India Inc will have to learn to live with risks abroad

Miles Johnstone, regional director, political risk — Asia, AON Global, Rahul Shukla, managing director and head of corporate banking, Citibank, India, Shobhana Subramanian, assistant managing editor, The Financial Express, Anil Sardana, managing director, Tata Power, and Nishith Desai, managing partner, Nishith Desai Associates. (Below) Members of the audience listen to the discussion on the challenges Indian companies face as they invest and expand abroad, and what they are doing to protect their interests

Shobhana Subramanian, assistant managing editor, The Financial Express: Good evening ladies and gentlemen and thank you all for being here. I welcome you all to the first edition of FE thinc. Before we start the discussion, a few words on Fe thinc. The idea is, much like the name suggests, to make the discussion a thought-provoking one, not necessarily coming up with all the solutions but nevertheless having a meaningful-enough interaction that will help corporations move in the right direction. We're kicking off the inaugural edition of thinc with a discussion on challenges and risks that India Inc faces as it invests and expands abroad. And what leading-edge companies are doing to protect their interests as they expand globally. What makes the subject relevant is the recent ouster of GMR from the $511-million airport modernisation project in the Maldives. That has re-focused the spotlight on foreign investments facing political risks. Other Indian corporations have also faced roadblocks. Essar's $750-million investment in Zimbabwe, for instance, as also Jindal's $2.1-billion project in Bolivia have both drawn attention to the challenges of investing abroad. Given persistently high commodity prices, the risk of resource nationalism is only likely to grow and, moreover, tactics used by governments to extract value from their natural resources will become more sophisticated. Mr Anil Sardana, since Tata Power has made some large investments in coal mines in countries like Indonesia, it would be interesting to get your views.

Anil Sardana, managing director, Tata Power: Yes, political risk is a big issue as is politics. But I don't think one should read into it as an Indonesian issue. Much before OPEC came into existence, there were players who were hobnobbing with each other and setting up a procedure through which all oil producers may come together. Today it is a formal organization and we can say that political risk is beyond politicians and where a group of people have come to decide the oil prices. Through a collective agreement they can set only a higher oil price. I see this phenomenon happening for every resource. You may say they may do it for the welfare of the local people. When they find that oil producers charge why should people who produce coal, iron ore or any other ore not have a similar policy? If we look at coal, especially at thermal coal, between three nations you have 98% of the world's exports, Australia, Indonesian and South Africa. Between these three countries, they reach the same price. That can't be sudden. So you may say that it is a political issue in Indonesia but I believe it is not. It is an economic decision somebody has taken, much like it was taken, for oil many years before. They have decided to charge collectively and arrive at the same price, of course, through different means. Indonesia says I will announce a price every month, Australia says I will announce 23% carbon tax, South Africa says I will give you parity with state-owned electricity utility purchases. I think one has to read without doubt that all resources worldwide today will either get into two types of contracts.

Shobhana Subramanian: Mr Nishith Desai, since you advise corporations on what steps to take before they venture overseas why don't you share your views? How good are the bilateral treaties that India has signed? Since 1994, India has signed BITs [bilateral investment treaties] with all major nations except the US and most of these are in force. India is also negotiating with several more countries.

Nishith Desai, managing partner, Nishith Desai Associates: I think the whole issue of political risk is not new to us. Early on in 1950s, OPEC had an agreement with India and at that time the risk was in-convertibility of currency, war etc. We do not have bilateral investment protection between US and India and that is why we see so much investment through Mauritius, although people think it is for tax reasons. When FIIs have to invest in India, they have to first protect their investment, tax comes later. This is not something that is new; it is just that Indian companies are globalising their operations. You should know upfront that there is political instability and there exists significant political risk, it is all about managing the risk and not avoiding it. There are some differences in bilateral investment protection treaties. If you take the UK and India and the bilateral agreement between Mauritius and India, the Mauritius treaty is much better negotiated from the perspective of a foreign investor, there are some fine nuances. Whether these are adequate or inadequate depends on which side of the table you are. In the process, you are also required to think about what would happen to your investment outside. India, for instance, has become the biggest exporter of concepts of retrospective amendments, so now other countries are doing it.

Shobhana Subramanian: Mr Miles Johnstone, a key conclusion of the last four MIGA-EIU Political Risk Surveys is while 'macroeconomic instability' is a top short-term concern for cross-border investors in developing countries;

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'political risk' remains a larger structural concern for foreign investors in the medium term. Also, according to MIGA-2012 within the range of political risks, adverse regulatory changes are the foremost concern of foreign investors over both the short and medium term, followed by breach of contract. Do you see many bilateral treaties being violated?

Miles Johnstone, regional director, political risk — Asia, AON Global: There are plenty of instances wherein treaties have been violated. Right now we are dealing with something between Ecuador and the US. We have Argentina and US bilateral treaty which seems to have gone out of the window. The one between Australia and Indonesia will be tested in case of Churchill mining, which is a very good example, where you have done your due diligence on the risk of corruption of the host country. India doesn't figure in this list. I don't think there are clear instances of developed countries reneging on contracts. The whole political risk in insurance market grew up facing the other way, the emerging markets. Now, we are finding not too many but requests to cover European countries and the US. It is wrong to look at insurance as substitute for a well-drafted legal document. But it is a final safety net behind these agreements. I think there is heavy emphasis on natural resources, it is very emotive. When a government looks at what voters are thinking about the country's natural resources disappearing overseas, it makes nationalistic noises to protect that. But of course they need that foreign direct investment to get the income that they are expecting. So, there is a huge bias towards natural resources.

Shobhana Subramanian: Mr Rahul Shukla, as a banker, how much weightage do you give to political risks while funding a cross-border transaction?

Rahul Shukla, MD and head corporate banking, Citibank, India: Suddenly you are grappling with political risks at a time when the global economy is not doing well. It does not happen only in emerging markets, what is happening today is that there is a lot of protectionism and not just relating to natural resources. You can sign any number of treaties, but if the government comes out and takes a stance, you are a prisoner to that. As a company in a country which has this huge demand, you got to have very solid reasons to go outside, maybe you are too large in the home market and want to tap the outside market. When you go outside, there has to be a reason, it can't be for arbitrage. Are companies expanding into areas where structures

Aon Global chairman Prabodh Thakker (left) discusses a point with guests

A member of the audience poses a question to the panel of experts have not developed? You would always step back and look at business model and the rationale before you step in.

Shobhana Subramanian: How do you deal with changes in regulations, like it happened in Germany for instance, with the drug industry and companies like Dr. Reddy's were caught unawares?

Nishith Desai: There are instances where bilateral treaties can be invoked for changes in laws. Most treaties do not protect adversarial tax changes but if the tax imposed tantamount to expropriation, then it is covered. In Russia, for instance, they imposed such a high tax on a Spanish company that it went bankrupt and significant compensation was paid, Russia lost that case. Using treaties creatively is an art. Have you thought of BITs? Some have a denial of benefits, whereby a third-country resident can't use the treaty.

Anil Sardana: There is a business case that a business looks at. We need to weigh the returns from investments in certain countries, which are much above typical thresholds, than one would get in the home market. We need to internalise that, then there is a calculated risk in going to countries like Mozambique. There should be clarity that there is an associated risk with the returns.

Rahul Shukla: As companies globalise, most companies around the world get active government support. The Japanese companies, if they're investing here, multilateral agencies support their firms, which makes it difficult for someone to go out and take particular action. Chinese companies are also going deep into Africa but with a lot of governmental aid. I think, that is not as active here though I can't quantify that. In that sense our companies have braved enough difficulties in conquering the local markets. When you go out, without active support, you will make make mistakes, but there will be positive learning.

Shobhana Subramanian: Should the Indian government have done more in the GMR case?

Miles Johnstone: The existence of a government guarantee on the other end of the negotiating table can have a huge effect on such decisions. But certainly, the private providers of political risk insurance have taken exactly that risk — cancellation of concession. However, there are many considerations to take into account and it's not easy. What we are seeing is the Chinese state provider backing off or being allowed freedom to say no a lot more times to the projects it supports. That creates opportunities for multilaterals like MIGA and the insurance arm of the Islamic Development Bank to step in for these long-term project risk as well as the private market insurers.

Shobhana Subramanian: Indeed, it looks like insurers are going to be doing brisk business. Gentlemen, it's been wonderful having you here and listening to your views. And I'm sure corporations venturing abroad would have learnt a great deal from the perspective that you have shared with us today. Thank you so much for having been a part of FE thinc and we hope to have you with us again soon.

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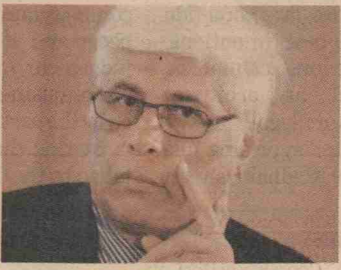

NISHITH DESAI, managing partner, Nishith Desai Associates

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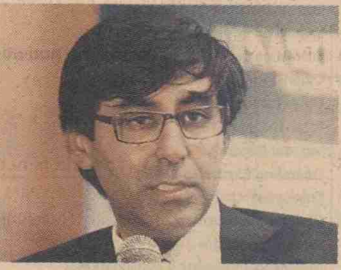

RAHUL SHUKLA, MD and head, corporate banking, Citibank, India

There is a lot of protectionism and not just relating to natural resources. You can sign any number of treaties, but if the govt takes a stance, you are a prisoner to that.

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If we look at coal, especially at thermal coal, between three nations you have 98% of the exports: Australia, Indonesian and South Africa. Between these three, they reach the same price. That can't be sudden.

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When a govt looks at what voters are thinking about their natural resources disappearing overseas, it makes nationalistic noises to protect that. But of course they need that FDI for the income.