CHAPTER : X

ROLE OF FINANCIAL CONSULTANTS AND FINANCIAL INSTITUTIONS
Till recently Merchant Banking has been almost synonymous with the management of new capital issues. Now merger and acquisition is viewed as the big growth area, especially by aggressive foreign banks like Citibank, Hongkong Bank and Standard Chartered. "Merger and Acquisition is bound to become a big business in about five years time" feels Jayanand Govindraj of Citybank. Even smaller merchant banking outfits like Boses credit capital and Champaklal Investment & Financial consultancy are Limbering up for action.

But one thing is certain, a precedent has been set. In a majority of these deals in the past, the involvement of merchant bankers has been marginal. The buyer and the seller talked without intermediaries and clinched the deal, while the merchant bankers only processed the papers. But now, in an increasing number of cases, merchant bankers or merger and acquisitions advisors have been identifying take-over or acquisition targets and negotiating prices on behalf their clients. The Industrial Credit and INvestment Corporation of India pioneered the Merger and Acquisition business in India. The merger of ICI group of companies in the early eighties was handled by the Industrial Credit and Investment Corporation of India.

The proposal to merge Krishna Ceramics Limited with Hindustan Sanitaryware and Industries Limited has been approved by ICICI, IFCI, IDBI and Andhra Pradesh Industrial Development Corporation. Mr H L Somany and his associates have purchased
the entire holding of the promoters, Financial Institutions and Bank. The financial institutions decided to sell their stakes because of the financial crisis in Krishna Ceramics.

Mergers on the advice of Financial institutions are also becoming popular. When two corporate companies are under the same management, if one of the company becomes sick, the financial institutions who lent money to these companies persuade them to get merged. The motive behind this type of merger is to recover the amount lent by them to these companies. The merger between Deccan Wires Limited with Panyam Cements & Minerals Limited and the merger between J&K. Steel Industries Limited with JK Synthetics have taken place on the advice of the financial institutions.

After setting up of the Board for Industrial and Financial Reconstruction, the process of takeover of sick companies is speeded up. Once the Board for Industrial and Financial Reconstruction passes judgement, all other clearances from other government agencies come automatically.

In a business feature on "The M&A opportunity" (Business World Dec. 7-20, 1988) gives the following views of the executives of the Financial Institutions.

Nobody's sure what is in store. But almost everybody has agreed that the preparations must begin now if they are not to be left behind when the real action begins on mergers and acquisitions.
"We are gearing up on mergers and acquisitions" admits Ashok Tankha, Manager (India) of Hongkong Bank's merchant banking division. "We are in the process of putting together a team to concentrate on Indian Deals".

City Bank already has a Delhi based Vice President as product head for M & A. "M&A is in its infancy but it will grow" says Jayanand Govindraj, Banking head for Western India. "We cannot compete with Indian banks in functioning, so we have to go into such activities to increase business", he adds explaining why M&A is important to his bank.

Other aggressive foreign banks are also entering the fray, standard chartered has a cell handling M & A as part of its corporate finance division while Grindlays is building a database on companies, products and markets to be ready for the M&A boom when it arrives., "We are trying to make ourselves more knowledgeable on the M&A process" says a top Grindlays Executive.

In contrast, Indian merchant banks like SBI capital markets and Canbank Financial Services still see M&A as being peripheral to their sphere of activity. For them, new issues management continues to be the mainstay of merchant banking.

However, private sector merchant banking outfits like credit capital and CIFCO are not missing any bets. Bhupen Dalal, Vice Chairman and Managing Director of CIFCO "We have a separate enterprise transfer group which handles M&A
activity. Apart from quoted companies, we have also been playing a role in the buying and selling of corporate assets. CIFCO was one of the advisors involved in the transfer of the Sarabhai soaps and detergents unit to a group of entrepreneurs in Bombay. The unit functions under the name and style of Swastik Surfacants.

Udayna Bose’s Credit capital, which is in the process of putting through three or four buyout deals, is setting up a full-fledged M&A cell.

Is there scope for so many players in what is at best a nascent market? Mahendra Kampani of JM Financial Consultants apparently does not think so. "We had an M&A wing but we are now deploying the people there elsewhere", says Kampani. He feels that Indian laws pose great hurdles for takeovers.

"Kampani's doubts are shared by all merchant bankers, but to a far lesser degree" says Govindaraj of Citibank. "When we talk of takeovers, we are talking of friendly ones". Citibank was a key player in the recent friendly deal in which Spartek took over Neyveli Ceramics. Tankha of Hongkong Bank is more bullish. "M&A has arrived in India. Even Japan, which was once against the idea, is going in for it. The Middle East and India are next in line for this phenomenon". "Hongkong Bank has a mandate to make a couple of acquisitions on behalf of clients, but not through hostile acquisition. His problem there are more buyers than sellers". "We have to locate willing settlers" he says. Although there are quite a number
of young entrepreneurs who wish to take a short cut to growth by acquiring existing companies or divisions rather than building them, "there are very few sellers", according to Mr M V Shah, General Manager, Merchant Banking, ICICI. And even when parties are willing to strike a deal, the absence of takeover finance poses a major problem.

In the west, the leverage buyout route has been successfully exploited by Corporate predators. Funds are borrowed against the assets of the company to finance the purchase. Over the years specialised leverage buyout companies have been involved in this profitable activity. In India, while the government encourages new projects through financial institutions, funds are not forthcoming for buying existing ones.

The changing economic environment is also responsible for the increasing number of acquisitions. According to Naina Lal, Manager, Merchant Banking Division, Grindlays Bank, Bombay, "Earlier, industrialists diversified into unrelated business merely because they had the licence". Now with liberation and licences to be had for the asking almost every industry has become highly competitive with a large number of players. In this scenario, Industrialists are finding it extremely difficult to manage diverse activities and are instead willing to rationalise their business by selling off certain interests and focusing more attention on the remaining.
M&A business is built on the strong bonds of confidence and rapport. The subsidiaries of nationalised banks have not been able to make much headway in this business. As a foreign banker points out, "With everything having to be ratified by the board in nationalised banks, it is impossible to keep secrets."

A senior official of a nationalised bank points out that more than reasons of secrecy, it is the nature of the deal struck in India which makes clients give a wide berth to nationalised banks or financial institutions. For it is true what large blocks of shares change hands, a not insignificant portion of the "true" purchase consideration is paid from unaccounted funds. The official price is lower to that extent.

The Shareholdings of Financial Institutions in many companies has a historical background. All the financial Institutions active in the capital market the Unit Trust of India, the General Insurance Corporation, the Life Insurance Corporation, the Industrial Credit and Investment Corporation, the Industrial Development Bank came into the capital market for different reasons. The Unit Trust of India came in to place the bulk of the unit holders funds in marketable securities. The Life Insurance Corporation and the General Insurance Corporation to invest surplus funds from insurance policies, while the ICICI, the FCI and the IDBI entered to disinvest shares allotted against
the initial financing of projects. Thus the ICICI, the FCI and the IDBI initially entered the capital market as sellers, the LIC and the GIC as marginal investors and the UTI as an active player.

The financial Institutions came to acquire large chunks of shares in many companies through the conversion of a part of their loans granted earlier into equity as also underwriting obligations in some cases. The power of part conversion of outstanding loans into shares can not be abused to interfere in the internal working and management of Industrial concerns or to take sides in corporate wars. Left to themselves, the financial institutions would not resort to such gross abuse of power but the dictates of the Government can not be resisted, particularly by the officials whose continuance in the institutions depends upon the "sweet will" of the Government.

Most alarming howe is the attitude and conduct of the institutions where they refuse to accept full prepayment of loans by industrial concerns so that they can retain their strange hold on the companies in the form of the right to convert loans into equity.

It will be interesting to note that three leading Financial Institutions i.e. the Unit Trust of India, the Life Insurance Corporation and the General Insurance Corporation have reportedly made a neat profit of Rs.15 crores in the "sale purchase" of 39 lakhs shares of a Blue chip company.
Some time in July 1989, the three financial Institutions had sold a bulk holding of 39 lakhs shares of L & T to Bob Fiscal Services, a division of Bank of Barods. As part of their "normal market operations, the three Financial Institutions sold 39 lakhs shares at Rs.110 per scrip for a unit value of Rs.42.90 crores.

The shares in turn were sold to an investment company of Reliance Industries Ltd. The company also reportedly made some purchases in the open market to increase its share holdings in Larson & Toubro. However because of some peculiar problems the shares were reportedly sold back. Unit Trust of India, Life Insurance Corporation of India and General Insurance Corporation paid a price of Rs.70 a share. The repurchase value of the share aggregated Rs.27.30 crores for 39 lakhs shares.

Thus in a less than six months, that is between July and December 1989, the three Financial Institutions made a neat profit of over 15 crores. It appeared non market forces helped the institutions in their normal market operations to make unintended profits.

In the case of purchase of the shares of Spencers Co.Ltd. by the companies under the R.P.Goenka Group, Citibank NA, Investment Banking Bombay advertised in the news papers that those who were interested in selling their shares could contact them. It may be noted from the above that the Financial Institutions are taking active interest in take over of corporate companies.
Of the numerous Banks which have announced the setting up of merger and acquisition cells, only a few have been successful even in getting their clients to lend them an ear. The very nature of this business restricts the players. In an interview to Business India (May-15-28, 1989) Sudeep Anand, Vice President Citibank observes that besides the two or three people working on a lead, nobody in the bank knows what is going on. "There are hardly any notings, it is all in our heads" explains his colleague, Jayanand Guvindraj, Vice President merchant banking operations.

When Dalal helped Sanjay Dalmia buy golden tobacco he recalls that the company secretary was not aware of takeover even the previous day. Dalal says Cifco obtained all financial details from Golden Tobacco Company on the pretext that the company was going in for a loan. This cautious attitude got Cifco a large number of clients later.

The rapport that a merchant banker shares with top industrialists and managements of Blue-chip companies is another critical factor in getting a good merger and acquisition mandate. The senior executives of Bank of America who are seriously involved in this business call on select industries almost weekly.

Dalal has the advantage of being on first name terms with most of his clients. When he gets information of units coming up for sale, his knowledge of clients comes in useful. "You do not have to hawk a unit to 15 suitors", says Dalal. "The
trick is to short list a few who are likely to be interested and sort them out". In India, community and region also play an important role in wrapping up business deals. Thus a Gujarati is probably unwilling to deal with a Marwadi, or a conservative South Indian is unlikely to see eye-to-eye with a flamboyant north Indian.

Not that balance sheet analysis and number crunching are unimportant, as Citibank realised when it advised Spartek Ceramics by sheer number crunching we were able to show the Spartek Management that a foreign exchange loan it had raised could have actually come cheaper", says P.S.Reddy, a merchant banking head, Western India, Citibank. This established Citibanks credibility with the client. Spartek's dealers wanted the company to go into the supplementary business of sanitaryware and the company and its options open. When Citibank suggested Neycer, the Spartek Management agreed. The acquisition of a 40 per cent stake in Neyveli Ceramics by Spartek was a direct outcome of this new confidence in Citibank.

The reason why banker's interest in merger and acquisition is still limited is that clients in India are not willing to pay the kind of fees merger and acquisition advisors demand worldwide. In the U.S, the commission for a deal works roughly on the well known shears on Lehman formula of 5:3 i.e 5 per cent on the first 5 Million, 3 per cent on the next 3 million and 1 per cent thereafter. "However in India for Rs. One Crore deal you are unlikely to get more than Rs.10 lakhs, i.e.no
more than 2 per cent" says an executive in Bank of America.

Even though the nature of business is small and fees low, merchant banks are gearing up for the future when they expect merger and acquisition to become big business will business houses get over their reluctance to sell and more important, will the government make transfer of companies easier? In the current mood of deregulation this is more likely than ever before.