India
Diligence

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Comment/ Insight

Identifying the *right* Indian partners or local advisors, employees, advisory board members, or similar, is crucial since a variety of soft risks flow from factors such as their personal standing, reputation, cultural leanings, community and political affiliations and previous conduct re western partners. Some such risks are

Manipulation

While not immediately apparent, 'manipulation' by the Indian side is a significant and on-going 'cultural risk' to Western companies in India. Often difficult to detect, manipulation permeates most negotiations, documentation, formal due diligence processes and the interface with government officials.

Some indicators: Excessive friendliness and hospitality by the Indian 'partners' too soon; unusual requirements for upfront 'costs' to make things happen; situations where 'valuations' are in issue; professional advisors with undisclosed ties with the Indian side; over-zealousness in trying to make introductions to bureaucrats; reluctance and indignation on the Indian side in providing more information beyond strict legal and financial due diligence; reluctance to allow Westerners a direct interface with government officials; unexplained bottle-necks, hitches and official scrutiny that suddenly seems to afflict existing joint-businesses or proposed new projects – but apparently 'solvable' by the local 'partner'.

Culture 'Distractions'

Some Western executives worry about 'cultural conformity' when dealing with the Indians – a chink exploited happily by the Indian side. Crash 'culture courses taken by Westerners just before dashing off to India are more useful on holiday than for business. It is crucial during business dealings to pay attention to hard and soft aspects of people and the situation. An imbalanced preoccupation with "not offending culturally" distracts, invites manipulation and attendant risks. After all, 'politeness' and 'respect' are universal norms and not particularly 'Indian culture'.

Undisclosed Promises & Commitments

Sometimes unexpected 'difficulties and obstacles' seem to suddenly afflict infrastructure or public sector related projects, sales and ventures in India, baffling westerners. Most likely reason: disgruntled recipients/ beneficiaries - usually officials or bureaucrats - of verbal promises made by the Indian 'partner'.

Some local Indian parties, in their quest to persuade the western partner, may use the tactic of offering quiet "promises and understandings" to co-operative officials, who in turn are likely to help the Indian party look solid, credible and 'well connected'. The ability of the Indian side to deliver its own promises to the western partner may also rely on such cooperation.

Unfortunately, it can be quite late in a project/ venture cycle before any adverse consequences of undisclosed promises kick in. By such time, substantial commitments in terms of capital, people and reputation have been made by the western side. Implications can be severe and complex depending on whether the Indian side made commitments on its own account, or on behalf of its proposed (and quite oblivious) western partner, or on its own account but would now rather the western partner makes good.

Financial Bleed

A maze of Indian regulations, tax complexities and bureaucratic influences are all fertile opportunity for some unscrupulous Indian 'partners' to slow bleed assets and value out of a joint venture vehicle. Community allegiances or pure financial motive can persuade some local managers, accountants or lawyers to help.

Inevitably, an Indian partner will want to call the shots in the local market – posing a challenge in stemming the bleed. Fudged accounting, manipulated valuations, undisclosed transfer pricing arrangements and un-auditable "necessary local costs of doing business" - can often blur the picture. However, if a western partner is not too distracted by the niceties of things, or too impressed by the structured, professional image of the Indian side, or is not in an 'ostrich-like mode' there will be tell-tale signs and flags:

A local Indian company, even if listed, is controlled in reality by a close-knit family or small clique, shrouded in misty deal-making and secrecy, paying lip-service to transparency and governance; Local partner negotiates hard, even if a minority shareholder, for control and role dominance and then appears to concede and settle for the right to appoint the JV's CFO/financial controller; Local partner wants its own existing group accountants, auditors and lawyers be appointed; Local partner insists that due to inherent sensitivities, it alone must be responsible for negotiating revenue-generating orders/ contracts, especially in government-related sectors; Local partner seeks to establish separate 'funds accounts' that foreign partners must not require details of 'for their own sake'; Convoluted contractual dealings with the Indian side's group entities; and so on.

Listed Family Companies: Transparent as Mist

India remains a 'family-controlled' business environment. The vast majority of Indian listed companies are in fact closely held by families or close-knit groupings operating like 'families'. While seeking prestige, additional finance and to deflect scrutiny through listing, the family is unlikely to cede real control even if it ostensibly controls a small minority of the total equity. This may not at first, or for a while, be obvious to a Western partner that seeks comfort in 'dealing with a public company'. Indian promoters/ family controllers are likely to deploy a variety of techniques for "carrying on as usual" – while appearing to comply with governance requirements for a listed company. For all practical purposes, and notwithstanding the company adorning all the ornaments of listed public company – basic compliance, professional management, state institutional investors, non-executive boards of repute, etc – the business will remain "family-controlled and managed" - with the attendant risks and issues. Manipulation on several fronts, as we noted in a previous India Brief, is a risk for western partners; most seem to place substantial reliance on the fact that a local partner is a 'listed Indian company' coupled with the "comfort" of 'usual legal and financial due diligence'. In fact, it becomes even more crucial to ascertain the real controllers and assess them for soft issues such as reputation and integrity and suitability.

Indian Advisory Boards

Companies in India, including and often particularly public 'family companies', often establish a non-executive Advisory Board composed of persons of high local profile. This can often work well for image. Similarly, foreign companies and their JVs in India may benefit from a local Advisory Board. However, this tool may work differently for western companies whose main business involves interfacing with the government or the Indian public sector- for example in Infrastructure, Oil and Gas, Defence procurement or any sector where the government is a customer for goods or services. Western companies seek local credibility and some 'local guidance' by appointing well-known local persons. However, where the business involves dealing with bureaucrats and government companies, it is highly unlikely that advisory board member will be content to draw the line, or discipline, under their limited roles. They are likely, whether disclosed or not, to flirt with 'making deals' and importing in the dimension of "Undisclosed Promises" – a topic we addressed in an earlier India Brief. It is a real risk that a particular individual's history, affiliations and track-record may actually alienate certain crucial quarters within the circles – proving the well-intentioned strategy counter-productive. The question whether to constitute a Board is best decided only after suitable local people have been identified with the proper scrutiny. Otherwise a Western company risks importing 'personal agendas', 'political affiliations' and a string of un-auditable 'expectations and promises' made to the system. Defeating the original purpose and adding another layer of risk.

IN NEXT ISSUE : "**Local Advisors"** and **"Agents and Multiplicity"**

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