Indian Enterprises Investing Abroad - Irritants, incentives and issues

R.Gurumurthy
Institute for Indian Economic Studies
Waseda University

The trend

- Indian firms investing abroad is not a new phenomenon but not quite visible in the past (Earlier IT, Pharma and Auto component manufacturing companies were venturing overseas but these deals were small in size).
- Indian ventures abroad are miniscule compared to the global landscape.It is a general trend that TNCs from emerging economies continue to expand overseas and very fast.
- Emergence of PE funds, collective investment funds and sovereign wealth funds as new risk takers in the global M&A space.

Trends in cross-border M&A

Trends in M&A (US$ billion)			
Year	Global	Indian	Indian outbound
2005	716.4	9.5	4.3
2006	880.2	15.3	9.9
Average deal size (US$ million)			
2006	12500	36	

Source: WIR-2007,UNCTAD; Dealtracker-2006GTI)

- Current scale of activity may not be sustainable due to rising competition and rising asset prices (World Investment Report 2007 - UNCTAD)
- Two things required for business expansion:
- 1.The capability at the individual firm/entrepreneur level
- 2.The enabling environment
- This paper approaches the subject from these two angles

Irritants

- In the past – command and control economy
- Industrial licensing policy:
- Regulation of monopolistic and restrictive trade practices:MRTP Act
- Rigid labour markets
- Over regulated financial markets
- Foreign exchange regulations

- Industrial licensing policy
- State domination due to scarce capital and presumably weak entrepreneur base after independence
- 1973: recognition to private sector’s role albeit within controls but there was this lurking threat of nationalisation
- 1980:recognition to the need to promote competition in the domestic market, upgrade technology and modernize
- 1991:clear recognition of private capital and the state as a facilitator

- MRTP Act (currently in transition to Competition Act)
- Since large industries are under State control, this is meant to control so-called large private businesses
- Good intent but wrong thrust resulting in an entry barrier
- Restricted capacity creation rather than monopolies
- Anomaly corrected in 1991 to bring an emphasis on restricting market share rather than on restricting asset size

- Labor markets
- Rigid and seemingly overlapping laws
- The low level of compliance to law could not improve the situation
- Regulated financial sector
- Foreign exchange regulations (restricted outward expansion of Indian firms)

Irritants

- Presently
- Inflexible labour markets
- Issues of governance and bureaucratic delays
- Slow pace of reforms

Incentives

- Those incentives offered by relatively liberalised policy framework
- Benefits of global presence, size and market share
- Access to new efective markets
- Growing domestic market
- Successful Indian diaspora and Indian entrepreneurship
- Aggressive PE funds and expanded sources of finance

Incentives

- Low wage costs and improving manufacturing standards
- Country’s potential as a global manufacturing hub
- Incentives of moving up the value chain
- Avoid marginalisation or elimination

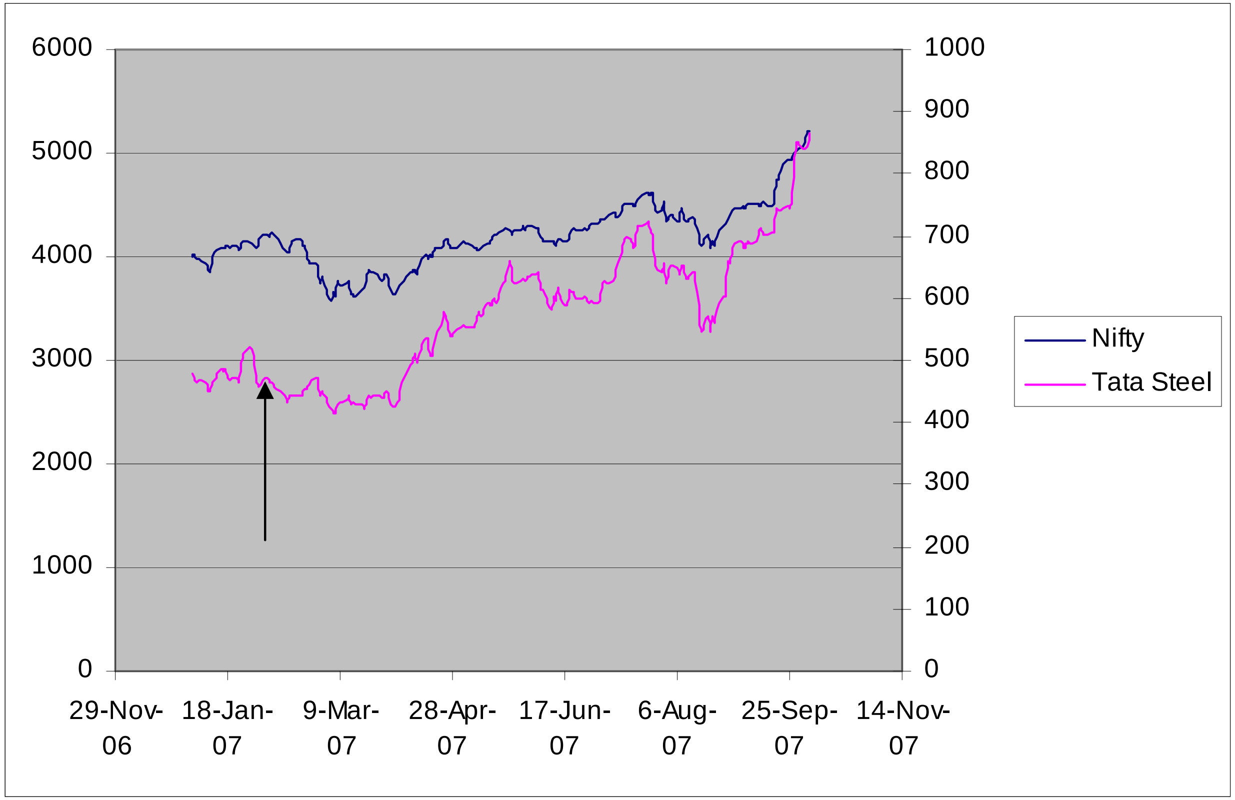
Issues

- High valuations
- Inherent dangers of LBOs (especially after the sub prime credit market crisis)
- Minority shareholders’ fate
- Herd behaviour
- Integration issues

Valuations

- Despite concerns about *futuristic valuations*, a study by global consulting firm KPMG *(“Increasing value from disposals*”) revealed that the sellers, both corporates themselves (almost 50% of the companies that were surveyed) and PE firms (a quarter of them) felt that they had not maximized the value on their latest disposals)

Valuations



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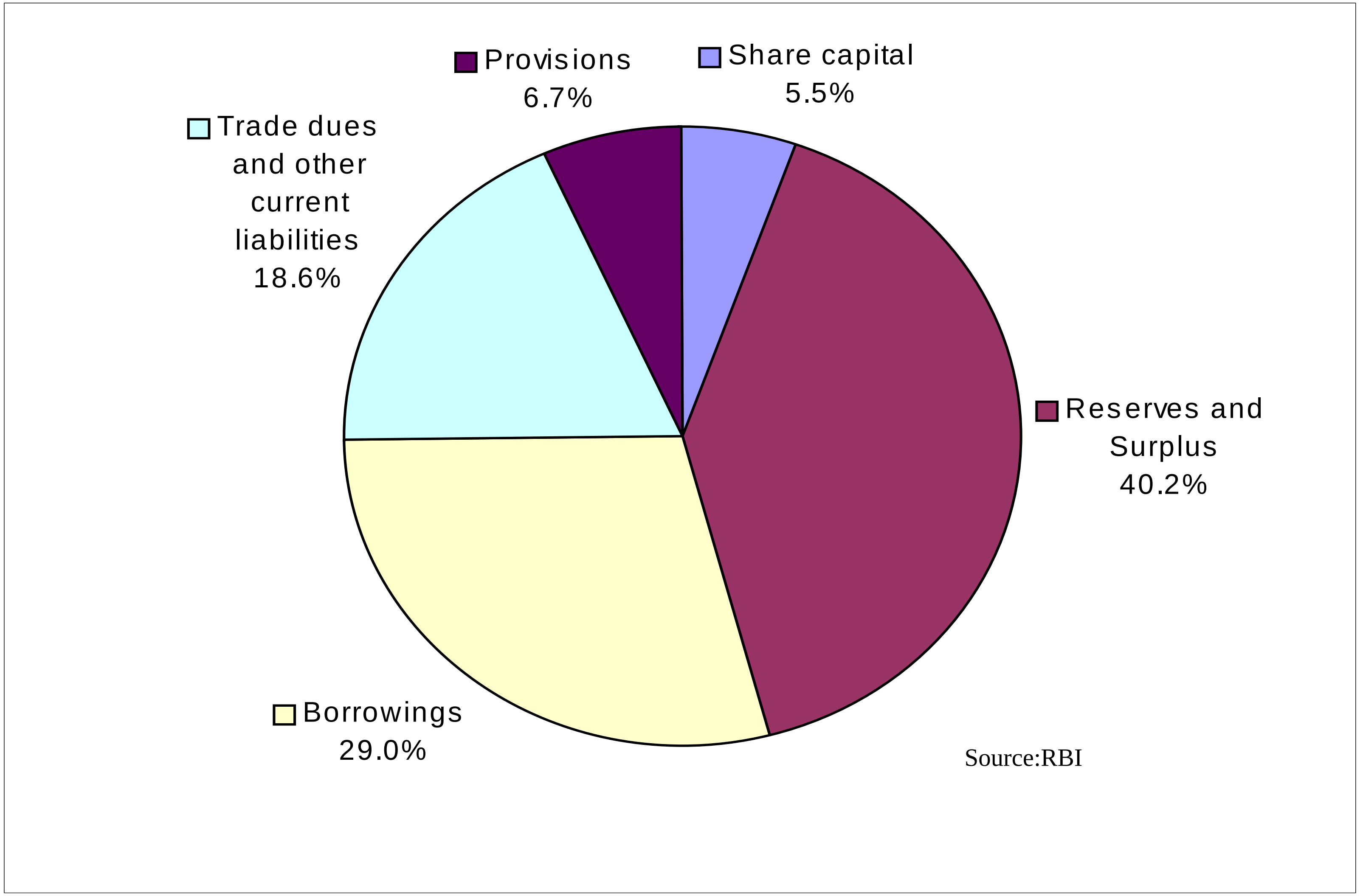
28-Apr-07
17-Jun-07
6-Aug-07
25-Sep-07
14-Nov-07
Nifty
Tata Steel

Valuations

- Tata Tea acquired Glaceu for US$ 677 million – sold to Coca Cola for US$ 1.2 billion in less than a year
- Two years ago, when one of the then largest shareholders of REPower, was offering 25% stake for € 20 per share Suzlon failed to grab that opportunity and later this year it paid € 150 per share (currently around € 128 with yearly low and high of € 54.75 and € 168 – as on 17th October, 2007)

Liabilities of select Indian companies



Select financial ratios of some large public limited companies

Select financial ratios	2003-04	2004-05	2005-06
Debt to Equity	47.9	42.7	36.4
Total outside liabilities to net-worth	139.5	131.1	118.6
Profits retained to profits after tax	68.3	74.0	72.6
External (foreign) sources to internal sources of funds)		67.2	190.7

*1064 companies Source: Reserve Bank of India

Moving into the top league

- Hero Honda – World's largest two wheeler company
- Reliance Industries-3rd largest refinery in a single location and largest producer of polyester fibre and yarn
- Bharat Forge-2nd largest forgings company
- Suzlon-4th largest wind turbine maker
- Moser Baer – 2nd largest optical storage media manufacturer
- Tata-Corus: 5th largest steel maker