Package of Measures on Forex

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In view of the developments in the foreign exchange markets, the Reserve Bank of India on August 20, announced the following measures :

Increase in Cash Reserve Ratio (CRR)

The Cash Reserve Ratio (CRR) to be maintained by scheduled commercial banks was increased from 10 per cent to 11 per cent effective from the fortnight beginning August 29, 1998. This was a temporary measure taken to absorb excess liquidity.

Increase in Repo Rate

The Repo rate was hiked from 5 per cent to 8 per cent with effect from August 21, 1998. This rate will be reviewed periodically keeping in view the liquidity conditions.

Forward cover for FIIs

Authorised Dealers (ADs) were initially allowed to offer forward cover facility to Foreign Institutional Investors (FIIs) to the extent of 15 per cent of the value of their investments as on June 11, 1998. This will be in addition to the facility already available for incremental investments. With effect from June 11, 1998, FIIs were permitted to take forward cover from ADs in respect of the incremental value of their portfolio (equity) investments. Over a period of time, it was proposed to gradually extend the facility of forward cover to the existing investments of FIIs in the equity markets.

Forward contracts

(a) The facility of rebooking cancelled contracts for trade related transactions covering imports was withdrawn. However, the contracts can be rolled over on or continue to be available for exports. Earlier, rebooking of cancelled forward contracts is not allowed for non-trade transactions while it is allowed for trade related transactions.

(b) On noticing instances of misuse of the facility where corporates have booked and cancelled the spot leg of the transaction without first locking into the forward leg, the facility of splitting forward and spot legs for a commitment was withdrawn with immediate effect. In 1993, in order to provide flexibility, all corporates were allowed to cover their forward commitments by first locking into a forward rate and thereafter covering the spot.

EEFC Facility

Exporters have been permitted to use the balances in Exchange Earners Foreign Currency (EEFC) accounts for all business related payments in India and abroad at their discretion including payments of airfare and hotel expenditure. At the same time, exporters were advised that to the extent possible, balances available in EEFC accounts should be used for effecting payments abroad. The Reserve Bank also cautioned that if there was evidence of wilful delays in repatriation of export proceeds, it may, on a case by case basis, reduce the entilement or withdraw the facility of maintaining EEFC accounts. Exporters were provided with the facility to utilise the balances in their EEFC accounts for effecting payments for all bonafide trade and business related transactions which are of current account nature. They were also permitted to utilise these balances for approved capital account transactions.

Extension of time for realisation

Exporters were advised not to delay repatriation of export proceeds beyond the due date. Applications for extension of time limit would be considered only in exceptional cases where the delay in realisation was on account of external circumstances beyond the control of the exporters.

Reporting of peak intra-day positions to RBI

In addition to the present reporting of end of day position to the Reserve Bank, A.Ds were advised to report (at close of business every day) their open position as at 10.00 a.m. as also their peak intra-day.

The Government of India had in May 1998 constituted a "National Task Force on Information Technology and Software Development" to recommend steps to remove bottlenecks in the path of rapid development of information technology and to give a boost to information technology (IT) and software industry. Recognising the potential of information technology for rapid and all round national development the National Task Force on Information Technology and Software Development has drawn up an "Information Technology Action Plan" for initiating action encompassing various aspects of development of the industry. The Task Force has identified bank credit as an essential input for information technology and software industry development. It has also recommended issuing guidelines to banks for extending working capital finance to the information technology and software industry.

Recognising the fact that banks are not comfortable with extending aggressive credit support to a relatively new area of software industry unlike other traditional industries, due to several factors which make the assessment of credit needs and the follow up difficult, the Reserve Bank has formulated guidelines to bring about uniformity in approach on various aspects of lending to information technology and software industry. It may be stated that these guidelines have been framed based on the recommendations made by a study group appointed by the Reserve Bank to study the modalities of credit extension to software industry as also taking into account the suggestions made by the industry associations.

The Reserve Bank has clarified that the banks are to modify the guidelines based on their own experience without reference to the Reserve Bank to facilitate free flow of credit to this industry.

The various segments of information technology and software industry could be broadly classified into four categories, software services, project services, software products and packages and IT related services. Guidelines for providing working capital to each of these segments are :

(a) Software services

Staffing services and programming services

These services, which are also known as manpower exports, involve deputation of professionals for delivering programming services at customers' locations within the country, as well as abroad, under different contracts. The working capital requirements for these services would be in the form of initial travel costs for order canvassing and mobilisation expenses, as also travel costs and living expenses of the personnel deputed for executing orders . Banks could consider extending working capital for bridging the gap in cash flows arising out of the amount of advance payment received from clients, if any, and the mode of receiving the balance payments. The party may, in a few cases, receive some amount by way of advance payment from the clients which would be mentioned in the contract; the contract would also indicate the mode of payment, i.e., whether by way of monthly/periodical payments or payment in lumpsum after execution of the contract. The working capital requirements of the party would among other things depend upon the gap in cash flows.

(b) Project services

(i) Customised software development

These services comprise providing solution to specific problems of the customer which would be utilised by corporate mainframe and minicomputer users. These services could be rendered either at customer's location or delivered on physical magnetic media (like floppies and diskettes) or through satellite communication networks. This services is normally offered under special contracts which provide for 'milestone' payments. In these cases also, working capital requirements would be for meeting the gaps as disclosed by the cash flow statements.

(ii) Systems solution and integration

This involves providing a complete business solution using information technology. In this, integrator addresses a business problem of the client and offers an IT based business solution. The work involves programming, testing, documenting customised software solution for clients and integration of this programme with the client's existing IT system as well as with the systems of the client's parties/associates.

Working capital requirements would arise mainly on account of expenditure on professionals, purchase of software packages/ tools.

(iii) Maintenance of software

In this category, the party takes up an assignment for maintenance of client's software. Typically, it takes on the complete responsibility for maintaining a suit of software of the client. These contracts cover trouble shooting operations and at times even updation of the software. Working capital for this activity would be needed mainly for meeting expenditure on professionals.

(c) Software products and packages

These comprise (i) systems software, viz, operating system software, conversion of programmes and utilities which enhance the computer's capabilities; and (ii) application software which lets the computer perform specific functions; packages like word processing, graphic design, financial analysis, etc, come under this category.

These products are prepared to meet standard requirements of end users and are sold as packaged units comprising software manual and other user aids (tutorials). The development of these products involve fairly large scale investment, the return on which can be realised only after the product is fully developed and sufficient demand is generated. By and large, no payment by the buyers would be involved at any stage of development and the developer would be receiving payments only when the products are purchased by interested buyers. In such cases, working capital requirements would be mainly for meeting expenditure such as salaries and expenses of the professionals associated with the development of the products. The period required for development would vary and, in some cases, may extend up to 24 months. Financing of this category would have to be done as a venture at considerable risk.

(d) Information technology related services (IT service)

IT services such as call centres, mentoring, teleconferencing, tele medicine, etc, result from the use of any IT software over a system of IT products for realising value additions. Working capital requirements may also arise for meeting the expenditure incurred in providing these services. These however may not be of a significant scale.

Operational guidelines

Assessment : It is recognised that a monthly cash budget system would be ideal for arriving at the permissible bank finance (PBF). Working capital needs for borrowers having working capital limits of up to Rs. two crore, may be assessed on the basis of 20 per cent of the projected turnover. But if the borrowers so desire, working capital credit needs of borrowers with credit limits up to Rs. 2 crore may also be assessed on cash budget system. Assessment of permissible bank finance on cash budget basis may be confined to borrowers having working capital limits of over Rs. two crore. While the peak deficit in the cash budget would determine the permissible bank finance, credit would be made available on the basis of deficits shown at relevant point of time. Cash budgets may be reviewed if the underlying presumptions have undergone a change and the credit limits may be accordingly modified. Further, software products and packages which are normally financed out of equity, seed money, venture capital may be considered for finance on a case to case basis. Investments in equity in dedicated venture capital funds meant for information technology is also eligible for inclusion within the five per cent limit prescribed for banks' investments in equity instruments. The Reserve Bank of India has allowed banks to invest in equity shares of public sector units, shares, convertible debentures of corporates and in units of mutual fund schemes, the corpus of which is not exclusively invested in corporate debt instruments within the limit of five per cent of their incremental deposits of the previous year.

Documents: To appraise the credit requirements of the borrower, the bank should obtain from the borrowers the operating statement, balance sheet, cash budget, statement of economics and a note on the assumptions underlying the operating statement.

Every proposal for financial assistance must be accompanied by a detailed project report and a business plan. Specifically, the documents must clearly describe the short-term and long-term goals of the unit, the strategies proposed to develop and market software, the stage-wise financial outlay and revenue/cost projections. The basis for seeking the proposed limits from the bank need to be clearly spelt out.

As the activity involved is different from the conventional activities, with which a banker is familiar, a detailed plan needs to be drawn up for evaluation of the progress made by the unit. The plan may provide for milestones to be delineated which could then be appraised.

Nature of credit facilities: In respect of credit facilities up to Rs.10 crore banks have freedom to sanction credit facilities by way of cash credit facility or overdraft. In respect of credit facilities of Rs.10 crore and above, banks would however restrict cash credit component to 20 per cent of the aggregate credit limit after excluding export credit sanctioned and disburse the balance as a demand loan component. As per the Reserve Bank's instructions issued in October, 1997, in respect of borrowers with credit facilities of Rs.10 crore and above, banks are required to bifurcate the facility into two components, cash credit and demand loans in the ratio of 20:80.

In the case of specific orders from abroad, the credit provided would amount to pre-shipment or post-shipment finance as the case may be.

Margin : It is open to banks to stipulate reasonable promoter's contribution to serve as margin.

Security : The process of development of software does not generate tangible goods as in the case of other manufacturing activity and the value of the end-product depends upon its acceptability to the client user. Further, as the success of the activity depends upon the skills of the professionals/promoters, the banks would have to carefully evaluate the promoter's track record, their competence, their stake in the business, marketing strategies, etc. It is open to banks to obtain collateral security, where available. First/second charge on the current assets if available may also be obtained.

Rate of interest : In respect of pre-shipment and post-shipment credit extended for financing exports, the concessional rate/s as applicable for such credit could be charged provided the conditions stipulated for concessional credit are complied with.

For all other types of advances, the rates will be as prescribed by the Reserve Bank for general category of borrowers and no concession would be available.

Periodical reporting system : In order to verify whether the actual cash flows are in conformity with the projected ones, the banks may periodically, say once in a quarter, obtain from the borrowers statement of actual cash flows so that midcourse corrections can be made in respect of further cash budget, if necessary. In respect of borrowers where cash budget is not the basis for sanction of limit, banks may devise an appropriate reporting system.

Follow-up : Considering the risks associated with this activity, and that banks would take some time to gain the necessary insight into the intricacies in financing it, banks may have to evolve tailor-made follow-up systems for paying additional attention to these advances by themselves.

IT financing cells : The Indian software industry is essentially export oriented contributing substantially to the country's foreign exchange earnings. It is, therefore, necessary that the efforts of the industry are supplemented by providing timely and adequate credit to this industry. The banks may have to streamline their administrative arrangements to achieve this aim. Banks may, therefore, identify the centres where the IT software and services units are sufficiently large in number and create IT financing cells in identified branches at these centres. Banks may also consider constituting appropriate screening committees for appraisal of credit proposals and monitoring the progress/performance. Such committees may have on them, among others, expert/s having knowledge and experience about the industry. It is open to banks to have consultations with the representatives of the industry associations. Further, it would be advisable to have one nodal point for clearance of proposals in the head central office itself.

Training : Banks may arrange for requisite in-house training of their staff on software industry. Deputation of staff for seminars/workshops conducted by industry associations/other agencies may also be considered.

Use of international credit cards

Further, the Reserve Bank has decided to allow use of international credit cards for:

(i) Import of software through internet : Authorised dealers may allow reimbursement upto U.S.$15000 per transaction to international credit card organisations towards advance for import of software through internet even before the software is downloaded.

(ii) Payments for services obtained through internet :

(a) Authorised dealers may allow remittances for reimbursement to overseas international credit card issuing organisations towards fees for training or education of scientific/technical nature of by their customers. This should, however, be done through internet on production of documentary evidence regarding the fees payable to the overseas beneficiary.

(b) Authorised dealers may also allow remittances towards payment for registration of internet domain name, hosting charges for websites/home pages overseas.

(iii) On assignments abroad : Authorised dealers may issue international credit cards to the software engineers going abroad on assignments for their use during such assignments abroad. The reimbursement should, howevever, be provided for from the accounts maintained abroad by the software engineer concerned.

Investment in joint ventures

In order to simplify investments of Indian companies abroad under exchange earners' foreign currency (EEFC) fast track window, the Reserve Bank of India has made the following relaxations in regard to availability of funds in the exchange earners foreign currency (EEFC) accounts of indian promoter companies and setting up of second generation concerns abroad by joint ventures (JV)/wholly owned subsidiaries (WOS) initially set up under the EEFC fast track window.

Authorised dealers can now approve proposals for overseas investment under the EEFC fast track window even in cases where the balances in the EEFC accounts are not sufficient to cover the proposed investment at the time of approval. Authorised dealers can approve this if :

(a) On the basis of the foreign exchange earnings track record of the account holder, sufficient accretion to the EEFC account is likely by way of future earnings to fully cover the proposed investment within the projected time-frame for implementation of the project.

(b) The proposal should be such that the Indian promoter company's contribution towards the project cost can be made over a period without affecting the overall viability of the project.

Second generation investments : Indian promoters may agree to their overseas joint ventures/wholly owned subsidiaries to set up second and subsequent generation companies without fulfilling these conditions, provided the first generation company was set up under the EEFC fast track route and setting up of second/subsequent generation company(ies) is intimated to the Reserve Bank in the prescribed annual performance report. However, where additional investment is made under the EEFC fast track window in an existing JV/WOS approved by the Reserve Bank/Government of India, the extant guidelines regarding setting up of second generation company will continue to apply.

PRIORITY SECTOR LENDING

(i) Loans to NCDC

Loans by commercial banks to national cooperative development corporation (NCDC) will qualify to be included in the priority sector lendings as indirect finance to agriculture if the national cooperative development corporation (NCDC) utilises these funds for on-lending to the cooperative sector for purposes presently coming under the priority sector.

(ii) Loans to NBFCs

Bank credit to eligible non-banking financial companies for financing of trucks for the purpose of on-lending to small road and water transport operators (SRWTOs) will now be eligible for being classified under priority sector if the ultimate borrowers (SRWTOs) satisfy the eligibility requirements for such classification. Advances to small road and water transport operators (SRWTOs) owning a fleet of vehicles not exceeding ten are eligible to be classified under priority sector lending of commercial banks.

Definition

"IT Software" means any representation of instructions, data, sound or image, including source code and object code, recorded in a machine readable form, and capable of being manipulated or providing interactivity to a user, by means of an automatic data processing machine falling under heading "IT products" but does not include "non-IT products".

"IT service" is defined as any service which results from the use of any IT software over a system of IT products for realising value addition. The term IT industry would cover development, production and services related to IT products. Information technology (IT) product would connote computer, digital/data communication and digital/data broadcasting products.

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