



National Institute of Bank Management

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Leveraging External Commercial Borrowing (ECB) to Reduce Borrowing Cost

Background

Gurleen has been working with Zenith bank for the last 3 years as a relationship manager in the Mid Corporate segment wherein she was able to understand various facets of business from the client's perspective. She understood the working capital products as well as the Term loan very well in addition to trade finance which many of her clients required. However, she has been recently transferred to the Treasury Sales team of the bank as a solution manager catering to the SME segment. The ask from the current role is to undertake merchant forex transactions for the clients assigned to her and increase the bank's wallet share. Zenith bank is a new age bank with online solutions available for undertaking foreign exchange transactions. The bank also has a presence across various countries and setup IBUs at various overseas locations.

Looking at the portfolio Gurleen realized that many of the clients have been routing their Foreign Exchange transactions through her bank while the limits are with some of the PSU bank. Owing to the lower cost of funds the PSU banks generally offer a better rate to client. All such clients had very low stickiness with her bank as only thing Zenith bank could offer was a better rate on Forex transactions.

The Customer

Advanced Software Technologies is a premier technology-first partner specializing in software product engineering, digital transformation, and AI solutions. Founded in 2015 by Anurag Mehta & his wife Shruti Mehta, the firm is headquartered in New York, with major engineering centres located in Pune. They have presence across 3 different locations in Pune with a total employee strength of 60.

The company provides comprehensive, end-to-end product development, quality assurance, DevOps, and professional IT services. Advanced Software Technologies possesses deep engineering domain expertise in high-tech infrastructure verticals, notably storage, networking, virtualization, and cloud

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systems. It serves global Independent Software Vendors (ISVs) and enterprises, helping them accelerate market delivery times while reducing operational and infrastructure costs

The Proposal

Currently the company operates its India operations from 3 different locations across Pune city. Currently the employee strengths of the company is 60 and the company plans to venture into new areas of software development for which they would be needing a bigger team. Advanced Software Technologies is also planning to buy out a larger office with a sitting capacity of 400 people. With this the India operations would be brought to new office for better synergies and also save various costs. The current revenues of the client is INR 20 crore with 25% exports. With the expansion into new areas of software development the client is projecting a revenue of INR 50 crore in the next 3 years with exports contributing 70%.

The Banker meeting

The client has been with a state-owned PSU bank since its founding days in year 2015 and have a very good relationship with them. The bank however, is not tech savvy and all the forex remittances are routed through Zenith bank. Since the client is a software company and is in the growth phase, they are looking for a new partner bank which could match their current bank in terms of limits. They even would like to have new salary relationship with a more tech savvy bank. Their current bank has quoted them aggressively for term loan for their new office facility at a ROI of 9.75%, which seems to be aggressive for a company rated AA. They have also shared a tentative proposal with the client.

The total cost of the project would be approximately 30 crore INR and the company is looking for a proposal to better the rate offered by their existing banker (which is at 9.75%). The proposal would be backed by a charge on the office building along with personal guarantee from the promoters, Mr Anurag Mehta & his wife Miss Shruti Mehta.

As a veteran Relationship Manager Gurleen was able to sight the opportunity to shift the entire relationship to her bank if she was able to provide a better solution to the client and proposed following solutions:

Zenith Bank would arrange an External Commercial Borrowing (ECB) for the client through their Dubai branch which would be at a tentative rate of 6M SOFR plus 200 bps (Current 6m SOFR trades at 3.60%). Since the product was new, the client had questions about the risk involved in the transaction as till now they had dealt only in the domestic currency for their loan requirements.

Gurleen had anticipated the questions and very patiently heard to the client's queries and explained to them that there would be 2 types of risk in the transaction:

1. **Interest rate risk:** - Since the loan was linked to a floating USD SOFR the outflow may go up or down based on the SOFR rates.
2. **Currency risk:** - As the client was based out of India and the loan would be in US Dollars it would also be subject to a currency risk if the INR depreciates against the USD.

Both the risks can be covered by undertaking SWAP with the bank to be undertaken by the bank's treasury. A separate limit would be setup for undertaking the hedging transaction.

Interest rate swap: - This would comprise of client paying a Fixed interest to the Bank and bank would be paying the Floating SOFR rate to the client. The current cost may be 25bps against the client. Thus, converting the floating rate liability into a fixed rate liability.

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Currency Swap: - Under this SWAP the client exchanges the initial USD amount with the Bank in return for an equivalent INR amount at today's rate. On all coupon days the bank would pay the client the USD coupons in exchange the client would pay in INR. The tentative client for the transaction would be 3%.

Compliances required: - The ECB is a regulated product and can only be availed after the client gets a LRN no from the RBI. Also, the client is supposed to comply with the monthly compliance by filing Form ECB 2 through there AD bank.

The Decision

The client has now the following options: -

1. To go with the INR borrowing with the current banker (where he can negotiate further). Also, the burden of compliance would not be there as the transactions remain in domestic currency only.
2. Undertake the ECB transaction on a fully hedged basis by undertaking a Full Currency Swap (FCS) wherein he covers the Interest rate as well as the currency risk but that would increase the costs.
3. The client has 20% of its revenue as exports and may not like to undertake the Currency Swap as he has got a natural hedge . He may undertake an IRS though to cover the Interest rate risk.

In option 2 & 3 he will have to comply with the mandatory compliance with the regulator. Which option should he undertake?