Why do Emerging Market Firms Issue Offshore Dollar Equity Linked Securities?

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Discussion

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Outline

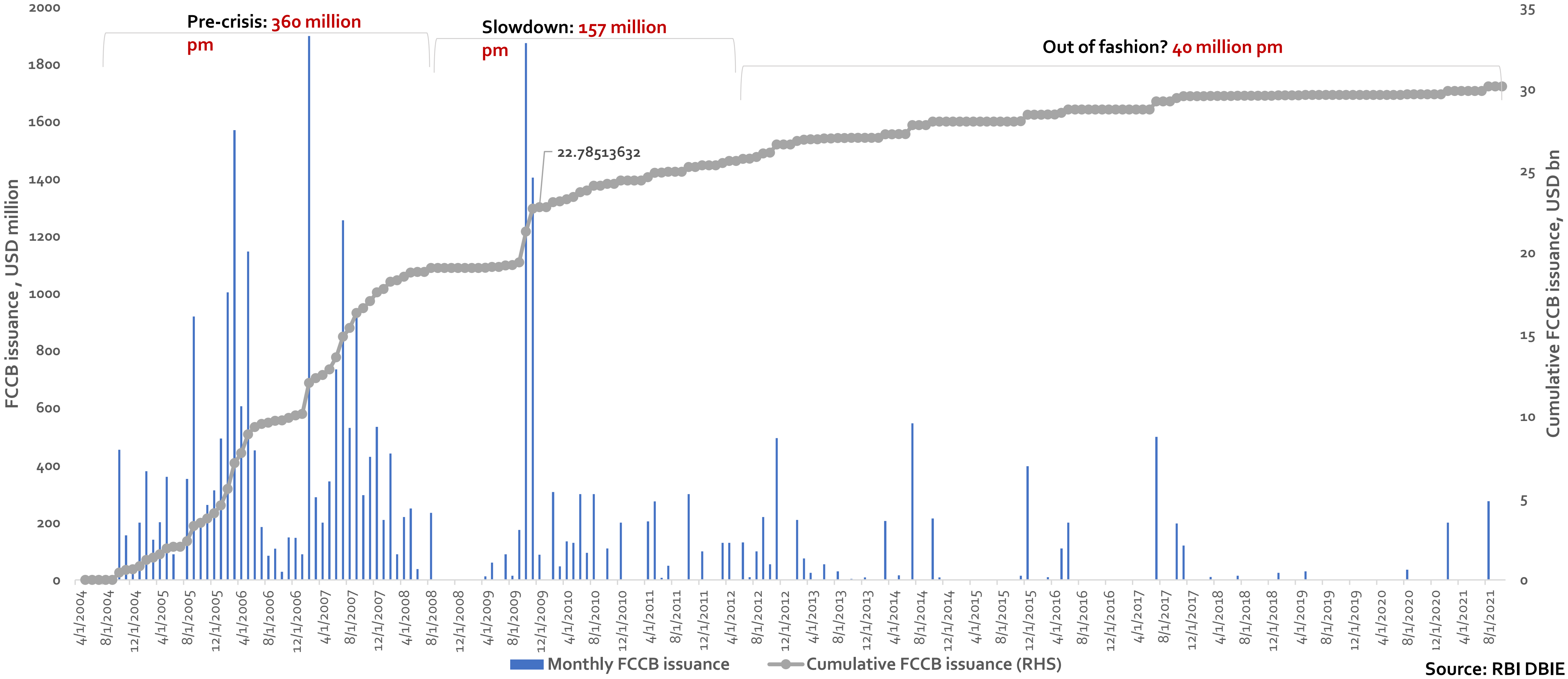
- **Summary of the paper**
- **Big picture**
- **Minor comments**

Summary of the paper

- **Why do Indian firms' issue FCCBs?**
  Relaxing capital constraints, cheap debt, carry trade like arbitrage
- **Which firms' issues FCCB compared to DRs?**
  Lower growth, natural hedge & profitability, higher leverage & R&D (?), tax savings
- **What are the real outcomes ?**
  More investment (skewed towards larger firms), higher default risk
- **What do stock markets think?**
  Negative across the board: Both announcement and long term

Paper with a wide scope, many contributions to the literature

FCCBs have gone out of fashion…

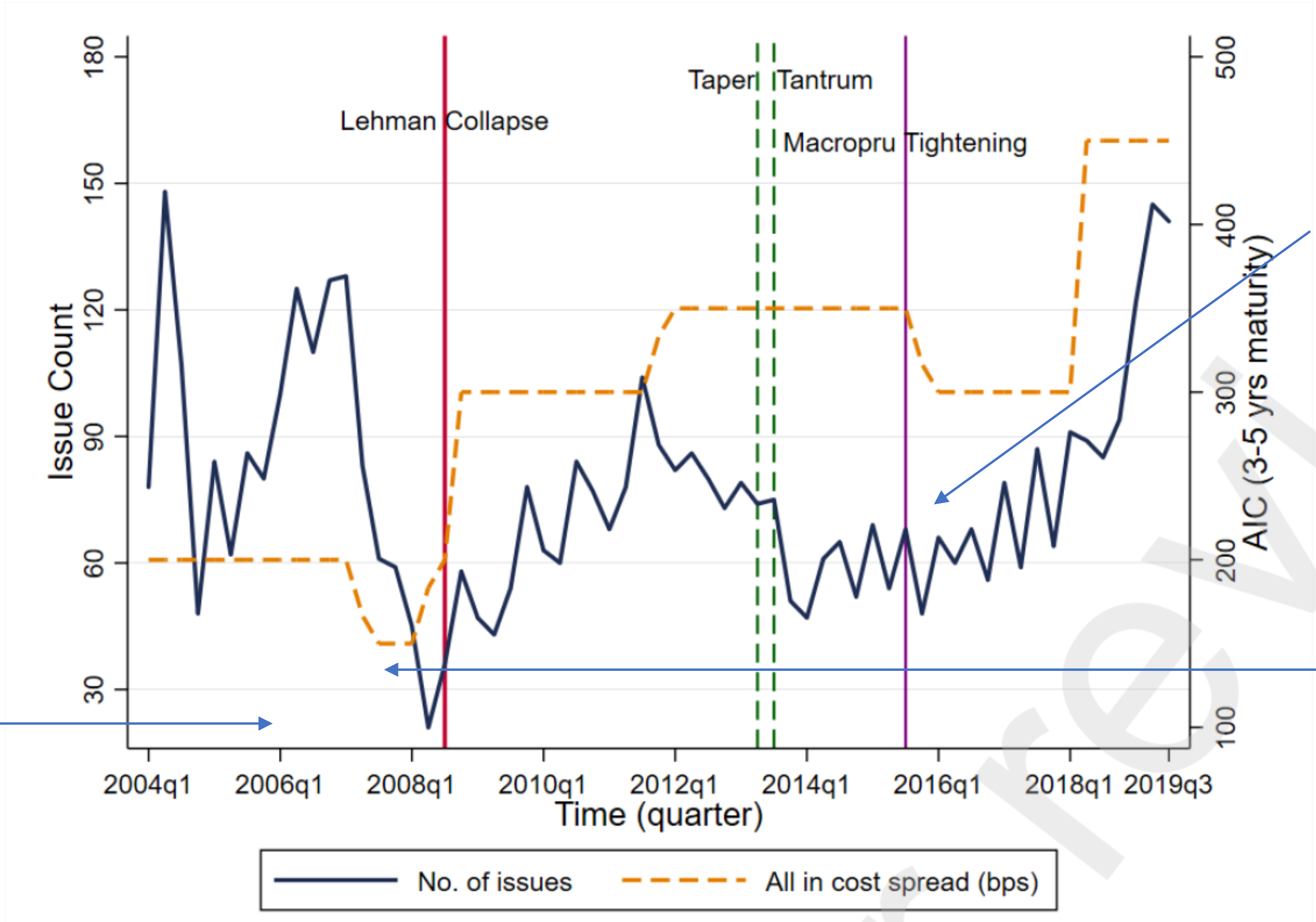


Source: RBI DBIE

FCCB: Debt or Equity?

- Paper takes the view that FCCBs are similar to offshore equity issues like ADRs/GDRs
- FCCBs in the Indian context are unique: Maturity restrictions, All-in-cost ceilings, End-use requirements
- FCCBs in peer EMs where such restrictions do not apply allow for a cleaner comparison with DR issuance, in terms of motive as well as outcomes
- FCCBs in India have been a way for firms to take advantage of Rupee appreciation/ Stock price appreciation/ evade all-in-cost ceilings to issue FCY debt that they may not have been able to via the traditional route.
- Macro "push" factors like carry-trade profits 'a la Archarya and Vij (2020) as well as RBI's own changing of all-in-cost ceilings are additional factors driving ECB/FCCB issuance

(a) Max All-In-Cost for maturity less than 5 Years and Number of Debt Issues



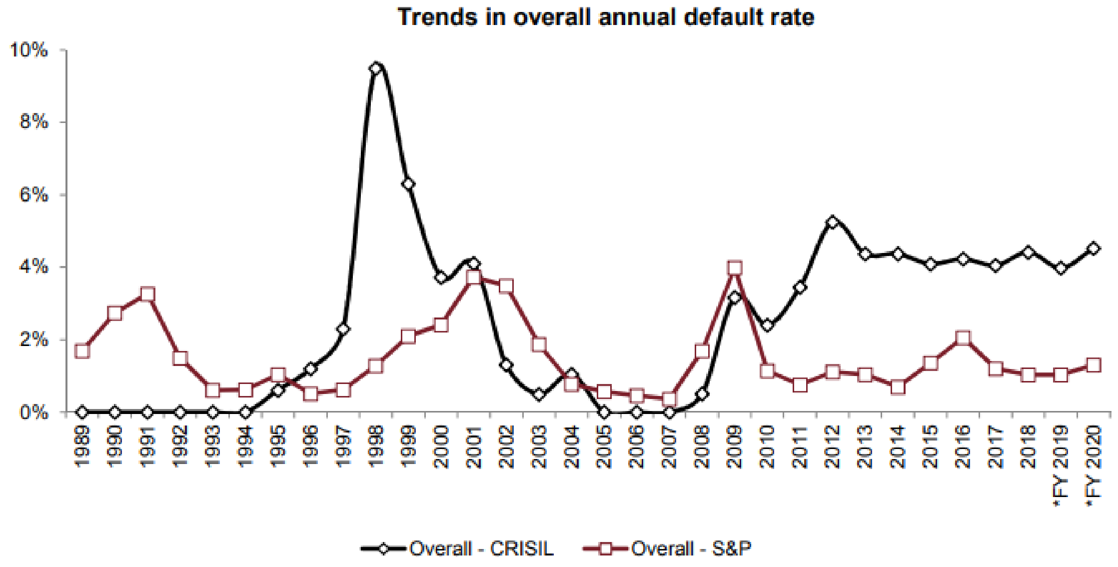
Bulk of the FCCB issuances were here, when all-cost-ceiling was too low

Acharya and Vij argue that reduction of all-in-cost ceilings are a macro-pru tightening, but in the pre-crisis period, low all-in-cost ceilings may have caused firms that are riskier to borrow via the FCCB route

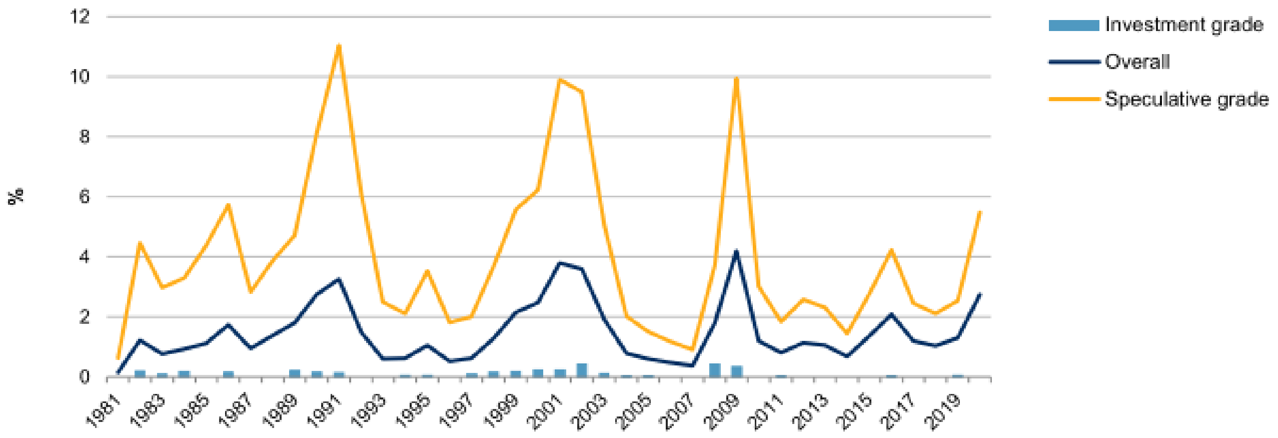
From: Acharya and Vij (2020)

FCCBs are more comparable to high yield ECBs than DRs in the Indian context and it has been a disaster by local/global standards with a 11.5% default rate

Chart 2: Overall annual default rates



Global Default Rates: Investment Grade Versus Speculative Grade



Sources: S&P Global Ratings Research and S&P Global Market Intelligence's CreditPro®.

Local default rates, Source: CRISIL

Global default rates, Source: S&P Global

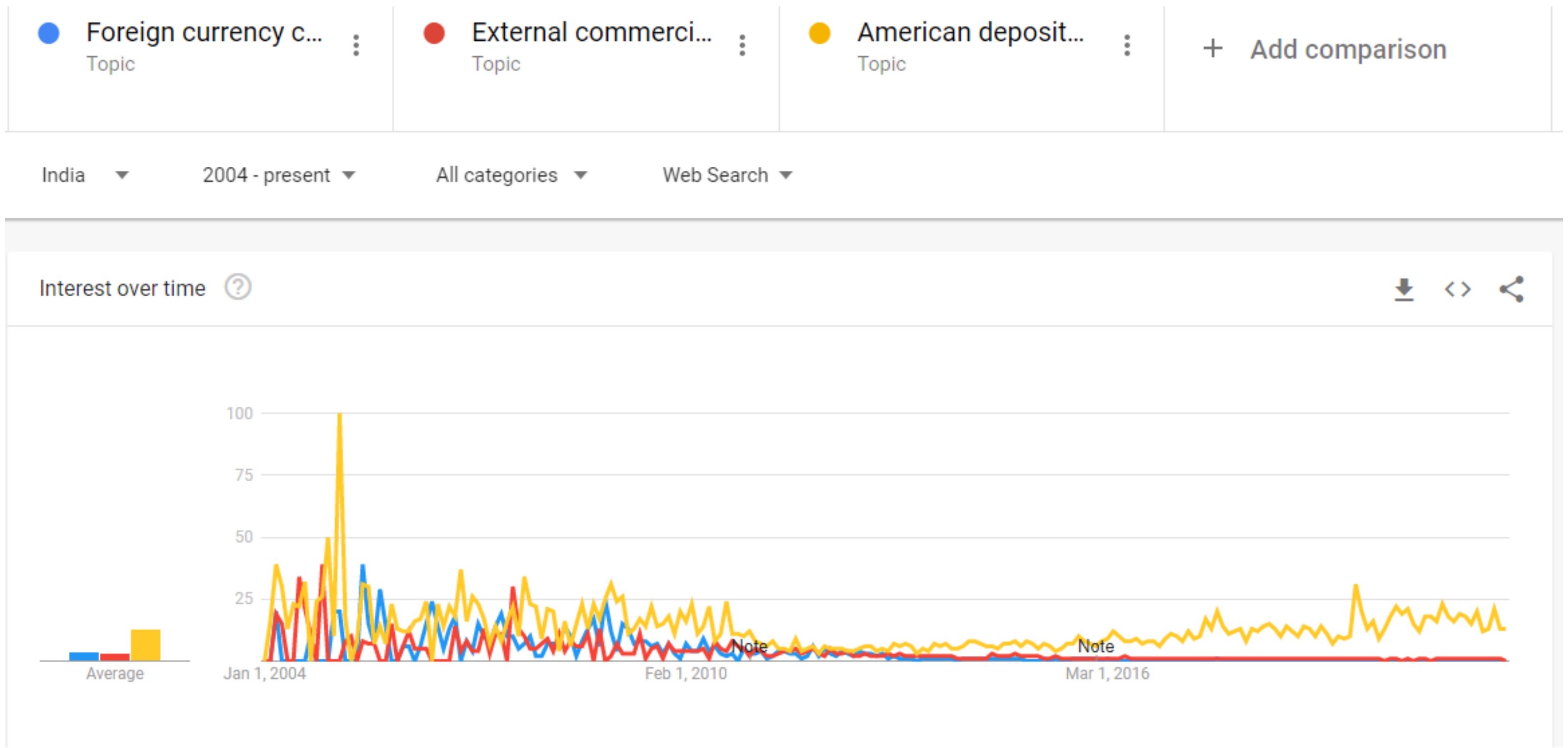
Wishlist

- An easy extension of the work would be to compare FCCB issuing firms with ECB issuers using the same framework used in the paper to compare FCCB issuers with DR issuers/ Domestic borrowers
- It would add a great deal of value in understanding the Indian context while providing the paper two novel policy angles (also comparability with EMs with Indian style capital controls like China, see Huang, Panizza and Portes (2018))
- How do FCCB borrowers fare versus ECB borrowers/ Are there second order effects to all-in-cost ceiling tightening via an instrument switching channel?
- Sahoo committee recommendations: Remove end-use requirements/ All-in-cost ceilings

Minor comments

- Adding FCCB value (scaled), all-in-cost ceilings at time of issue as explanatory variable
- Adding macro controls (carry trade index, CIP deviation, REER deviations)
- Adding firm age as an explanatory variable
- Adding ICR as an explanatory variable
- Adding Foreign currency exposure variable/ Natural hedge ratio (FCCB value/net exports) as an explanatory variable
- Splitting estimation across different time periods (Rupee was not a float between May 2003- March 2007 , Pre vs post-crisis)

Thank you!



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