Indian enterprises investing abroad – Irritants, incentives and issues

R.Gurumurthy[1]

Institute for Indian Economic Studies
Waseda University
Tokyo

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I. Introduction

India has been a capital deficient-labor surplus economy. Thanks to the earlier policy prescriptions dictated by its Fabian socialist ideologies, failure to bridge this gap had constrained the achievement of potential economic benefits for the next four decades after India got its independence. Why, then, despite the immense potential for growth within the country, Indian entrepreneurs are venturing abroad? Are there valid compulsions behind this motivation? If not, how much of it is hubris? Amidst a wave of global consolidations, whether the Indian companies could afford to relax? Whether the Indian entrepreneur feels that, despite the potential within the country, the local business environment is still not catalytic enough to commit all his investments within the country? If that is the feeling, is it the wisdom that the opportunities outside the country, in the interim, should not be missed? Most importantly, is it a realisation that in

[1] The opinions expressed in this paper are the author's own and do not represent those of any organization he is/was associated with.

globalised environment national boundaries have lost their emotional appeal to transnational businesses (as we know that a third of world trade takes place on an intra-firm basis) and that firms are guided by not only mere expansionist polices but also by a Darwinian survival instinct to counter competitive pressures?

At the outset, Indian enterprises venturing overseas is neither a new phenomenon nor out of place. It is only that an evolutionary phenomenon has got "visibility", thanks to a few mega and adventurous overseas acquisition bids by Indian companies, such as the ones from Indian business conglomerates Tatas and Birlas. The heightened cross border activity involving Indian companies is also in tune with such a phenomenon across the globe – the global M&A space witnessed around US$ 3 trillion deals in 2006 – thanks to the development of financial engineering, surge in global liquidity, elevated risk appetite, and the seemingly never ending opportunities for synergies. We also need to take note of the fact that the cross border M&A deals from emerging to developed nations are on the rise and would be striving to match those in the reverse direction.[2]

The organization of this paper is as follows; after this brief introduction and some interrogations, ***Section II*** will discuss some theoretical framework to explain why firms expand their presence abroad – in other words, the motives behind trans-nationalisation. That would be followed by a detailed discussion, in ***Section III*** on the evolution of domestic economic policy that has impacted the Indian firms, both positively and negatively at various stages. In ***Section IV,*** an analysis of industry-wise as also firm-wise compulsions and strategies as they venture abroad, is made. Concluding remarks are in presented in ***Section V***. Discussions about Indian ventures abroad are not only restricted to mere M&A but pervades all sorts of ventures such as relocation, extension of domestic operations and greenfield investments overseas.

[2] Emerging Markets International Acquisition Tracker, KPMG

II.A brief review of theoretical framework and the evolving paradigms

According to John Dunning, who has done some pioneering work on the activities of transnational companies, there are both *firm-specific* advantages and *location-specific* advantages that prompt companies move beyond their parent country. On the firm-specific attributes, *ownership advantages* decide why a particular company rather than others have the advantage of taking up a particular investment decision, while the *internalization advantage* explains why and under what circumstances a particular company might prefer direct presence in an alien location to licensing. On the other hand, *location-specific* advantages will be the deciding factor why a firm moves production base outside the parent country. When the *location-specific* advantages favour production in the home country of the multinational corporation (MNC), international activities will take the form of exporting (Ietto-Gillies. G - 2005). This "eclectic theory" was considered by many as nothing but a shopping list of variables to which Dunning's reply was that this should be treated as a *system* or a *paradigm* rather than a theory. There are the others such as Vernon and Cantwell who proposed some kind of dynamic theories –while Vernon's was based on the "product life cycle" theory that of Cantwell was premised upon innovation and technological advantages of a firm. In any case, most of the theories have explicit or implicit assumptions of either efficiency objectives or strategic objectives of a firm (Ietto-Gillies. G - 2005). As per an approach based on the "product life cycle" theory, a firm that invents or innovates initially enjoys a monopolistic status but such a status will gradually disappear as competition grows due to several reasons including products coming off the patents, in which case the firm either tries to dump the existing businesses, or move up the value chain or relocate to take advantage of costs and upcoming markets where the demand for such a matured product either continue to exist or in a nascent stage. Broadly, a firm can have two objectives viz., *efficiency objectives* that have a short-term profit motive and *strategic objectives* that might ignore the short-term profit motive for the sake of

more strategic long-term goals such as market position and market share. Strategies could be *offensive* or *defensive* which means that companies in anticipation device strategies to counter possible threats from rivals or if they are caught unawares, could even device strategies to defend their territories. Hence, more often, while judging a take-over or buy-out deal, the question needs to be counterfactual – what would have happened had a particular company not gone for such a strategy? In any case, *'in a world of big players with uncertainty over the structure of costs and the reactions of other players with dynamic changes in the medium to long term, with imprecise knowledge over the structure of costs and revenues, strategies may be more the result of hunches than precise mathematical optimizations'* (Ietto-Gillies. G – 2005). Such dilemmas sometimes make us feel whether the alpha-male syndrome is behind such motives, where the decision of the chief executive, thanks to the powers he enjoys (this is quite possible in the case of Indian companies where the promoters, especially family oriented businesses dominate the decision making process, aided by passive individual and even institutional investors), is the ultimate factor. Kogut (1983) highlights the benefits of *multinational networking* and the *informational externalities* such as the knowledge about operating in various markets that accrue to a firm as a result of transnationalisation of business. Then we also come across very valid arguments that there needs to be a shift from a strategic approach focused only on *strategies towards rivals* to a *strategy towards various other players in the system* such as labour and governments, as firms expand (Ietto Gillies). Some firms treat internationalization as a strategy to fragment labour (Cowling and Sugden (1987) and Sugden (1991)) which in some cases outweigh the disadvantages of loss of scales that the fragmentation of operations into various locations causes. Then one can borrow from the finance theory that a portfolio approach is better to diversify risks in terms of products as also geographical locations. What is also unsaid by most of these paradigms is the concomitant benefit, in the form of costless brand promotion, which accrue to companies that ventured abroad – one may witness this in the case of many Indian companies that ventured abroad recently and won take-over bids against

fierce rivals and in the process got a wider global media coverage. (In the context of Tata Motors' bid to acquire Ford's Jaguar and Land Rover, Ratan Tata is said to have confirmed this view that the acquisition would help bring global visibility to the conglomerate which until recently was little-known outside India[3]).

As regards the Indian companies' global ambitions, what role does the ego of the CEOs play? Kate Ludeman, CEO of Texas based Worthetic Corporation, a leadership management firm and the co-author of the book "Alpha Male Syndrome" believes that the desire of CEOs to create something big can often outstrip the economic value of a decision[4]. But she also agrees that *the phenomenon of global buy-outs is new in India and five years later the buyers could look like visionaries*. On the flip side, Indian companies whose boards are either dominated by the promoters or even otherwise conform to the CEO's wishes, makes it immensely possible that the CEO's personal wishes and ego dominate the decision. However, but for a decisive CEO and his vision, the firms can also fail to seize opportunities especially when the time is ripe for business expansion. This is what, marketing expert, Prof Jagdish Sheth, confronts, in his book "*The self destructive habits of good companies*" when he asks, "Why did Microsoft not have a Google in its vision? Or, Why did Coca Cola not get into non-carbonated beverage seven years ago?" According to Prof. Sheth complacency is one of the reasons why companies destroy themselves and in order to get out of complacency they need to re-engineer or re-invent themselves and also give themselves a new vision. The conclusion is, that the alpha male syndrome is not undesirable and it does play a significant role in a firm's expansionist policies. L.N Mittal of Arcelor Mittal fondly remembers how the Wall Street Journal called his earlier Kazakhstan venture as his waterloo while it, in fact, ultimately proved to be his best business decision ever.

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[3] Associated Press

[4] " Ego and Strategy", M.Anand - Businessworld dated 26th March, 2007

An interesting question that might confront one at this juncture is that, while for developed economies a relocation of their production base could be on account of the cost advantages on the labor front, what could be the motives behind a transition economies' outbound FDI? Talking in the context of some central European transition economies, Marjan Svetlicic[5] felt that, "The market-seeking motive was the most important deciding factor for outward FDI while lower labour costs were, on an average, the least important motive for investing abroad … lower labour costs are more a facilitating and not a decisive factor".

Lastly, there is this new phenomenon of national governments' supporting such expansionist polices either directly (through state owned companies) or indirectly (facilitating local corporations) for both strategic and economic reasons, as could be witnessed in the commodities space like oil and other mineral ores. It is a different matter that this factor is also blamed for the sharp rise in valuations of the target companies and the investment banks' growing interest in the M&A space.

III. Evolution of domestic economic policies

With the benefit of hindsight one might call it a distorted policy environment – some may go further naming it a perverted policy stance – but the economic policy that guided India for the next three decades or so after its independence (1947-1980) has an interesting twist. The post independence economic policy, *inter alia*, focused on self-reliance and import substitution. But a closed economy with a policy thrust on self-reliance also meant making everything at home. Coupled with another policy distortion in the area of education where the thrust was on higher education – for instance, *in 2000, India spent 86 per cent of per capita GDP on each student in tertiary education and only 14 per cent of per capita GDP per student on primary education*; to emphasise this point, *India spent substantially more in purchasing power parity (PPP) adjusted dollars per*

[5] Transition Economies' Multinationals – Are they different from Third World Multinationals?

student in tertiary education than China, Korea and Indonesia in that year (Kalpana Kochhar et el)- were in a way, instrumental in shaping what India is today – diversity both in its production base (result of self reliance since everything had to be produced within) and in skills (result of the education policy along with the policy of self reliance)[6]. With government dominating the investments, there was also a huge capacity build-up across various industrial activities, though complacency and lack of competition prevented them from becoming efficient.

Looking backwards, the erstwhile industrial licensing policy, state of labour markets and the regulatory environment have stymied the growth of industries and checked the ambitions of the entrepreneurs. Policy of *social control* which severed the nexus between the industry and banking institutions further contributed to this phenomenon – though the same policy might have somewhat contributed to the development of capital markets and the emergence of risk capital outside the banking system. The resultant monopolies and inefficiencies under a protected environment could not make the domestic industries internationally competitive. While these are some of the reasons that arrested the growth of industry and entrepreneurial abilities *within* the country, shortage of foreign exchange and the consequential foreign exchange regulations along with a poor credit rating of the country prevented Indian companies expanding abroad. Economic reforms towards the end of the last century greatly contributed to break this jinx and Indian private sector was made to face internal and external competition – to be fair, many domestic industries proved their mettle and survived; some of them even became globally competitive. To put it succinctly, all these policies ended up keeping the average size of an Indian firm rather small, denying them the benefits of economies of scale. In addition, these policies also restricted Indian firms and entrepreneurs from expanding outside India.

[6] India's pattern of development: What happened, What follows – IMF Working Paper by Kalpana Kochhar et al.

(a)The industrial licensing policy:

The emphasis of the first industrial policy initiatives was on self-reliance and import-substitution. Since capital was scarce and the entrepreneurial base was perceived to be not strong enough, the role of the State became crucial in assuming a predominant and direct responsibility for industrial production,. Though the 1973 industrial policy recognized the role of private and foreign initiatives and permitted investments from large domestic industrial houses and foreign companies in certain identified high-priority industries, the subsequent political compulsions emphasized the role of small-scale, tiny and cottage industries. While the private sector was allowed to play a role, albeit within controls, the threat of government take-over (nationalization) was a bigger constraint why the private sector hesitated to take investment decisions. The benefits attached to small scale industries to encourage labour intensive manufacturing in the private sector (such as tax concessions, special dispensation in terms of credit delivery as also cost of credit, reservation of production of specific goods to this sector etc.,) incentivised companies to remain within the defined parameters (reluctant to grow in size for the fear of losing incentives). While the policy of self reliance pushed the Sate to assume the responsibility of producing a broad range of things which in a way benefited the country in terms of a strong and diversified industrial base (in fact a high degree of self reliance in a large number of items – raw materials, intermediaries and finished goods – has been achieved), the extant industrial policy stance along with other laws and regulations such as the labour laws and the Monopolies and Restrictive Trade Practices (MRTP) Act restricted competition and the growth of Indian businesses within India.

While many might now blame it on the past industrial policies of the country, it would be interesting to know that the domestic private sector itself was more willingly called for a massive State intervention in economic matters rather than supporting free markets. On the eve of Independence, in 1944, many Indian industrialists including the then patriarchs from the houses of Tatas and Birlas,

the same business houses which, currently are spearheading India's corporate transnationalisation, came up with a document called "A brief memorandum outlining a plan of economic development for India" (popularly known as the Bombay Plan), which echoed their preference for State intervention.

It is only in 1980 that the industrial policy clearly recognized the need for promoting competition in the domestic market, technological upgradation and modernization. Later in 1991 the government's industrial policy statement emphatically said, "the bedrock of any such package of measures must be to let the entrepreneurs make investment decisions on the basis of their own commercial judgment … Government policy and procedures must be geared to assisting entrepreneurs in their efforts". And thus, shifted the focus of industrial licensing system away from the concept of *capacity licensing* and containment of capacity.

(b)Labour markets

Coming to its labour markets, Indian labour laws are considered to be quite rigid. For instance the Industrial Disputes Act, 1947 requires the employer to seek Government's permission to lay off workers if the employer is employing 100 or more workers. The Factories Act, 1948 does not allow Factories to employ women at night. The Contract Labour (Regulation and Abolition) Act, 1970 is inflexible with regard to engaging contract labour by the industry. Besides, labour being a concurrent subject under the Indian Constitutions (in other words both the central and state governments can legislate on matters related to labour), the situation looks stark giving an impression that there are a number of overlapping legislations to deal with. In any case these laws were said to have kept in check the maneuverability and expansionist policies of several Indian enterprises. Labour laws along with their enforcement and trade union practices together will decide the flexibility of the labour markets and going by all these parameters Indian labour markets have been considered to be one of the most inflexible. The fact that *labour legislations in India tend to be aspirational with limited*

effectiveness in the absence of a credible enforcement mechanism (Nagaraj.R, 2007) could not improve the situation in a substantial way.

(c)Foreign exchange regulations

A relatively closed economy with hardly any significant contribution to international trade and low levels of private capital inflows led the country to a hands-to-mouth constraint with regard to its meager forex resources. This led to a policy of import licensing as also stringent foreign exchange regulations, which in a way impacted business expansion of firms both within and outside the country. On the other hand, along with regulatory restrictions, their insignificant size in comparison to their global peers and their credit ratings denied Indian firms, access to international financial markets.

(d)Curbs on monopolies and restrictive trade practices

The Monopolies and Restrictive Trade Practices Act came into effect in 1970 mainly to, as the name suggests, restrict the growth of monopolistic businesses and restrictive trade practices. As the State had been already dominating the industrial scene, the MRTP Act was to control the big non-governmental business enterprises. The extant industrial licensing policy (requirement of license turned into an entry barrier) and the MRTP, which focused more on the pre-entry scrutiny (again an entry barrier) constrained the growth of competition and only those businesses already established or those that could get their way through the bureaucratic mazes in turn developed into a kind of inefficient monopolies – an irony. With "*the growing complexity of industrial structure and the need for achieving economies of scale for ensuring higher productivity and competitive advantage in the international markets the interference of the Government through the MRTP Act in investment decisions pf large companies has become deleterious in its effects on Indian industrial growth*"(1991 Industrial policy statement). The MRTP Act was in a way noble in its intent and aspirations, but the way its provisions were implemented has now been blamed for the arrest of industrial growth in India. Some would argue that it has only regulated growth

but not prohibited it[7]. While semantically the law was synonymous with efforts to address anti competitive business practices, practically it restricted the growth of the then big companies (also loosely called *MRTP companies*, with asset size more than Rs.1 billion -or equivalent to around US$ 25 million at current exchange rates) as they were required to seek Government approval for expansion of existing activities as well as establishing new undertakings. The problem with the MRTP Act again is not with the intentions but with the emphasis – which was more on restricting the size of the businesses arbitrarily without properly assessing the potential business space and secondly, placing a restriction on the size of assets; the MRTP Act along with industrial licensing and other policy restrictions kept the *available* opportunities at a great variance with the *potential* opportunities, as this, in reality, led to the restriction of asset size rather than market share. These shortcomings were recognized and rectified when in 1991 the MRTP Act was amended, inter alia, to bring changes in the criteria for determining dominance, which thenceforth would be based only on *market share of 25% of the total goods produced, supplied, distributed or services rendered in India or substantial part thereof.*

The impact of these policy changes could be seen in the way the character of Indian out bound FDI (OFDI) has changed. OFDIs, which were limited to small group of large sized family owned business houses, and in projects where mostly the Indian side assumed a minority stake in joint ventures (JVs) in the 1970s and 1980s later has undergone significant changes in the 1990s. Unlike earlier, the Indian businesses, now armed with options to finance their ambitions, went for complete control of their acquisitions and the target investments also broadened from certain specific low profile countries to developed countries (Pradhan.J.P – 2007)

(e)Regulated financial sector.

[7] MRTP Act Metamorphoses into Competition Act – Dr. S.Chakravarthy.

Underdeveloped capital markets along with credit restrictions (*selective credit controls*) constrained industries from expanding despite potential opportunities. Domestic companies had thus developed a tendency of relying mostly on internal accruals, which in any case need not be the most efficient source of financing besides limiting the expansibility of Indian enterprises.

(f)Liberalisation and the transition

While the eighties have seen a gradual shift in the policy stance to give the private sector a larger role-play, the period after 1991 has some important developments that helped the private industry mature. One such development spanned over the entire decade of the nineties and peeped into the new millennium. This period, marked by interest rate deregulations, gave the domestic industry its first taste of what could happen to their maturity mismatched balance sheets on account of interest rate movements. The early nineties, when the liberalization process started, also threw up new opportunities for the domestic industry, which went on an expansion spree through higher "gearing"[8]. This also happened at a time, when the unshackled interest rates shot up sharply. Then came the reversal of high interest rates, which brought many private sector companies to the verge of bankruptcy (*please see Table 1*). There were additional lessons both for the industry and authorities from the south east-Asian crisis. Industry became cautious and the ensuing period saw a consolidation and painfully undertaken de-leveraging of balance sheets. This post deregulated interest rate environment that was followed by easy liquidity conditions completed one interest rate cycle and has made the newly liberalized private sector learn its valuable lessons, which helped them later in their proper assessment of *leveraged buy outs* (LBO – please see *Box1* for 'why Indian companies prefer the LBO route), the method mostly resorted to by Indian companies in their overseas acquisition bids. As internal sources along with equity started dominating the firms' investment decisions once again, their gearing improved substantially (*please see Table 2 as also Figure 1*), giving them

[8] "Gearing" is the degree of financial leverage.

the foothold to re-launch their LBO strategies. Regulatory relaxations with regard to raising resources abroad (through depository receipts as well as external commercial borrowings) by Indian firms also aided this process.

Post Y2K and 9/11, a policy stance across the globe that ensured easy liquidity conditions increased the risk appetite across the board. In the meanwhile, private capital flows started dominating the global capital flows, and innovations in the financial markets changed the semantics of traditional leverage ratios as also facilitated the availability of finance to sub-prime borrowers through credit enhancing structures. (*Table 2 gives an indication of the rise in foreign sources in 2005-06*)

Table 1: Structure of interest rates

Year/Period	PLR* (%) of Term Lending Institutions	Yield on medium term (5-15 years)GoI** security(%)
1979-80	11	5.70-6.30
1980-81 to 1989-90	14	6.44-11.80
1990-91	14.00-15.00	9.44-12.70
1991-92	18.00-20.00	9.50-13.42
1992-93	17.00-19.00	9.50-14.78
1993-94	14.50-17.50	12.70-13.30
1994-95	14.50-18.50	11.30-13.86
1995-96	16.00-20.00	5.75-14.07
1996-97	15.00-19.50	5.75-14.44
1997-98	14.50-18.00	5.20-14.00
1998-99	13.50-17.00	5.75-13.74
1999-00	13.50-17.00	6.50-13.84
2000-01	13.00	9.37-12.50
2001-02	12.50	5.14-13.85
2002-03	12.50	5.60-9.27
2003-04	12.50	4.41-6.78
2004-05	12.50	4.71-7.73
2005-06	12.50	6.49-7.92

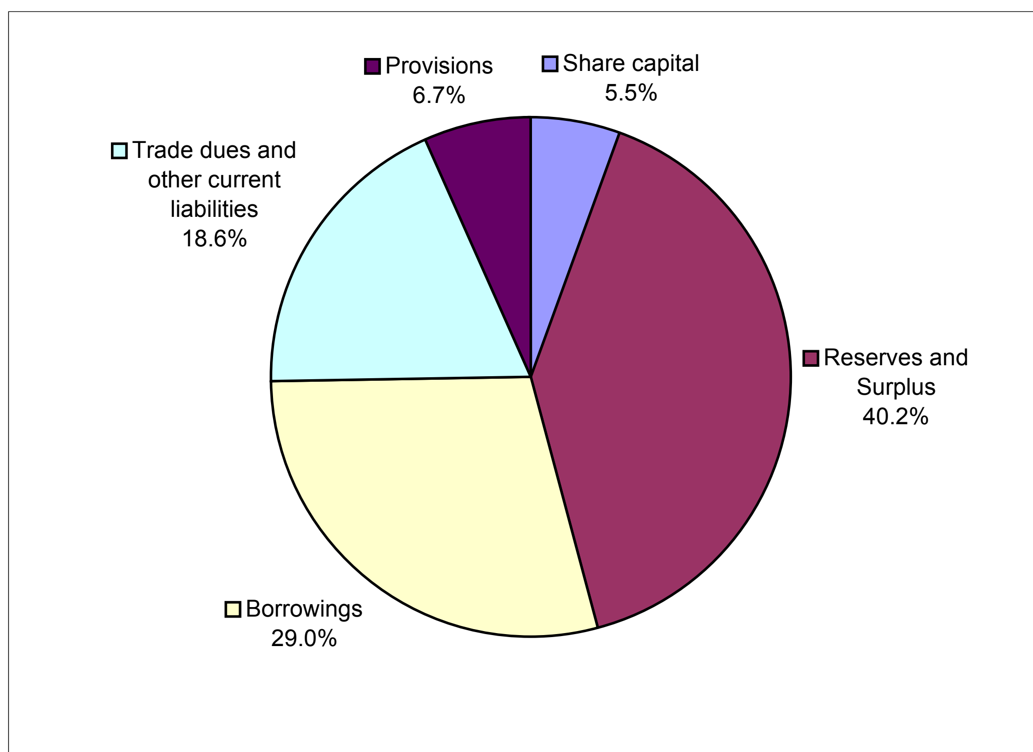
*prime lending rate ** Government of India security – annual gross redemption yield
Source: Reserve Bank of India – Handbook of statistics on Indian Economy

Table 2:Some financial ratios of select* 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 (sources of funds)		67.2	190.7

*1064 companies Source: Reserve Bank of India monthly bulletin – June 2007

Figure 1:Composition of liabilities – select* large public limited companies - 2005-06

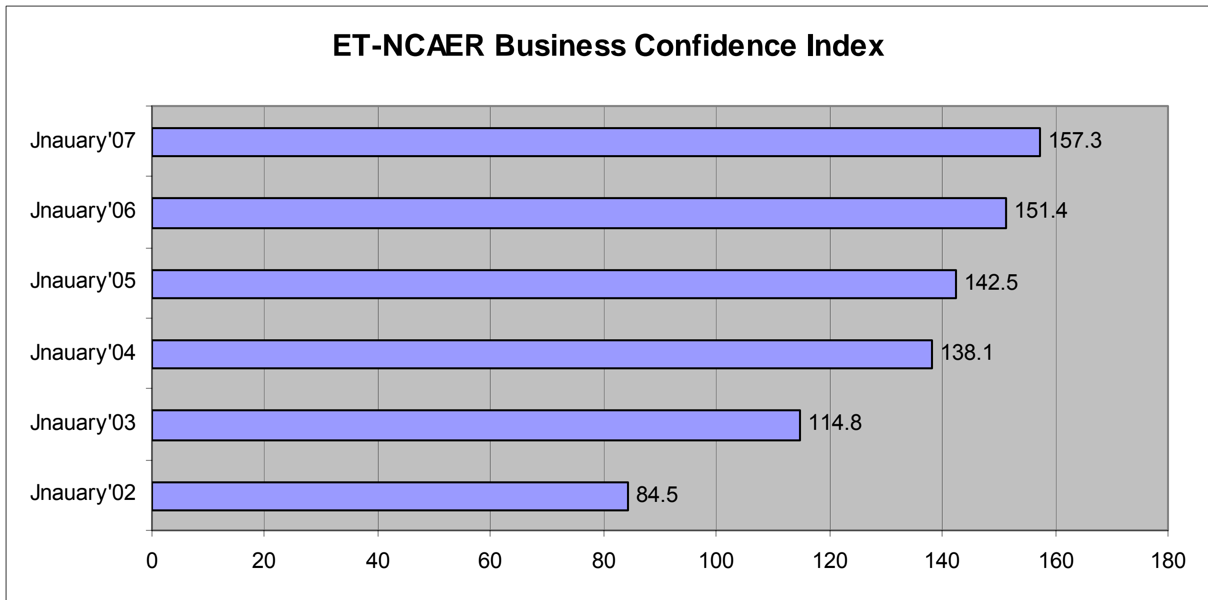


*1064 companies

Source: Reserve Bank of India monthly bulletin – June 2007

As the growth of Indian economy moved on to new trajectory in the new millennium, the business confidence also improved substantially (please see Figure 2), triggering higher risk appetite in investment decisions. While, these are the enabling changes that mostly relate to the policy domain, the industry and firm level motives will be discussed in the next Section, with some case studies.

Figure 2:Business Confidence



Source: Economic Times

Box 1: Why Indian companies prefer LBOs?

For obvious reasons, Indian companies go for LBO strategy. On the one hand, for foreigners who were owning shares in the target company do not in general prefer share swaps from the Indian acquirer, given the limited liquidity for Indian company shares offshore. For the Indian shareholders of the acquirer company also it tantamount to *equity*, and sometimes, *earnings dilution*. It is believed that, through LBO and an SPV (special purpose vehicle) structure they can de-risk the acquirer company and its shareholders from the negative fallout of the M&A, as the SPV structure has a *bankruptcy remoteness* advantage. Furthermore, as explained earlier, the non-attractive share swap proposition to target companies' shareholders, complete Indian firms to opt for LBO route. LBO on the other hand can leverage on the target companies' assets as also cash flows to finance the concerned M&A deal. A typical example of most of the LBOs undertaken by Indian companies could be seen from the Tata Tea's acquisition of Tetley, UK.

Tata Tetley deal was the first Indian LBO transactions and the largest overseas corporate acquisition until then. For acquiring Tetley, Tata Tea has created an offshore SPV, viz., Tata Tea Great Britain (TTGB). Initial capital of ₤ 70 million was provided to the SPV by Tata Tea (₤ 60 million) and Tata Tea Inc., the US subsidiary of Tata Tea (₤10 million). The SPV was leveraged at a debt equity ratio of 3.36 to raise the remaining ₤ 235 million. The LBO was structured as non-recourse one to Tata Tea by securing against Tetley's assets, both tangible and intangible (brand). The entire debt was divided into 4 tranches with terms ranging between 7 to 9.5 years.

IV.Industry and firm level motives and compulsions

Indian firms feel a need to aggressively pursue inorganic growth and this urge is supported by opportunities thanks to maturation of businesses in some locations and saturation of markets elsewhere. Despite Indian government's continuation with economic reforms, coalition politics and the slow pace of reforms also tend to frustrate the Indian enterprises who, in the meanwhile are trying to tie the loose ends in other areas, wherever opportunities exist. One such alternative for the Indian entrepreneurs is to move or expand businesses where the risk-return balance favours them. Companies have grown leaner and more efficient and their greater leeway to leverage has come in handy at an appropriate time, thanks to their low leverage and strong cash flows from operations. Economic and commodity cycles and the so-called high valuations do not seem to deter them at this juncture. Against this backdrop, the rest of this section will present an analysis of some of the major cross border acquisitions/overseas ventures by Indian firms/entrepreneurs to collate a list of factors that went behind these strategic acquisitions.

(a)Metals and mining

(Companies discussed: *Tata Steel, Essar Steel and Jindal Steel (in the Steel industry), Hindlaco (in the aluminium industry), Vedanta Resources (Mining) andRain Calcining Ltd.,)*

Table 3: Major Acquisitions by Indian companies in the minerals and metals sector

Company (industry)	**Target**	**Price**
Tata Steel (steel),	Corus, UK Natsteel, Singapore	£ 6.2 billion $486 million
Essar Steel (iron ore/steel)	Algoma, Canada Minnesota Steel, US	Can$ 1.85 billion Undisclosed
Jindal Steel and Power Ltd.(iron ore/steel)	El Mutun Mines, Bolivia	Won rights to develop 20 billion ton iron ore mine and to set up 2 million ton steel plant
Hindlaco (amuminium)	Novelis, Canada	US$ 5.9 billion
Rain Calcining Ltd., (calcined coke)	CII Carbon LLC	US$ 595 million
Vedanta Resources (mining)	Sesa Goa, India (from Mitsui)	US$ 981 million (51% controlling stake)

.

(i) Steel Industry: The ongoing boom in the commodity cycle and expectations about its sustenance for a longer time to come, given the yet unsaturated Chinese appetite and nascent Indian scenario looks to be the prime attraction for this sector. During the bidding process, many thought that it would be audacious on the part of Tata Steel, first of all for having embarked upon the venture and then for having paid a supposedly higher price for the target. But after the successful bid of Mittal Steel for Arcelor, people in the steel industry wanted critics to ask a counterfactual question – what would happen if the existing companies do not go for inorganic growth? The fact remains that after the Arcelor Mittal episode, the leading players in the global steel industry had to wake up for introspection. *While China has changed the demand side dynamics for the steel industry, Arcelor Mittal has changed the industry's supply side dynamics,* indicating the possibility of formation of a few big players, if not a cartel, with greater bargaining power, both for selling their final products as also for buying raw materials. For marginal players in such a scenario, it is a *do or die* situation. While the rising metal prices and growing demand are the factors on the one hand, defensive strategies to ward off any takeover move and to protect their

own turf in the domestic markets are the other reasons why many companies like the Tata Steel, Essar Steel and Jindal Steel have embarked upon overseas expansions. Though, for a conglomerate like the Tatas, there could be many synergies (for instance they also have interest in downstream utility industry like the automobile manufacturing), even on a standalone basis, Tata Steel feels that the acquisition of Corus brings in advantages in terms of having a global supply chain and a passport to new geographical areas. On the other hand, Essar Steel, which has acquired steel companies in North America (Algoma of Canada and Minnesota Steel of the US), seems to be banking on standalone assets that give them an access to customers as well as raw materials at the same place. For the Jindals also the Essar strategy could be attributed, though for them their primary motive appears to be gaining access to Bolivian iron ore mines (may be to feed their domestic steel manufacturing facilities back in India though the company at this juncture do not seem to nurture such plans for it might not be politically feasible immediately), even as the company is planning to establish a greenfield steel mill and a power plant in Bolivia itself. Given the procrastinated processes involved in setting up greenfield projects or in enhancing the current capacities back home, all these Indian firms might have decided to go for overseas investments that could save them precious time to be in the markets at the right time when things matter. The Corus acquisition also gave the Tatas the benefits of leveraging R&D as also advanced markets for their upcoming greenfield projects back home and elsewhere. Then the resulting larger dimensions of the companies also give each one of them an appropriate size and strength for further acquisitions and consolidation.

Drivers:

- **Current buoyancy in commodity cycle and the emerging demand**
- **Seeking markets and size through both organic and inorganic growth**
- **Building the value chain to improve value addition and reduce revenue volatility**
- **Seeking brands, technology and promoting brand equity**

For Tata Steel, the company has an access to low cost raw material back home (it is the only private sector steel company that currently owns a mining right in India). In other words, Tata Steel management might be banking on the geographical advantages which they call it *de-integrated method* of steel making where you break up the supply chain and produce parts of it where it makes the most economic sense[9].This has got much logic given the two important attributes of metal industry *one*, brand does not matter much for this producer good and the *other*, the bulkiness of the commodity that puts constraint on its transportation. Though some are sceptical about the merits of Tata's venturing into a cyclical industry where the current boom is already around half-a-decade old, Industry experts feel that, given the advantage of being the lowest cost producer of the metal (to compare its cost advantage with that of Corus, Tata Steel generates three fourths of Cours's operating profits while the former's revenues are a fourth of the latter) and captive resources of raw materials, Tata Steel still stands to gain even if there is a sharp fall in prices. As per Tata Steel, their cost of production is around US$ 150 a ton as against the industry average of US$ 330 a ton. In addition one needs to look at the skewed ownership pattern in iron ore producers vis-à-vis steel producers – the world's top five iron ore producers control an overwhelming 90% of the market, while the top five steel producers command only 20%, possibly indicating the vulnerability of steel producers who do not have the advantage of possessing some captive resource base. (This further reveals the strategy of Indian companies in scouting for iron ore and coal resources across the globe). According to Peter Fish of MEPS International, there is another interesting point – that none of the main consuming countries has any raw material to make steel, while the main iron ore resources are in Brazil, Australia, India and Russia and if one ignores Australia the others consume a small proportion of global consumption. The resource-backed

> "Because of the size and scale of the Corus deal, we seem to be cast as a group on an acquisition spree, which is not the case. We would be interested in an acquisition only if there is a product gap that it can fill, there is a strategic fit, or a particular geographical presence that it offers."-*Ratan Tata*

[9] Businessworld, 19th February, 2007

advantages also are the other dominant reasons behind Jindal Steel's ventures into Bolivia (where it acquired El Mutun mines) or Essar's ventures into North America (Minnesota Steel, which Essar has acquired are said to have1.4 billion tons of iron ore reserves).

(ii) Aluminium Industry (*Hindalco – Novelis****):***As compared to Tata Steel – Corus deal, the second largest cross-border purchase by an Indian venture viz., Hindalco buying Novelis might look baffling and adventurous, despite the fact that Novelis is the world leader in aluminium-rolled-products (with nearly one-fifth of global market share). Novelis emerged out of the Alcan–Pechiney merger when the rolled-products business had to be divested thanks to the US and European anti-trust regulations. That in itself may not sound bad; what went wrong with Novelis was that along with its creation it also inherited a huge debt of nearly US$3 billion. To add fuel to fire, the management in pursuit of expanding their market share, went for a fixed price long-term selling contract with its major clients, without the backing of a matching fixed price purchase contracts for its raw materials procurement. This has turned otherwise a *positive-net-operating-income* business into a loss-making venture. When the deal was finalized between Hindalco and Novelis, the debt equity ratio of Novelis was a whopping 7.23:1. This also made a typical LBO impossible for Hindalco, leading to some equity dilution and enhanced risks for its shareholders. It is difficult to conclude that the Birla's are extending their philanthropy into the business domain to rescue Novelis! If that is not the case, what else do they want to achieve through such a seemingly risky investment? .

While Hindalco is an integrated player that manufactures alumina and primary aluminium products, Novellis operates in the downstream sector with a *brand equity* in packaging industry and a good client base. Despite the problems mentioned above with regard to Novelis, both companies are known for their cost conscious manufacturing strategies. Novelis's facilities are also in close proximity to its markets. The apparent benefit that Hindalco is looking for is the total value

chain through the acquisition. Hindalco also has the benefit of owning bauxite mines and captive power generating facilities, which positions it amongst the bottom quintile of the global cost curve (Metalworld[10]), with an operating cost of around $1,100 a tone, supposedly one amongst the lowest. Hindalco also feels that given the lower price volatility of value added products compared to primary metal, it could reduce the revenue volatility through this acquisition. Meanwhile, the company is also planning massive capacity additions to become one amongst the world's top five aluminium producers in the world by 2012 for which it has been on the lookout for end users.

While Hindalco paid a good premium for an otherwise loss making company, the company justified it saying that the price was reasonable given the US$12 billion assets of Novelis and that a similar company would take 10 years to build from the scratch. But the size of assets is no justification for the high price since the return on assets and return on equity is more important (why should the target company made itself available for a price less than its asset value?), Hindlaco seems to be banking on the new markets for Novelis products, including India a few years hence and is eager for an inorganic growth. India with a per capita aluminium consumption of 1.6 kg compares poorly with 8 kg for China and around 30 kg for the developed world. The canned beverages market in India is still in a nascent stage and that presents huge opportunities for dominant players in the domestic market like Hindalco.

Drivers:
• **Need to enter downstream operations to contain revenue volatility** • **Seeking buyers for its brownfield and greenfield projects being planned back home for producing basic metal**

Hindalco also wants to take advantage of the global presence and brand image of Novelis (the later has manufacturing facilities in 36 locations across 11 countries), given the former's brown field and green field expansion plans for

[10] February 2007

producing the metal. Besides, Novelis is a technology leader. Producing the metal is a power intensive operation and despite the high power tariffs in India, the country is one of the lowest cost producers of metal in the world. Global demand for aluminium, growing at a 4.5% CAGR in the past decade is not matched with the supply. Though China produces one fifth of the global output and is a net exporter, it is reportedly cutting on production due to power shortages and several plants in Europe, North America and Russia are closing their smelters and these are the other motives why Hindalco is betting large on its expansionary policies. Having said that, the Birlas (owners of Hindalco) have gone ahead with the deal after much hesitation and that shows that it is *more* of a bet *than* of a strategy based on sound scientific logic and the sagacity of the decision might be known only later.

(iii) Calcined Coke (*Rain Calcining Ltd.,- CII Carbon LLC****):*** Taking advantage of the requirements of both steel and aluminium industries and the expansion plans of companies like Tata Steel and Hindalco, Indian company, Rain Calcining Ltd., has acquired US based CII Carbon for US$ 595 million to become the world's largest producer of calcined coke. Calcined petroleum coke is a pure form of carbon that is used in steel and aluminium industries. Rain Calcining has been growing both organically and inorganically and is planning to double its existing capacity to nearly 1 million tons by 2009. This one again shows that the acquisitions are driven by opportunities that emerge from demand supply gap, economies of scale through synergies and to reduce the freight rate volatility as in the instant case the company exports a significant portion of its production while importing the entire raw material (green petroleum coke).

(iv) Mining*:(Vedanta Resources, UK):* Founded by a scrap metal merchant, Mr.Anil Agarwal, *Vedanta Resources* is a FTSE 100 metals and mining company, with ambitions to become one of the world leaders in the mining industry like Rio Tinto. It has operations spread over India, Zambia, Australia and Armenia and interests in Aluminium, Copper, Zinc, Lead and Gold. Agarwal, in 2002, won the

bid to acquire the loss-making Indian public sector company, Hindustan Zinc. Since the target company was loss making, Agarwal did not encounter any difficulty in acquiring it. He also proved his mettle in turning over the company soon, by cutting costs to half and increasing the capacity to five fold. Now, Hindustan Zinc is the most profitable company for Agarwal and is the lowest cost producer of Zinc in the world. Agarwal is also undaunted by the commodity cycles and lower commodity prices and says, “everyone’s going to die, but we must die last”[11]. The Group’s turnover (US$ 6.5 billion in 2007) has gone up nearly 7 folds in the last five years with EBIDTA around 42% (US$ 2.7 billion) of this turnover. It has recently acquired a controlling stake of 51% in Indian iron ore mining company Sesa Goa, from Japan’s Mitsui for nearly US$ 1 billion, beating rivals like Arcelor Mittal. Vedanta is an example for the Indian entrepreneurs’ managerial talent, vision, aggressiveness as also their focus on India despite their overseas ventures.

(b)Beverages:

(Cases discussed: Tata Tea in the soft drinks domain and UB Group in the alcoholic beverages segment)

(i) Tata Tea and Tata Coffee:Tata Tea has been in the process of transforming from a plantation company into a contemporary beverages company. While Tetley happened to be the first big venture for the Tata Tea (and also the first overseas LBO from India), the company since then has gradually made more than half-a-dozen notable overseas acquisitions which catapulted it to be a serious contender along with the likes of Coca Cola, in the global M&A space. The company’s overseas ventures date back to 1983, when it acquired 51 tea estates from the world’s leading tea plantation company, James Finlay.

With the acquisition of Tetley in 2000, in what was said to be the largest takeover of a foreign company by an Indian company till then, Tata Tea could spread its wings across the globe – as Tata Tea was a leader in Indian packaged-tea

[11] The Economist, July 26, 2007

industry while Tetley was the second largest tea company after the Brooke Bond-Lipton (of Unilever) and a market leader in UK and Canada. Tetley was also a popular brand in other leading markets such as the US, Australia and the Middle East. *But it is also a fact that the Tata Tea's expansion strategy was a carefully crafted one since 2000 as it was facing the danger of being overwhelmed by Unilever on the domestic front*.

Tata Tea seems to have done well through its acquisitions without losing the sagacity as is evident from acquiring 30% in Glaceau only to sell it later (for US$ 1.2 billion as against a purchase price of US$ 677 million, within less than a year) for a hefty profit to Coca Cola. The sale of Glaceau stake to Coke also made immense business sense as the company by then made a hefty profit as also the sale proceeds came handy to an already stretched leverage of the company. In a way, Tata Tea - Tetley and Tata Tea - Glaceau have provided two different kinds of strategic experiences to the Tata Tea management which the company may leverage further as it is readying itself for further acquisitions, more in the energy drinks segment

Drivers:
• **To ward off the danger of being marginalized in the domestic market** • **Seeking markets as also brands** • **Adding products to expanding domestic markets** • **Strategic investments**

Table 4: Tata Group's overseas acquisitions in the beverages segment

2000	**Tetley UK**	**£271 million**
2005	**Good Earth Corp., US**	**Undisclosed amount**
2006	**1.JEMCA, Czech Republic** **2.Eight O'Clock Coffee, US**	**Undisclosed amount** **$220 million**
2006	**1.Glaceau, US (partial)** **2.Joekels Tea, South Africa**	**$677 (sold to Coke for $1.2 bio in 2007)** **Undisclosed amount**
2007	**Vitax, Flosana brands, Poland**	**Undisclosed amount**

Tata Tea itself says that its goal is to *challenging for leadership in Tea around the world*. While the acquisition of Glaceau would have helped them expand their beverage business in North America and then into Europe along with using Glaceau's existing distribution network for its own ready-to-drink tea, now that it has been sold off, Tata Tea might be seeking other opportunities to fulfill these ambitions. Having said that much, Tata Tea is not only looking at the overseas markets for acquisitions given its recent acquisition of a stake in Indian mineral water company Mount Everest Mineral Water Company

(ii) UB Group – Whyte&Mackay:

Table 5:Major Acquisitions of UB group in the alcoholic beverages segment

2005	**Shaw Wallace &Co, India**	**Rs.15.45 billion**
2007	**Whyte& Mackay**	**£595 million**

The UB group has done its homework properly before venturing abroad; after consolidating its position in the domestic market, the group started looking at overseas acquisitions, at this juncture mainly for reaching out for a supply chain for its expanding domestic operations and prospective ventures into other emerging markets. Despite its being the world's third largest alcoholic drinks company (next only to Diageo and Pernod Ricard), United Spirits major shortcoming had been the absence of *scotch whisky* in its portfolio, especially when India itself is a potential market. According to Vijay Mallya, Chairman of United Spirits, the Whyte & Mackay (W&M)'s spread of brands across the spectrum from "value" to "super premium" made it the ideal vehicle with which to penetrate the well segmented Indian market. Prior to the acquisition of W&M, United Spirits used to import scotch form Diageo and W&M for blending the same with the locally manufactured whisky, which was popularly known as IMFL (Indian made foreign liquor). Thanks to the high import duties on spirits, Indian whisky consumption has been dominated by native molasses distilled varieties

(original scotch whisky consumption is said to be around 1% of the total whisky consumption) and the limited imports are used for blending them with local varieties to position them as a premium category in the Indian markets. The Scotch Whisky Association also enjoined the Indian whisky manufacturers from calling the native whisky “scotch”. While Scotch whisky consumption is said to have grown by 10% globally in 2006-07, the growth in emerging markets like China, India and Russia is over 20%. While enhancing the product range and catering to the growing needs of India and China, which are the focus markets for United Spirits, are the prime motives, another important motive behind Mallya’s bid for W&M was the erstwhile import tariff structure in India– a duty of 550% on imported bottled spirits and a 200% duty on import of bulk spirits. Hence, having a bulk scotch production facility abroad could strengthen United Spirits against domestic competitors, - as the W&M acquisition brought along with the world’s largest grain distillery, a bottling unit and bulk scotch inventory of 115 million litres – but these tariff induced cost advantage are not to accrue to the company as envisaged since the government of India later this year agreed to realign the tariffs, subsequent to a complaint from the US and European Union through the WTO. But despite this the emerging potential in terms of domestic demand and market extension makes it a strategic acquisition for United Spirits.

Drivers:
• **Need to enter the scotch whiskey market** • **Procure supply chain for catering to the domestic market** • **Aiming to benefit from import tariff anomalies**

Incidentally, Mallya’s other ventures, whether it is buying Spyker Formula-1 Team (for US$ 109 million) or his ventures into the aviation sector including a planned bid to buy a controlling stake in Epic (for US$ 200 million), the US based private aircraft manufacturer (though these acquisitions are proposed to be made in his personal capacity) are seen as making use of these as promotional tools for his liquor business as there exists lot of restrictions in India for promoting and advertising liquor.

(c) IT related industries

Indian IT and IT related companies along with the country's pharmaceutical companies have been spearheading the OFDI for a long time though given the low average size of investments in these sectors, such overseas ventures haven't been eye-catching. Of course, Indian IT space is known for its special position in the global outsourcing industry. Having established its own brand in terms of quality services and timely delivery, the Indian IT space is also losing some of the wage cost advantages to other emerging players. This industry has also been facing immigration related problems from the established client-locations. Hence the immediate solution to address these problems found their way in shifting the industry focus from *offshoring* to *near-shoring* to *localization* of operations. Size of the firm and spread of its operations also matter in an industry where the vendors' geographical presence and size (which decides the capability of a company) wins them global business. Inorganic growth comes in handy, to gain a timely global foothold – since such global acquisitions not only fetch the acquirer the requisite domain knowledge along with experienced employees but also a *ready to market* client base. Companies are also looking at moving up the value chain as the wage pressures and declining margins make their traditional low-end services unsustainable. The geographical location and spread also matter in this industry as the menace of global terrorism requires them to set up parallel sites across geographical locations, while the nature of business requires them to spread across time zones. All this is being termed as the "global delivery model" by the Indian IT industry as against the traditional "India centric models". Indian companies are also trying to "offshore" work to time zones making offshoring itself non-India centric. For instance, Mexico that falls in the similar time zone and

Drivers:
• **Seeking size** • **Global presence to derive logistics and cost optimisation** • **Geographical spread for risk reduction** • **Near-shoring and localization (to get over immigration and integration related issues by being geographically and culturally close to clients)**

is within a quick flying distance from anyplace in the US and linguistic and cultural proximity to Latin America (which is a potential market) and Malaysia with a cost competitive advantage serve as some good alternative locations to India. Then the appreciating trend of the Indian currency against the US$ also prompted the industry to fine-tune their strategies since their India-centric operations could become unviable as the wages are in Indian rupees while the revenues are in depreciating dollars. Indian companies are also looking to provide end-to-end solutions where they are losing to foreign players in IT related services and they are trying to fill such gaps – for instance the recent acquisition of Infocrossing, a US company by Wipro (for US$ 600 million, the largest overseas acquisition by an Indian IT company) as the former has an expertise in remote infrastructure management, which Wipro lacks.

Unlike firms in other industries, the Indian IT companies normally are wary of large overseas acquisitions for their impact on their margins. Despite higher wages the higher productivity in the manufacturing sector could place the foreign firms in advantageous position vis-à-vis their Indian counterparts; but the same cannot be said about the Indian IT industry vis-à-vis the other emerging IT markets for outsourcing. Besides Mexico and Malaysia, China, Vietnam, Kenya, Philippines, Thailand, Poland and Mauritius are emerging as potential rivals for the Indian outsourcing industry. Some of them have the low wage cost advantage which, however, is not matched with English speaking abilities to cater to western markets, and these are becoming the prime destinations for non-voice based back office services (such as insurance claims processing, accounting and medical and legal transcription). An increasing possibility of losing the cost advantage (on account of wage pressures and rising realty prices – some surveys showed that the salaries in the software industry rose by nearly 20% in 2007) coupled with the recent shocks from a rupee appreciation (wages are in rupees and earnings are in foreign currencies, mostly in US$ - Rupee appreciated by around 10% against the US$ in 2007) compels the industry to look for overseas locations for hedging both currency and wage related risks.

Infosys' acquisition of Royal Philips Electronics' back office facilities located in Thailand, Poland along with those in India is a typical example of this growing trend in the IT-related industry.

(d) Pharmaceutical Industry

Drivers:
• **Seeking markets aggressively for generic drugs** • **Seeking established R&D facilities after the change in patent laws** • **Production facilities near markets**

Opinions about Indian generics pharmaceutical industry have been ambivalent, thanks to the country's erstwhile patent laws that recognized *process patenting* and not *product patenting*. While the multinational pharma industry is sour with this, many in the developing and underdeveloped countries would gratefully acknowledge the contribution of the Indian pharma industry for making several life saving drugs accessible to the poor. Now that the erstwhile patent regime has undergone a change (India now follows product patenting), the industry needed a reorientation in its strategies. It becomes imperative for the Indian companies to acquire R&D facilities – given the importance of market timing, it also makes immense sense to grow inorganically through M&A route rather than establishing greenfield ventures, which also brings in the advantage of proven and ready to use R&D facilities, availability of domain knowledge expertise and access to new markets. Another attraction for the domestic pharma companies has been that the prescription drugs market, especially in Europe, which are often restricted to firms belonging to that particular country are the trading bloc, such as the European Union. The industry also is one of those that are fast consolidating, as the companies vie for size. The industry also has a great potential in countries like Japan where the scope for generics markets is immense given the fiscal impact of health insurance related services (where there is a huge scope for reducing the cost of medicines once these markets allow the use of generics on a wider scale). Indian pharma companies hence want to have an enhanced

global visibility in the generics markets, besides trying to make their presence felt in product innovation.

Table 6: Some of the major overeas acquisitions by Indian Pharma Companeis

Acquirer	Target	Deal value	Remarks
Dr.Reddy's Laboratories Ltd	**Betapharm Germany**	**US$ 570 million**	**1.R&D facilities of Beta Institute for Sociomedical Research 2.Access to world's second largest generics market, i.e., Germany**
Sun Pharma	**Taro Pharma Israel**	**US$ 545 million**	**1.Access to a huge portfolio of FDA approved generic drugs 2.World class manufacturing facilities in Canada and Israel**
Ranbaxy Labs	**Terapia Romania**	**US$ 324 million**	**1.Access to growing Romanian generics market which can be expanded to pother potential generics markets such as Russia, Poland, Ukraine etc., 2.R&D and manufacturing facilities.**

While some of the acquisitions (for instance, the acquisition of Betapharm by Dr.Reddy's Labs) were said to be quite expensive, Indian companies were not reckless as could be seen by the withdrawal of several Indian pharma companies from the race to acquire Merck's generics arm. Even Ranbaxy left the fray to acquire Betapharm quoting high valuations. In fact, critics say that the acquisition of Betapharm by Dr.Reddy's might not be as beneficial to the latter as it had been thought, since some time after the acquisition of Betapharm, the Economic Optimisation of Pharmaceutical Care Act (AVWG) took effect in Germany. While the legislation's intentions were to increase the scope for usage of generic drugs, it also brought in price-caps for the drugs that could affect the margins of Betapharm. Many analysts believe that this is one of the reasons why Dr.Reddy's labs slowed down later in its overseas ventures for acquisitions.

(e)Energy related industries

(*Here again the focus of this paper is on the private initiatives rather than on the state sponsored strategic initiatives for acquisition of global energy assets through state owned companies, which have been in vogue, of late*).

(i) Suzlon : Wind Turbine maker Suzlon makes a good case study in several aspects – whether it is about the Indian entrepreneurial abilities, their quest for building a value chain, their ambitions to become one amongst the world leaders and finally about their strategies to cope up with competition from other emerging low cost manufacturers. Suzlon, established just over a decade ago (in 1995) has now become the world's fourth largest wind turbine manufacturer – it was not even amongst the world's top ten as recently as in 2002. The company has turned out to be a true visionary to foresee the explosive growth in the demand for renewable energy resources. According to Mr.Tanti, the head of Suzlon, wind energy generation remains competitive as long as crude oil price is above US$ 40 per barrel. Over the years the company has built a strong international presence – given its preeminent position in the wind turbine know-how Denmark as the headquarters for its global expansion; R&D and design base in Germany; Netherlands for designing and developing rotor blades, given its leadership in aerodynamics; and manufacturing facilities in Belgium, North America, China besides India.

Drivers:
• **Emerging opportunities for clean energy** • **Opportunity to provide end to end solutions, which the competitors are not providing** • **Opportunity to build a product range that competitors do not have**

Table 7:Major Acquisitions by Suzlon

2006	**Hansen Transmission, Belgium**	**€ 465 million**
2007	**REPower, Germany**	**€ 1.35 billion**

Last year (2006) it acquired Belgium's Hansen Transmissions International NV for an enterprise value of €465 million. Hansen is one of the largest wind energy and industrial gearbox manufacturers in the world. It is said that the other leading wind turbine manufacturers (in other words, Suzlon's main competitors) viz., Vestas of Denmark and Gamesa of Spain, are heavily dependant on Hansen's gear box supplies and given the demand supply gap in gear boxes, the acquisition of Hansen was quite strategic for Suzlon making it a strong player in its business. Suzlon also secured a supply chain, as it was dependent on another competitor, Siemens' Winergy for gearbox supplies. Suzlon's acquisition of REPower of Germany this year for an enterprise value of €1.34 billion made it possible for an accelerated expansion into Europe, which constitutes half of world's wind energy market. REPower also is a leader in manufacturing high capacity (5MW) turbines. While some analysts felt that the REPower deal[12] would be a drain on Suzlon's margins and cash flows (there are already indications to that extent), Suzlon is banking on rising volumes from REPower's portfolio that would generate positive marginal returns (since the fixed costs would be taken care of after crossing a critical mass) and the product portfolio of REPower (which is different from that of Suzlon's). In addition the deferred acquisition arrangement from the other leading shareholders viz., Areva (around 30 per cent which it can sell to Suzlon after one year) and Martifer (around 23% which it can sell after 2 years) could make the deal comfortable for Suzlon. Suzlon also talked about the synergies that could bring down the costs through these acquisitions apart from the benefits of wider market reach and production facilities near markets (lower logistics costs, dedicated delivery capability and a flexible response to local markets, the company says, are its advantages).

What is the future strategy for this company? According to Mr.Tanti[13], Suzlon is *unlikely* to make further acquisitions after REPower, given the fact that the

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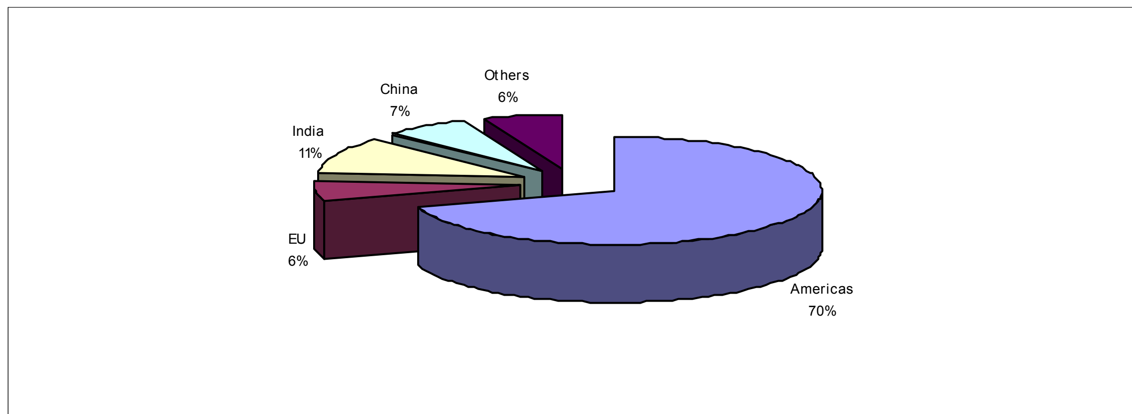
[12] Interestingly, two years ago, when one of the then largest shareholders of REPower, was offering 25% stake for €20 per share Suzlon failed to grab that opportunity and later this year it paid €150 per share. That shows the price paid by Suzlon for REPower, but Mr. Tanti was confident that he could create three times the value in three years.

[13] Reuters news, Singapore 12th September, 2007

company now has the full value chain and the focus henceforth will be on consolidating the business and grow organically. The company is planning to increase the wind turbine production capacity from the current level of 2,700 MW to 5,700 MW by March 2009 – in other words the company is looking at a growth that will be double that of the industry growth of 20-30%, in the next few years.

Figure 3:

Order book spread of Suzlon (excluding REPower and Hansen, July,2007)



Source: Suzlon

(ii) Aban Offshore: Aban Offshore, the largest Indian offshore drilling company in the private sector, over the years, seemed to have emerged as another visionary. The company, set up two decades ago, assumed significant risk and started investing in *offshore drilling* in the nineties when the industry was regulated and the energy prices were at their lows. Its recent acquisition of Sinvest a Norwegian drilling company for an enterprise value of US$ 1.35 billion made it to the headlines. The acquisition also made it to the top ten in the global offshore drilling industry. The acquisition, made with a debt equity ratio of 4.4:1 bloated the company's debt to over US$ 2.5 billion. While the huge debt on account of LBOs was a concern, though for the analysts, given the rig shortage and the high lease rentals (which were said to be around US$ 150,000 a day in 2004 for deepwater rig have apparently gone up beyond US$ 500,000) the pay back period is also reduced. In the meanwhile, Aban is also planning to offload a part of its equity (now a higher enterprise value) to reduce its debt, as the

financial leverage remains a high risk. With 16 operational rigs the company is said to be generating US$ 400 million in cash flows from operations annually. The company whose stock (Rs.10 face value) was quoting around Rs.30 towards the beginning of 2001 is now around Rs.3,200[14] (Rs. 2 face value).

Broad based trend

It is not that only the top-notch Indian companies are venturing overseas for a footprint nor is it a recent phenomenon. Nor is the phenomenon confined to a few industry sectors. *Essel Propack* is the world's largest manufacturer of laminated tubes. One third of global supply of such tubes used widely in packaging industry comes from 20 of its factories spread over 13 countries. (Recently there were reports that it was planning a buy out of Alcan's packaging unit). *Asian Paints* is the third largest paint manufacturers in Asia and operates in 21 countries and 29 paint manufacturing facilities across the world. Recently, *Karuturi Networks*, that runs a floriculture business, has acquired the Dutch floriculture major company Sher Agencies for Euro 50 million to become the world's biggest rose producer. *Praj Industries*, the bio-processing engineering company, made its presence felt across 40 countries. Process of 'thinking global' started long ago for *Bharat Forge*, the leading auto components manufacturer that has built a presence across Europe, in the US and in China through a series of acquisitions – it has a clear strategy: to use the front end technology of North American and European facilities to dovetail the low manufacturing cost advantage of China and India. In fact the auto component manufacturing companies are also leading the pack of overseas acquisitions and investments, but again these acquisitions are small sized. In fact, it is said that the auto component industry ranks only next to IT and pharma in terms of number of overseas acquisitions (please see Table 9). According to Dun & Bradstreet India, the industry, which was worth US$10 billion in 2005-06 was growing at 20% annually and the exports which were around 20% of the revenues were growing at 24% annually. The industry, which was solely dependent on the domestic automobile industry till the 1990s, has

[14] end of September, 2007

undergone a rapid transformation as an emerging global outsourcing hub. As India is also emerging as one of the global hubs for automobile manufacturers, the local auto component manufacturers also need to match global quality standards. Both these compulsions within and form overseas markets forced these companies to go for inorganic growth to survive in an industry that is becoming extremely competitive.

Table 8: Some of Indian ventures abroad by Indian auto component manufacturing companies.

Tata Mootrs	Daewoo Commercial, Korea
Mahindra & Mahindra	Jaingling Motor Co., China
Bharat Forge	Carl Dan Peddinghaus and CDP Aluminiumtechnik, Germany Federal Forge, USA Imatra Kilsta AB, Sweden Scotish Stampings Ltd., Scotland China FAW Group
Motherson Sumi	WOCO Group, Germany G&S Kunststofftechnik
Amtek auto	GWK, UK New Smith Jones Inc, USA Zelter, Germany French Witham, UK
UCAL Fuel Systems	AMTEC Precision Products Inc, USA
Sundaram Fasteners	Bleisthal Produktions Gmbh Precision Forging unit of Dana Spicer UK Cramlington Forge, UK Greenfiled plant in Zhejiang, china CDP GMBH

Source: Automotive Components Manufacturing Association of India (ACMA) and other news reports

On the other hand, it is also true that Indian manufacturing is gearing to meet the global competition (this is more evident in the auto components industry) as they have been striving to match global quality standards with the benefit of low wage advantage. Evidence for this could be seen from the number of Deming quality awards won by Indian companies, as against ever quality conscious Japanese companies, in recent years.

Table 9:Indian companies among Deming award winners since 2001

Year	India	Thailand	Japan	Total
2001	1	2	1	4
2002	1	1		2
2003	4	2	1	7
2004	3	3		6
2005	3		1	4
2006			1	3
Total	12	8	4	26

Source: JUSE

V. Conclusion

At the outset, but for a few mega deals, Indian ventures are still miniscule compared to the global M&A scenario. But the average deal size is growing and the trend is visible across industries and irrespective of the firm size. The good thing is that all this is happening with the initiative of the private enterprise, rather than that of the State. While it is not to undermine the importance of State intervention, efficiency of public sector is often questionable. Evidence for this could be gathered from the failure of domestic state run companies and the latter successes achieved by the private sector companies in the area of *oil and natural gas exploration.* Industry representative bodies such as the Confederation of Indian Industries (CII)[15] have stepped in to provide all possible support to Indian companies that seek global presence. The state can certainly be catalytic at this juncture. As Thomas Friedman said it aptly, “In the increasingly flat world, imagination would be the driver of future progress and governments need to empower imagination”.

Coming to the task of judging the sagacity of the Indian enterprises in their overseas ventures, while the companies give evidence supporting their wisdom, some smell an air of arrogance in the atmosphere. In fact, many of these

[15] *Going Global* Initiative of CII

companies are preparing themselves for the emerging Indian market, though the overall motives, for the time being, are achieving synergies, need to create global presence, brand image and size, procuring established R&D facilities, moving up the value chain along with forward and backward integration, reducing their own vulnerability to a take over, making use of obsolete technology in nascent markets, brand building and last but not the least, a bit of adventurism to fulfill their ambitions. At the same time, the trade off is between the high cost of acquisition and an opportunity cost. Are they really reckless in paying any amount for their acquisitions? One cannot be sure of this since such a feeling is neither pervasive nor absent. 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. Speaking on behalf of the buyers the study says that the buyer landscape has been changing fast with the increase in liquidity and the rising influence of PE firms. Valuations[16] seem to be outrageous sometimes, but then the value lies in the eyes of the acquirer. On the other hand, from some of the case studies discussed earlier, it is also clear that the Indian firms have not paid *less* for their acquisitions. The issue, however, is about the minority stakeholders’ protection, when the acquirer happens to be a public limited company where the minority shareholders or the common investors do not have voice or opt to remain as passive investors (this happens in the Indian context).

It is rightly said that not only foreign investors even domestic investors are frustrated by the several of those *often talked about* shortcomings in India. Domestic companies do not want to miss opportunities awaiting the reforms to take a final shape, given their abilities and the availability of finance along with

[16] For instance, Tata Steel shares, which were hammered down by nearly 12% after the announcement of winning the Corus deal to around Rs.450 levels were quoting as high as around Rs.840 in the first week of October 2007. In the meanwhile, Tata Steel also declared its first consolidated accounts, bringing together the operations of both Tata Steel and Corus

their strong balance sheets. Hence many firms are doing a balancing act between their domestic and foreign initiatives. New generation of entrepreneurs with an ability to look for opportunities and a greater risk appetite are taking chances. Meanwhile, business models have changed and there has been an urgent need to grow businesses inorganically for seeking size, technology and the benefits of logistics. Several companies do not want themselves to be seen as mere *off shore or marginal players*. While business compulsions could be understood, time only can prove whether all these ventures are successful in the long run, as the integration problems continue to bog them for a few more years – especially if the ventures are said to be strategic rather than merely synergetic. Many of these recent overseas acquisitions, are yet to satisfactorily demonstrate that they had overcome the integration issues, which proved the Achilles heel, for instance, for many Japanese overseas acquisitions in the past.

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