

Managing Risks in India

Common Mistakes made by US Companies



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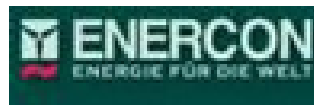
We are one of the leading strategy and transaction advisory firms focused on US-India sector

- IMaCS Virtus Global Partners (“IVG Partners”) is a New York based advisory firm that offers services to North American companies seeking India related growth and investment opportunities. Our mission is to enable our clients to transform their business by adding India as a key part of their global footprint.
- We are headquartered in New York with eight offices in India.
- The firm is part of ICRA Management Consulting Services Limited, which is a fully-owned subsidiary of ICRA Limited, one of India's leading credit rating agencies.
- Our clients benefit from our local presence, strong relationships, knowledge of local business practice, experience, and financial expertise.

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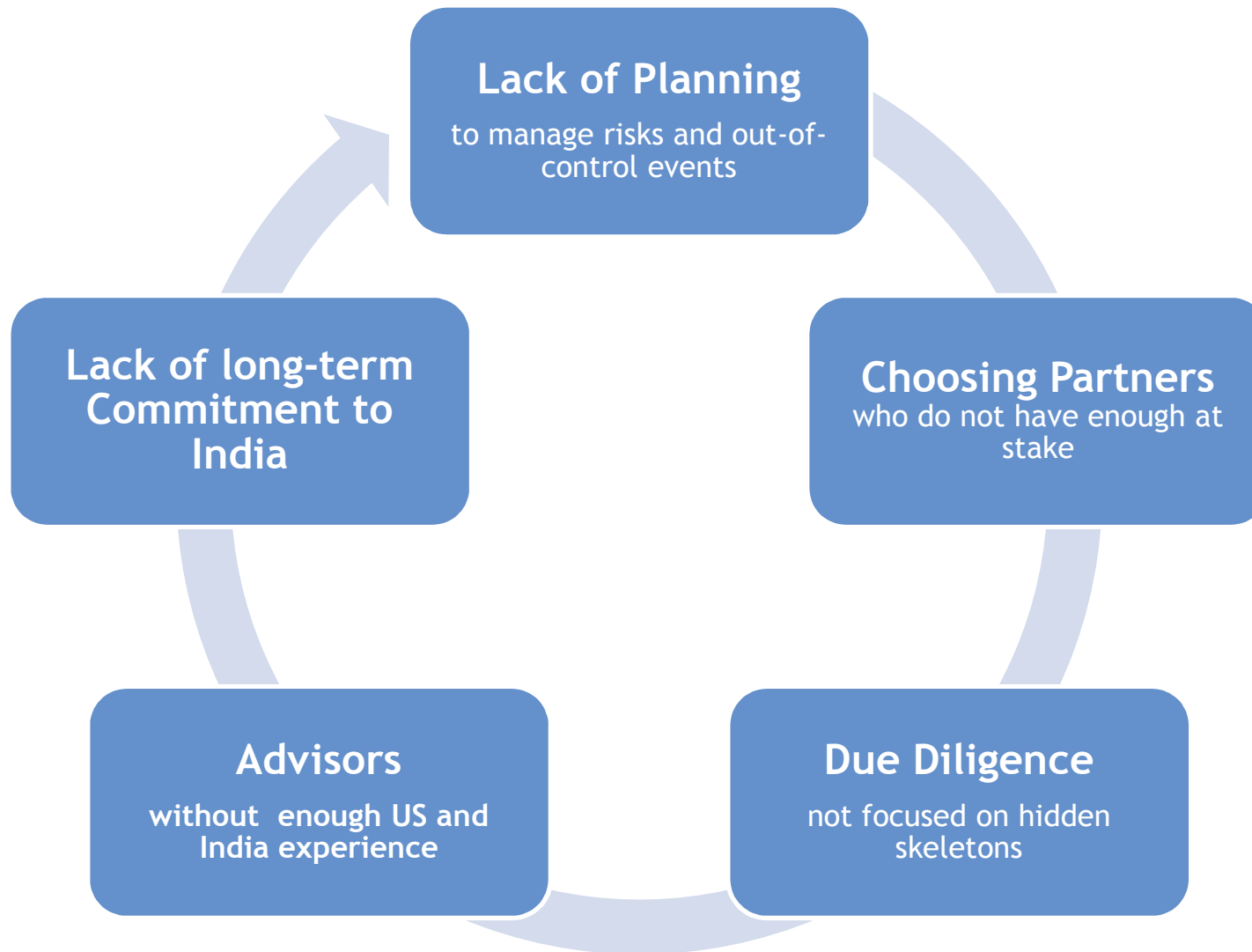
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Top Five Mistakes Made by US Companies in India



1. Lack of Planning to manage risks and out-of-control events - Market Size, Trends and Competition



Estimating Market Size

- What is the addressable market size for the product or service being sold - **not the market size of industry?**
- Which external factors can create or diminish the market potential?
- How does the typically long replenishment cycle impact profitability?

Analyzing Industry Trends

- Based upon historical analysis, what are the likely trends for customer spending on this product or service over the next five to ten years?
- What upcoming regulatory (such as FDI) policy changes can alter the market structure and profitability?
- Are there other western companies operating profitably in this segment?

Assessing Competitive Landscape

- What is the degree of maturity, performance and profitability of local firms?
- What are the local barriers to entry?
- What will be the competitive response to a US company's product launch?

1. Lack of Planning to manage risks and out-of-control events - Structure, Location, Feasibility



Structuring Investments

- What is the least risky approach to staging investments?
- What is the most efficient use of early stage capital infusion?
- What is the worst case scenario for capital expenditure?

Short listing Locations

- What is the availability of human capital and resource pool in this region?
- What challenges could the current state of infrastructure, logistics impose?
- Have there been instances of project delays and issues due to government and environmental regulations?

Feasibility Analysis

- What is the worst case financial projection?
- What is the breakeven point, cost curves (fixed vs. variable) and expected margins?
- What are the execution risks? What risks have other western companies faced in this industry?

2. Choosing Partners who do not have enough at stake



Commitment

- What factors could impact the priority and commitment of local partners?
 - Are there monetary incentives based on future value creation?
 - Are critical milestones mutually agreed upon?
-

Mindset

- What has been the track record of local partners with respect to past initiatives and past collaborations?
 - What will be local partners' openness to new ideas?
 - How important is management control to local partners?
-

Governance

- Will other family owned companies of local partners be involved?
- What will be the level of accounting, audit controls and board oversight?

3. Due Diligence not focused on hidden skeletons and related party transactions



1. Finding Hidden Skeletons:

Inadequate disclosures impede the ability to access critical information that might alter the investor's perception with regard to the value of the company, environment issues and aggressive tax positions among others.

2. Checking Related Party Transactions:

Indian businesses are generally structured as conglomerates or group businesses which create extensive related party transactions.

3. Due Diligence not focused on hidden skeletons - comprehensive diligence and past history



3. Request information even if it is not readily available

Comprehensive information required for the due diligence process is not readily available with the Indian companies due to lack of detailed management information system. The forecasting tend to be aggressive and methodologies might not be robust, often leading to simplistic projections. This results in the need to explore more risk areas and takes more time for the due diligence.

4. Research Management/ Promoter's past history

It is often observed that founding members will refuse to give up control and might not be open to new ideas. This characteristic might not be apparent during negotiations but often shows up at a later stage of business building.

4: Advisors without enough US and India experience



Desired Attributes

- ▶ Local Presence both in India and the US
- ▶ Track Record of working with mid to large companies in India and the US
- ▶ Deep knowledge of both the Indian and US core industry markets
- ▶ Experience advising both the US and Indian management
- ▶ Senior level access to leading industry executives and investors in India.

5: Lack of long-term Commitment to India



- ▶ The Indian market offers significant revenue potential in the long-term but there will be pitfalls in the short-term. Preparedness is the key.
- ▶ A step-by-step investment plan based on milestones ensures a balance between under-investment and over-investment
- ▶ It takes time to understand the customer buying patterns and work through operational challenges.

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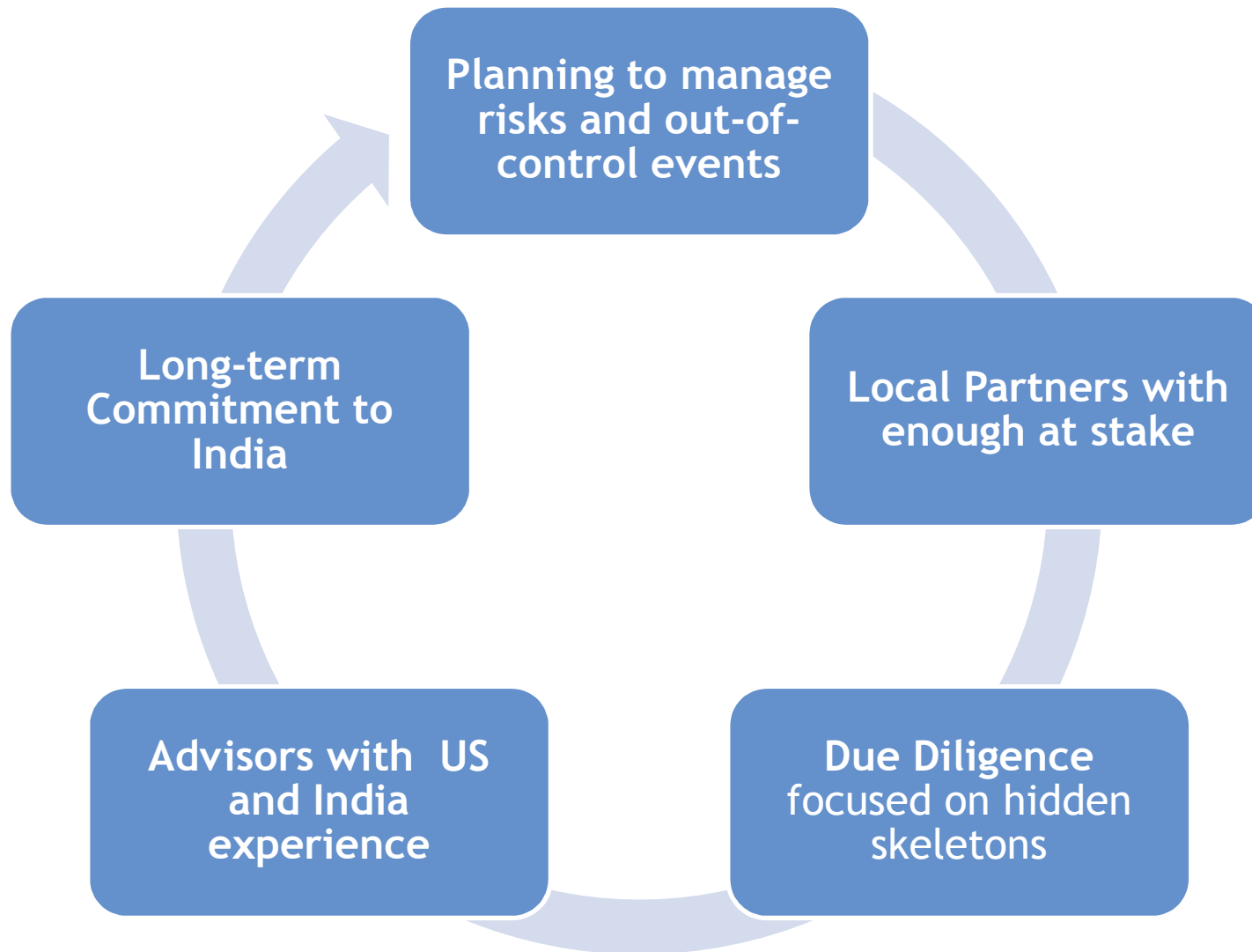
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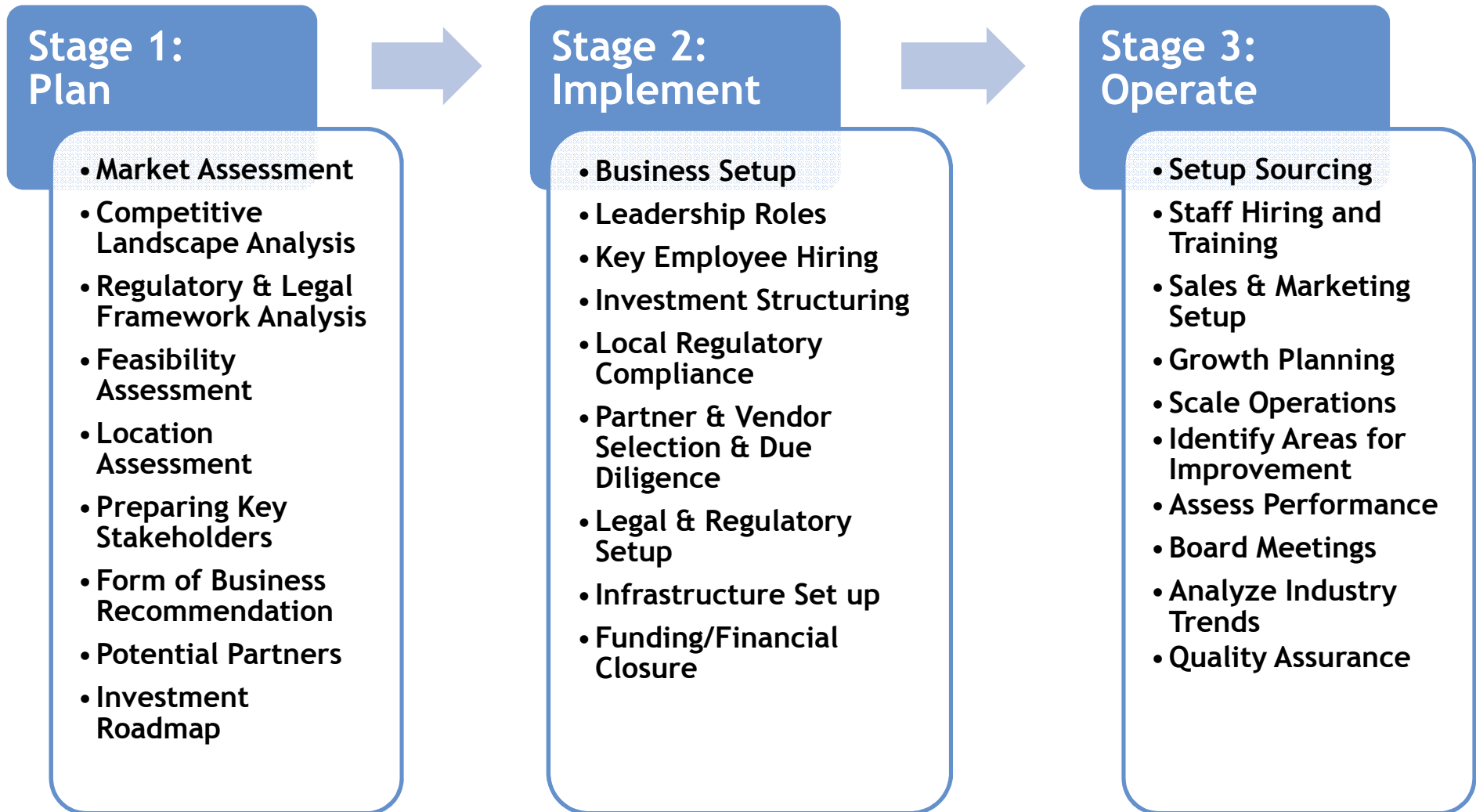
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Keys to Success in India



Creating a India Risk Management Strategy - An IVG Framework



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IVG Customer Case Study: Water Filtration Equipment Company assessing India's market potential

Company Overview and Strategic Approach

Company serves municipalities and industrial enterprises by providing them with best in class filtration media and equipments that help make clean water. Company offers both standard products (off the shelf) and customized products, with each contributing roughly equally to its top line.

As the share of population residing in urban areas in India is expected to increase significantly, it faces supply side constraints and concerns relating to availability of fresh water primarily owing to pollution and inadequate investment in water resource management. This presented an opportunity for company to target India as a market.

Company was seeking to formulate an India entry strategy in the Water filtration business based upon an analysis of market opportunities, competitive landscape, prevailing regulatory environment, and the financial expectations of management of Company



Lessons Learned

- **Addressable market was much smaller than expected:** Even though the overall market size of water industry equipments in India was over \$2 billion, the actual market size for this Company's products turned out to be very small - \$20 million. This was also driven by longer replenishment cycle and lack of perceived need for Company's product.
- **Higher working capital requirement due to long sales cycle:** A study of customers' buying behavior and sales cycle resulted in the realization that a high amount of working capital will be needed to run operations in India.
- **Ideal location for export to the Middle East and African markets:** Given India's proximity to the Middle East and African markets, it can be used as an export market while the local market develops. Labor rates in India are comparable to China for mid size batch manufacturing and there are several government incentives that encourage exports.

IVG Customer Case Study: Auto Component Manufacturer setting manufacturing plant in India

Company Overview and Strategic Approach

Company is a rapidly growing manufacturer of high volume, precision machined and assembled products in cast iron, non-ferrous castings, steel forgings, sand and permanent mold castings.

The Indian auto components market is expected to grow from current \$26 billion to \$100 billion by 2020. In the last six years, the market has grown from \$6.7 billion to \$26 billion with a CAGR of 21%.

Given this market opportunity, Company was seeking to establish a machining facility for castings and forgings in the city of Chennai in India to serve the domestic and global OEMs.



Lessons Learned

- **Early mover advantage is critical in India:** An early mover advantage makes a big difference for US Companies to leverage their advantage and build strong supplier relationship with US/European OEMs expanding or establishing in India.
- **Indian OEM customers are extremely price sensitive:** Even though the Indian market is large and growing in size, selling to domestic customers is a challenging proposition given their focus on cost. As the local competitors trade off quality and process to match price expectations, it reduces the addressable market size for a US supplier.
- **There is lack of high quality suppliers to global OEMs in India:** There exists a large unmet need for reliable and high quality suppliers to: a) US and European OEMs expanding and establishing operations in India, and b) Export of machined components from India to Europe and the US.
- **Senior management hiring can be challenging:** Given the operational complexities of setting a new casting-machining venture in India, a strong, dedicated, and experienced management team is required to drive success. However, hiring and retaining capable management team has been a challenge for several companies.

IVG Customer Case Study: Retailer of Lifestyle Products selling in India

Company Overview and Strategic Approach

Company is one of the world's leading hair and beauty salon chains. The company has presence in over 17 countries with over 350 salons and 16,000 customer visits daily.

Given the growth in Indian consumer's disposable income and aspiration of Indian middle consumers, Company wanted to tap the Indian market. Huge market demand in the Indian personal care industry had created a great opportunity to introduce a premium international brand and establish a market leadership position.

Company's goal was to open up to six upscale stores in Mumbai, Delhi, and other metropolitan cities focusing on middle income female consumers.



Lessons Learned

- **Heterogeneous market and customer buying patterns creates need for regional focus:** There exists big difference in regional buying behavior of consumers, especially in retail products. Hence a marketing strategy comprising several regions is difficult to implement in India compared to a homogeneous market like the US.
- **Marketing efforts cost less and are more effective compared to the US:** Marketing Campaigns in India are cheaper than the US and more effective, especially when catered to the rising aspirations of the middle class population.
- **Regional efficiencies can yield high revenue:** Local markets, if targeted effectively, can provide large revenue growth and hence geographic expansion need not need to be a high priority at the initial stage of company's growth in India.
- **Real estate and rentals are a larger component of expenditure compared to the US:** Given the rise in real estate prices in India, retail rentals can be extremely high and lower profitability.

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Other Important Considerations - Legal

Key Considerations

- Owning the Intellectual Property
- Protecting Trade Secrets and IP
- Potential for Local Liability
- Tax Considerations
- Employment Issues

Enforcing the Contract

- Customers want home jurisdiction and governing law.
- Arbitration v. Court - from an enforcement perspective.
- Execute an onshore contract with the subsidiary, if possible.
- Avoiding Indian courts other than for injunctive relief, if possible

Other Important Considerations - Recruitment/ Retention Strategies

Recruitment

- For every 5 openings, only 1 qualified candidate
- Employees seen as internal “customers”
- HR managers judged as salespeople- rather than administrators

Retention

- Differentiating company from competitors
 - compensation and benefits tailored to particular job
- Create a sense of togetherness
 - de-emphasize pay-for-performance
- More important whether person liked and respected
 - performance ability not valued as strongly

Other Important Considerations - Negotiations

- Preparation is a key to success in India.
- There is low sensitivity to time.
- Negotiations should be at the highest level of the Indian organization.

Do's

- Rely on written agreements, not YES.
- Modern India relies on contracts
- Consider other firms.
- Bring a group of negotiators.
- Save concessions for strategic implementation.

Don'ts

- Don't be swayed by kindness
- Don't bring up business on the first meeting.
- Don't trust every manager as equal

- “We will see”
- “I will try”
- “Possibly”

Means “NO”

Other Important Considerations - Monitoring Performance

- ✓ Assess Performance
- ✓ Keep Management Focused
- ✓ Identify Areas for Improvement
- ✓ Review Monthly Reports
- ✓ Participate in Board Meetings
- ✓ Attend Industry Conferences

Monitoring Performance

- ✓ Discuss Results with Management
- ✓ Talk to Department Heads, Other Managers
- ✓ Scan News Headlines
- ✓ Analyze Industry Studies, Research
- ✓ Check for Fraudulence, Inconsistencies

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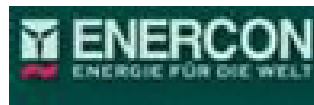
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We provide strategic and transaction advisory services and access to opportunities in India and markets, with exceptional execution capabilities.



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- Tata Capital
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- Axis Bank
- Bank of Nova Scotia
- SREI Infrastructure Finance
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- IL&FS

Our Competitive Advantage

- ❖ **Focus only on US-India transactions**
- ❖ **A deep knowledge of core industry markets;**
- ❖ **A relentless focus on maximizing value for our clients**
- ❖ **Strong operational and transactional experience**
- ❖ **Senior level access to leading industry executives and investors globally**
- ❖ **In-depth technical and financial skills for value-enhancing deal structuring**
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