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# Investors wary of firms' political links

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Aveek Datta & Anirudh Laskar

Mumbai: Foreign and domestic institutional investors are increasingly turning cautious about political risk while investing in companies in the wake of several controversies that have embarrassed the government and singed firms, with several politicians and corporate executives actually being sent to jail.

Understanding the political leverage and affiliations of companies in which they are looking to invest has become part of their pre-investment research, say the heads of research at brokerages and institutional investors. And if a company is found to be too dependent on political connections for securing business, investors are staying away from it, they add.

Saurabh Mukherjea, head of research at Ambit Capital Pvt. Ltd, a Mumbai brokerage, said institutional investors have been asking his team to help them understand the political leverage of companies in which they are considering investing. "If they find a certain company to be politically connected, they want to stay away from the stock," he said.

Ambit, Mukherjea added, has even tweaked the way it presents research reports to clients accordingly. In June, it introduced a new parameter to analyse firms—political connections. Ambit's scale is colour coded. A green flag implies that a company doesn't use its political connections to materially influence its business while a red flag indicates that a company's competitive advantage is highly dependent on such affiliations. An amber one indicates a bit of political leverage, but not much.

There was a time when investors valued political leverage, but they have since realized it doesn't work, said another analyst.

"In 2006-07, investors loved some companies in sectors such as real estate and infrastructure, betting big that they will be able to influence policy in their favour," said Sanjeev Prasad, head of research at Kotak Securities Ltd. "Now, investors have realized that there are other challenges as the prices of many of these stocks have collapsed; it has been proven that it is not a sustainable model."

Even worse, investors are realizing that such relationships could actually hurt companies.

As it has in the so-called 2G scam, where several politicians, bureaucrats and companies are being investigated over the allotment, in 2008, of spectrum or radio waves to firms on favourable terms. The then telecom minister A. Raja has since resigned and is in prison along with a few senior executives of real estate firm DB Realty Ltd, the Anil Ambani-controlled Reliance Communications Ltd, and Unitech Wireless Ltd's former chairman Sanjay Chandra.

Last month, Karnataka chief minister B.S. Yeddyurappa had to resign over allegations of his involvement in an illegal mining racket. The report by the state's anticorruption body that brought about his fall also named several companies.

The immediate impact of the allegations shows up in the share prices of the firms involved.

For instance, the scrips of companies such as Sun TV Network Ltd and SpiceJet Ltd, which have established promoter-politician links, have underperformed the broader markets over the last fiscal.

Sun TV and SpiceJet are owned by Kalanithi Maran, elder brother of Dayanidhi Maran, former textiles minister who recently resigned after allegations surfaced that he had used his office as telecom minister (he held the post before Raja) to benefit Sun TV in which his family is the dominant shareholder.

For the year ended 31 March, SpiceJet lost 34.31% of its market value on BSE, while the benchmark index, the Sensex, gained 10.94%. Sun TV gained 4.96% in the same period, although the stock is currently trading at 45.55%, off its 52-week high seen on 5 January.

Investors were previously not as interested in the political connections of the companies they were investing in, said the head of a foreign institutional investor.

"Foreign investors rely on macro-political reports, but recent events have forced them to do this exercise even on a micro basis," said U.R. Bhat, managing director of **Dalton Capital Advisors (India) Pvt. Ltd.** "As a part of the ongoing consultancy services, they are now emphasizing on the political risks involved in companies where they invest."

And they are especially conscious of the political risks in sectors such as real estate, infrastructure and telecom, added Siddharth Shah, who heads the funds practice at Nishith Desai Associates, a Mumbai-based law firm, and deals with a number of foreign investors looking to invest in Indian companies.

Other than the research wings of brokerages, investors are also resorting to the help of specialist external agencies.

The head of a Mumbai-based private equity fund that raised money from foreign investors said checking the background of promoters, including their political relationships, is now a key part of its process of vetting investments, especially in infrastructure and real estate companies. "We usually take the help of companies like Kroll and KPMG for this," he said.

Richard Dailly, managing director of Kroll Consulting Llc's India office refused to specifically comment on the issue, but said in an email that in general, "it is true that we are frequently asked to look into allegations of corruption and non-compliance globally, on behalf of both Indian and non-Indian investors".

The trend is a temporary one, added Shah. "What is positive is that a kind of cleansing activity in the system has started," he said.

And the focus, said Prasad of Kotak, is now on companies with "clean accounts and good corporate governance".

In a 14 June report, Ambit Capital analysed the performance of the stocks of companies with high political affiliations vis-à-vis those that are less influential. It said it relied on its own network of contacts in political and corporate circles to assess the extent of political leverage of a company.

The report classified 25 companies out of its coverage universe of 360 as those with a "strong connect" and said the stocks of these firms gave a negative return of 20% over

fiscal 2011. In the same period, the combined market value of its entire universe—360 firms—declined only 6%.

*aveek.d@livemint.com*

*Shraddha Nair contributed to this story.*

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