgment, based on the relevant quantitative and qualitative factors affecting the credit quality of the company/issuer.

## Benefits of a Credit Rating

For the SME sector as a whole, ratings can provide an important impetus in raising standards through better financial discipline, disclosure and governance practices. Ratings can be an important feedback tool for managements. An interactive rating process helps managements gain unique perspectives on business and financial issues and on best practices, from rating experts who have in-depth sector knowledge and understanding of risk. Independent agency ratings for SMEs, based on high standards of analytical rigour, can provide greater confidence to lenders, and consequently broaden the range of financial resources available to SMEs.

## Benefits to Lenders

The rapid growth of the SME sector creates exciting lending opportunities for banks and financial institutions. However, with increasing NPAs and regulatory concerns, banks have adopted a more cautious approach towards lending. A credit rating takes a significant chunk of the perceived uncertainty out of their lending decisions, and reduces time and transaction costs in the system. The Indian rating industry has established its credibility in providing in-depth and unbiased analysis; ratings are therefore highly respected by lenders.

## Benefits to SMEs

SMEs can leverage their ratings for negotiating better borrowing rates and strengthening their relationships with bankers. Ratings can also facilitate faster processing of credit facilities, as rating reports provide most of the information banks need for approving loans. Further, SMEs can use ratings to enhance their credibility with other counterparties as well, such as technology providers, suppliers, and customers. A good credit rating enhances the corporate image of an SME and increases its visibility. It not only promotes growth, expansion and creates better business opportunities, but also at times acts like a marketing tool.

There are scores of benefits for having a credit rating at investment grade and above. Out of all the benefits the pricing benefits and easier access to credit owing to an investment grade rating and above is probably the most important benefit. To be able to appreciate the pricing benefits we need to understand the change in regulatory scenario for banks in India.

## Regulatory Aspect to Credit Rating

The guidelines issued by the Reserve Bank of India (RBI) in April 2007 for the implementation of a New Capital Adequacy Framework allows commercial banks to allocate capital in relation to the credit risk embedded in their exposures. Credit risk in this case would be measured by the rating assigned to such exposures by approved external credit assessment institutions (ECAIs). As capital is the most expensive source of funding, any decrease or increase in such capital allocation could translate into substantial savings / additional costs for banks.

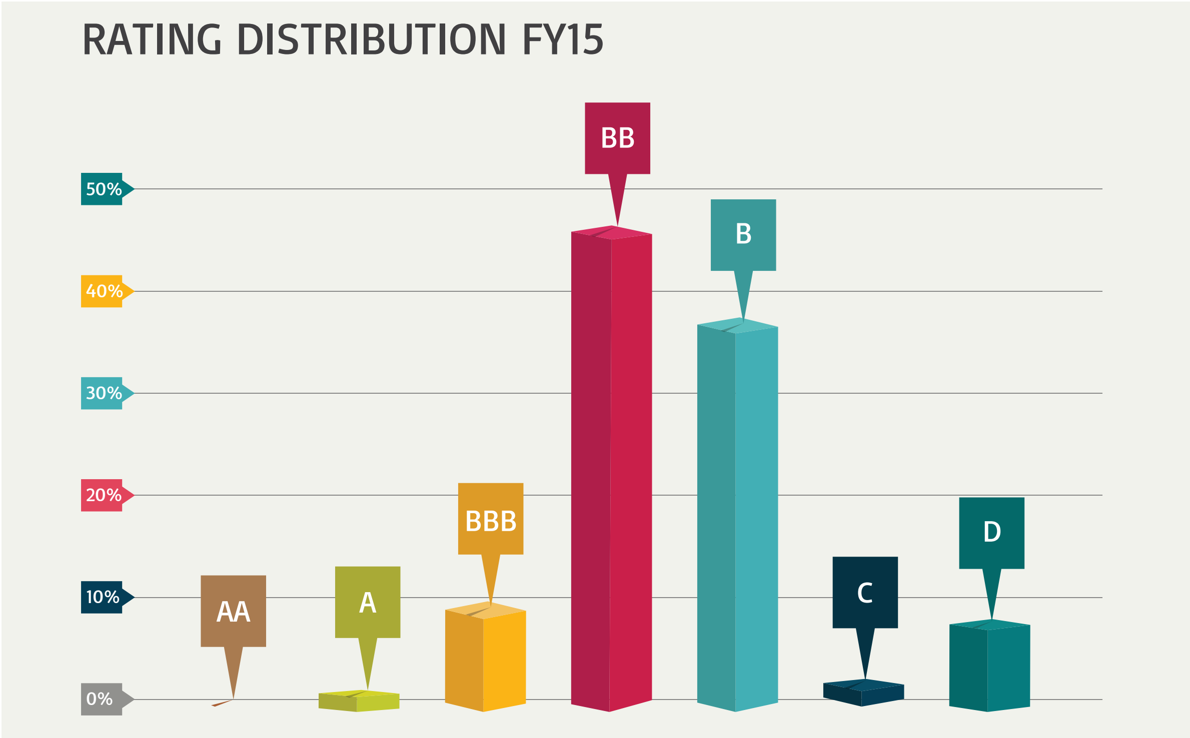
The revised framework for capital adequacy has been effective from March 31, 2008, for all Indian banks with an operational presence outside India (12 public sector banks and 5 private sector banks) and for all foreign banks operating in India. It has been applicable to all other commercial banks (except local area banks and regional rural banks) from March 31, 2009. Credit rating is not mandatory under Basel II. But banks are likely to save capital if they get their loan portfolios rated. If a bank chooses to keep some of its loans unrated, it may have to provide a risk weight of 100% for credit risk on such unrated loans. Hence it is essential for banks to get the loans rated.

RBI's regulations envisage full implementation of Basel III capital requirements by March 31, 2019. The regulations are designed to enhance the quality and quantity of capital held by banks. Basel III enhancements covers four broad domains namely - The quality and quantity of capital, Liquidity standards and stable funding, Checks on leverage and counterparty risk management and More comprehensive and transparent disclosures.

Basel III norms are already being implemented in phases between April 2013 and March 2018. It emphasizes on banks to have a core capital ratio of 8% and a total capital adequacy ratio of 11.5% against 9% now. Capital adequacy is a measure of a bank's financial strength expressed as a ratio of capital to risk-weighted assets. The risk- weights have been assigned proportionate to the credit rating assigned to the entity, ranging from 0% to 150%. Moreover, besides the credit risk, operational risk and market risk have also been introduced in the Basel III norms which will invite higher capital ratio to risk weighted assets. Also, the unsecured portion of NPA (Non-Performing Assets), net of specific provisions will be risk weighted additionally up to the extent of 150%.

Basel III norms concentrate on the capital adequacy framework of a bank and the quality and quantity of capital held. Hence, a bank will be enforced to have sufficient capital to provide a stable resource to absorb any losses arising from the risks in its business. Capital is divided into tiers according to the characteristics/qualities of each qualifying instrument.

Since the entities will be examined at various risk levels like non-payment and inadequacy of profits/ revenue reserves, high capital threshold, market fluctuations, exposure to debt in comparison to equity capital, etc., SMEs may have to augment more equity capital through various ways in order to ensure a better debt equity ratio. Hence, entities with good credit ratings based on several such parameters will be preferred for lending.




Moreover, Credit Ratings will hold more importance as banks will be incentivized to adopt internal and external ratings-based methods to measure credit risk, rather than using a standardized approach to allocate risk weights more prudently. The Budget for the year 2016 has also announced an introduction to a new credit rating system for infrastructure projects, which is an indication that Government, too, will be adopting a more cautious approach towards the quality of the capital in the days to come.

## Conclusion

Credit rating is an effective negotiating tool in the hand of the issuer to access cheaper credit facilities. In the current banking scenario, where banks are grappling with NPAs and dearth of capital, there will be huge competition among banks to acquire customers with credit rating of investment grade and above. The number of issuers with investment grade and above are far less (BBB and above only 10%) amongst SMEs. As the majority of the issuers are in the range of B to BB when the Banks are competing to acquire customers with investment grade rating from such a small pool, the later has maybe an upper hand in negotiating better terms and conditions. Apparently it leads to faster credit decision making and quicker loan approval. The following graph captures the distribution pattern of ratings across issuers in FY 2015:

Credit Rating will not only ease down availing credit for these entities, but also will help in negotiation for better pricing and other associated terms & conditions. Hence, it is an important and a significant goal for the organization like any other business goal to improve its credit rating to investment grade and above. To achieve the aspired rating, the organization needs to address systemically various risks like business, management and financial and chart out a plan of actions to fulfill those objectives.

# AMENDMENTS TO FDI POLICY
# A PATH BREAKING MOVE TOWARDS INVESTOR FRIENDLINESS

## Introduction

The Department of Industrial Policy and Promotion (DIPP) released a Press Note 12 dated 24th November 2015 codifying the amendments proposed to the FDI Policy 2015 released on 10 November 2015. These amendments are aimed at increasing sectoral caps for FDI investments, increasing the ease of investments in certain sectors and bring in activities under the automatic route. The Finance Minister Mr. Arun Jaitley further proposed to significantly relax the FDI policy in several sectors in his Union Budget 2016-17 presented on February 29th, 2016 to attract more overseas investments. These proposed reforms shall arrive as an extension to the amendments issued by the DIPP. In this article, we have covered the highlights of the extant changes made by the DIPP and proposed changes made by the Honorable Finance Minster in his Union Budget 2016-17.

## DIPP: Highlights of Press Note 12

### Impact on Sectors

#### A. E-Commerce

A manufacturer is permitted to sell its products manufactured in India through wholesale and/or retail, including through e-commerce platforms, without government approval.

The definition of "Manufacture" in the FDI policy has been amended to mean the following:

> "a change in a non-living physical object or article or thing (a) resulting in transformation of the object or article or thing into a new and distinct object or article or thing, having a different name, character and use; or (b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure."

Earlier, an Indian manufacturing company having FDI was not permitted to do retail trading in any manner whatsoever through e-commerce platforms.

#### B. Construction Development

The Construction Development Sector has faced a significant amount of stress in the past few years on account of a slowdown in demand, mounting debt and lukewarm investment interest from abroad on account of onerous provisions in the previous FDI Policy.

As a welcome move, the government has relaxed the FDI norms in this sector by doing away with the conditions of minimum area to be developed (20,000 square meters) and a minimum amount to be invested within 6 months of the commencement of business (USD 5,000,000).

Each phase of the construction development shall be considered as a separate project for the purpose of the FDI Policy and will be subject to certain conditions as under:

- Exit is permitted at any time if the project is completed before the lock-in period;
- Moreover, foreign investors shall be permitted to exit and repatriate their foreign investment before the completion of project under automatic route, provided that a lock-in-period of three years. The lock-in period would be calculated with reference to each tranche of foreign investment has been completed;

- The transfer of stake from one non-resident to another, without repatriation of investment will not be subject to any lock-in period or any government approval;
- Conditions of lock-in period will not apply to hotels, tourist resorts, hospitals, Special Economic Zones (SEZs), educational institutions, old age homes and investments by Non-Resident Indian (NRIs);
- 100% FDI under automatic route is permitted in completed projects for operational and management of townships, malls/ shopping complexes and business centers;
- The Press Note clarifies that the earning of rent/income on lease of property, not constituting a transfer, shall not amount to 'real estate' business and hence shall not be prohibited from receiving FDI under the FDI Policy.

## C. Defence

As per the earlier FDI policy in the sector, foreign investment up to 49% was permitted under government approval route. Portfolio investment and investment by Foreign Venture Capital Investments (FVCIs) were restricted to 24%. However, in the new FDI Policy, foreign investment up to 49% will be allowed under automatic route and investments beyond 49% will be considered under the government route i.e. Foreign Investment Promotion Board (FIPB) and not the Cabinet Committee on Security as per the earlier regulation.

However, infusion of fresh foreign investment within the permitted automatic route level, in a company not seeking industrial license, resulting in a change in the ownership pattern or transfer of stake by existing investor to new foreign investor, will require government approval.

## D. Single Brand Product Retail Trading (SBPRT)

Foreign Investment in Single Brand product Retail Trading is aimed at attracting investments in production and marketing, improving the availability of such goods for the consumer, encouraging increased sourcing of goods from India, increase employment and enhancing competitiveness of Indian enterprises through access to global designs, technologies and management practices.

The new FDI Policy announced has permitted FDI, up to 100 per cent, in single brand product retail trading. The following are the relaxations brought in by the Press Note:

**Domestic Sourcing:** 30% local sourcing rule applies from the date of first opening the store, as opposed to the date of receipt of FDI and that in sectors involving 'state-of-the-art' and 'cutting-edge technology', this sourcing norm may be relaxed, subject to government approval.

Previous prohibition on retail trading through e-commerce has been removed for an entity which has been granted permission to undertake SBRT.

**Indian Brands:** Indian brands are permitted to undertake SBRT activities and should be owned and controlled by resident Indian citizens and/or companies controlled by resident Indian citizens. An Indian manufacturer is permitted to sell its own branded products in any manner – wholesale, retail, e-commerce. An Indian manufacturer would be the investee company which is the owner of the Indian brand and which manufacturers in India, in terms of value, at least 70% of its products in-house and sources, at most, 30% from Indian manufacturers.

**Duty-Free Shops:** 100% FDI permitted under automatic route in shops operated in Customs bonded areas.

**Wholesale Trading / Cash & Carry Wholesale Trading:** Same entity shall be permitted to carryout both wholesale and SBRT provided that each business separately complies with conditions laid down in the FDI policy and maintains separate books of accounts.

## I. New Sectors To FDI

100% FDI is now permitted, under the automatic route, in the tea sector, coffee, rubber, cardamom, palm oil tree and olive tree plantationsRegional air transport is now eligible for foreign investment up to 49% under the automatic route.

## II. Key Reforms

- **Companies/Trusts/Partnerships owned and controlled by Non-Resident Indians**
  Under Schedule 4 of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations, investments made by NRIs are deemed to be domestic investments at par with investments made by residents. This regulation has been extended to companies, trusts and partnerships owned and controlled by NRIs. Hence, investments by such entities shall be treated at par with domestic investments in India.

- **Companies without Operations**
  No government approval shall be required for an infusion of foreign investment into an Indian company, undertaking activities which are under the automatic route, which does not have any operations and also does not have any downstream investments. Upon commencement of business, compliance of sector caps and conditions will have to be ensured.

- **Limited Liability Partnerships**
  100% FDI has been permitted under the automatic route in LLPs engaged and operating in sectors/activities where 100% FDI is allowed, through the automatic route without FDI-linked conditions. Further, LLPs having foreign investments are now permitted to make downstream investments in another company or LLP in sectors in which 100% FDI is allowed under the automatic route and there are no FDI-linked performance conditions.

  The terms 'ownership' and 'control' with reference to LLPs have been defined.

  'Control' would mean the right to appoint majority of the designated partners, where such designated partners, with specific exclusion to others, have control over all the policies of the LLP. An LLP would be considered 'Owned' by resident citizens if more than 50% of the investment in such LLP is contributed by resident Indian citizens and/or entities ultimately owned and controlled by resident Indian citizens and such resident Indian citizens and entities have the majority of the profit share.

- **Banking (Private Sector) – Full fungibility of foreign investments**
  The Press Note has introduced full fungibility of foreign investments in the private banking sector. FIIs/FPIs/QFIs (subject to applicable norms) can now invest up to a sectoral limit of 74%, provided there is no change of control and management of the investee company. This will provide greater access to foreign capital by the private banking sector

- **FDI by way of Share Swap**
  Unlike previously, no approval of the Government will be required for investment in automatic route sectors by way of a swap of shares. However, valuation of such shares will have to be made by a Merchant Banker registered with SEBI or an Investment Banker outside India registered with appropriate statutory board.

- **Enhanced Limit of FIPB Approval**
  Foreign investments beyond INR 50 billion under government approval route shall be placed before the Cabinet Committee on Economic Affairs (CCEA) after FIPB clearance as against the previous INR 30 billion threshold.

| Sector/Activity | Previous Cap and Route | New Cap and Route |
|---|---|---|
| **Broadcasting carriage services** | | |
| • Teleports (setting up of up-linking HUBs/teleports)<br>• DTH<br>• MSOs operating at national/ state/district level and undertaking upgradation of networks towards digitization and addressability<br>• Mobile TV<br>• HITS | 74%<br>(upto 49%: Automatic Route Beyond 49% up to 74%: Government Route) | 100%<br>(up to 49%: Automatic Route Beyond 49%: Government Route} |
| • MSOs not undertaking upgradation of net works towards digitization and addressability and LCOs | 49%: Automatic Route | |
| • Terrestrial Broadcasting FM<br>• Uplinking – news and current affairs TV channels | 26%: Government Route | 49%: Government Route |
| • Uplinking of Non – News and Current Affairs TV channels<br>• Down-linking of TV Channels | 100%: Government Route | 100%: Automatic Route |
| **Air Transport Services** | | |
| Non-Schedule air transport service | 74% (100% for NRIs)<br>(upto 49%: Automatic Route Beyond 49% upto 74%: Government Route) | 100%: Automatic Route |
| Ground Handling services | | |
| **Satellites – establishment and operation** | | |
| Satellites – establishment and operation | 74%: Government Route | 100%: Government Route |
| **Credit Information Companies** | | |
| Credit Information Companies | 74%: Automatic Route<br>(FDI+FII/FPI*)<br>*allowed up to 24% only for listed companies | 100%: Automatic Route<br>(Condition with respect to FII/ FPI investment condition has been retained) |

## Proposed Reforms in the Union Budget 2016

Mr. Arun Jaitley, the Honorable Finance Minister of India, in this Budget 2016 – 17 has further proposed several relaxations to the existing FDI Policy which aims to attract more overseas investments and also promote the ease of doing business. The proposed reforms are spread across several sectors.

In a welcome move for global retailers, in the Food Processing Retail sector 100% overseas investments is proposed with approval from the FIPB. In the Insurance and Pension sector, the Budget has proposed to allow investment under the automatic route up to 49%, subject to extant guidelines on Indian management and control to be verified by the sectoral regulators. To assist banks and financial institutions (FI) address the problem of bad loans, the FY'17 Budget has proposed 100 per cent FDI in ARCs through automatic route. The FY'17 Budget also proposed that foreign portfolio investors will be allowed up to 100 per cent of each tranche in securities receipts issued by ARCs subject to sectoral caps.

The FY'17 Budget has also proposed to hike the investment limit for foreign entities in Indian stock exchanges from 5 per cent to 15 per cent on par with domestic institutions. Also, the existing 24 per cent limit for investment by foreign portfolio investors (FPI) in Central Public Sector Enterprises (CPSEs) other than banks, listed on stock exchanges, is proposed to be increased to 49 per cent. Further FDI is also proposed to be allowed beyond the 18 specified NBFC activities in the automatic route in other activities which are regulated by financial sector regulators.

In other reforms the Budget has proposed to accord residential status to foreign investors, subject to certain conditions, instead of a 5 years business visa granted at present. In order to ensure effective implementation of Bilateral Investment Treaties (BITs) signed by India with other countries, the minister proposed to introduce a "Centre State Investment Agreement" to incentivize states to ensure fulfilment of obligations under treaties and thereby attract more foreign investments in such states.

## Conclusion

The amendments to FDI Policy from Government of India have eased restrictions on foreign direct investment ("FDI") in India with a view to promote the 'Make in India' and 'Startup India' initiatives. According to the Department of Industrial Policy & Promotion, India has now thrown open 92.5 per cent of FDI through the automatic route, which is a welcome development. With time and efforts from government and private sector companies, these changes are expected to trigger a spurt in FDI into the country.


## About Vivro

Vivro is a Financial Services Group engaged in the business of providing Investment Banking, Corporate Finance, Corporate & Financial Advisory and Asset Resolution Services. Vivro Financial Services Private Limited is a Merchant Banker registered with the Securities Exchange Board of India (SEBI) and Vivro Capital Advisors Private Limited is a Company that provides Asset Resolution Services to Banks and Financial Institutions.

## Our Team

Vivro is founded by experienced professionals who have been engaged in Capital Market and Corporate Finance services for the last three decades. Our company is supported by a team of more than 90 enthusiastic and motivated people from different backgrounds with varied educational accomplishments and expertise. The talent pool of our company comprises of Chartered Accountants, Company Secretaries, MBAs, Lawyers as well as Ex-Bankers who have held senior positions at various banks and financial institutions. This mix of people infuses elements of creativity and professionalism in our workplace, which adds tremendous value to the services that we offer. With a strong team in place, Vivro is able to deliver value added solutions, tailor-made to suit the requirements of our clients.

## Our Value Proposition

Vivro has emerged as a knowledgeable and reliable partner for businesses both in India and Abroad. Vivro has catered to several companies over the years and it enjoys tremendous confidence from clients, investors, lenders, brokers and financial institutions. Our advisory services and our ability to access the right capital for the right investment opportunity have resulted in significant stakeholder value creation. Vivro has a disciplined and demonstrated process specifically tailored for each client and transaction to maximize value.

## Capital Market Services

Our Capital Markets team assists private companies to raise capital from capital markets through

- Initial Public Offers of Equity & Debt, Placements, while they assist public limited companies in a host of capital market transactions ranging from Rights Issue,
- Qualified Institutional Placements,
- Institutional Placement Program, and various other Merchant Banking compliances relating to Takeover, Open Offers, Buybacks, Delisting, etc.

## Corporate Finance

Vivro syndicates and structures debt finance through several instruments such as:

- Term Loans/ Project Loans
- Working Capital Finance/ Corporate Loans/Letter of Credits/Bank Guarantees/External Commercial Borrowings
- Factoring/Commercial Paper
- Inter Corporate Deposits, Structured Finance, Infrastructure Financing, etc.

## Corporate Advisory

Our corporate advisory services:

- Private Equity and Venture Capital placement and advisory
- Mergers and Acquisitions: Buy/ Sell advisory as well as schemes of arrangement for corporate reorganization
- Valuation Services and Fairness Opinions
- ESOP Structuring and Valuation

## Business Consulting

Our Business Consulting Services:

- Business and Expansion Plans and Strategies
- Corporate Governance and Reporting
- Corporate Organization
- Succession Planning
- Entry into India Services

## Asset Resolution

Vivro is empaneled with over 30 banks and carries out effective strategies for recovery of NPA accounts, enforcement of assets under law, arranging for sale of assets or eventual settlement to affect Final Recovery of advances on behalf of these banks and financial institutions.

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