Indian Enterprises Investing Abroad - Irritants, incentives and issues

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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)

<table>
<thead>
<tr>
<th>Year</th>
<th>Global</th>
<th>Indian</th>
<th>Indian outbound</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>716.4</td>
<td>9.5</td>
<td>4.3</td>
</tr>
<tr>
<td>2006</td>
<td>880.2</td>
<td>15.3</td>
<td>9.9</td>
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### Average deal size (US$ million)

<table>
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<tr>
<th>Year</th>
<th>Average deal size</th>
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<tbody>
<tr>
<td>2006</td>
<td>12500</td>
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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 effective 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

![Graph showing Nifty and Tata Steel stock prices from November 29, 2006, to November 14, 2007. The graph displays the stock price movements with markers indicating significant points.]
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

- Share capital: 5.5%
- Reserves and Surplus: 40.2%
- Borrowings: 29.0%
- Trade dues and other current liabilities: 18.6%
- Provisions: 6.7%

Source: RBI
Select financial ratios of some large public limited companies

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