Go Public? Stay Private…

> *The Indian automotive industry hasn't witnessed ~~many~~ any carmakers, barring Maruti-Suzuki, going public in the last thirty years. At the same time, many suppliers have floated on the stock exchanges. Why do vehicle manufacturers shun away from listing on stock exchanges?*

Going public, which is floating the company's stock on an exchange, is the ultimate high point in the life of an enterprise. Every entrepreneur has wet dreams of Initial Public Offerings (IPOs) and most start-ups strive to climb the summit one day.

Floating your stock on the exchanges is a huge responsibility. From the point of view of transparency, ethics and corporate governance, a publicly traded company has a much greater responsibility than a privately held enterprise.

At the same time, a publicly traded company has a much better valuation than a privately held one. Typically, with everything else similar, a private company would struggle to get a valuation of more than 2-3 times its earnings. However, a listed company can easily achieve a 10-20 times multiple of earnings.

Banks and financial institutions too reckon publicly traded companies much more favorably. They offer loans on better terms and there are generally more avenues available for listed companies to raise debt.

Why do companies go Public?

However, more than the financial flexibility, there is more to why companies go public. To start with, going public gives the company huge funds in the form of equity that has been offloaded to the general public. The original owner still has controlling ownership of the enterprise but the entry of investor money means that the scale of operations is now huge.

Also, the senior management's Audis can now be legit funded from investor money.

In more real terms, companies go public for four reasons.

1. **Romp on Investor funds:** The most common reason for taking companies public. Why work in a constrained environment with a few millions in bank when you can play with a couple of billions and do pretty much everything that you have been doing till date. The most obvious examples of this have been real-estate companies.
2. **Expand faster:** The most genuine and ethical reason to go public is to expand faster than what a private enterprise status will allow you to. So if a company can open 100 outlets with 100 million, it can open ten times that with ten times the funds. Add to that, the larger scale of operations will generate better margins and significantly greater profits. Most Dot Com companies go public because of the underlying desire to expand faster than ~~can be managed~~ the competition.
3. **List and sell out before the business concept collapses:** Another popular reason for companies to go public and one most popular with real estate companies – ride the boom cycle, make money for the promoters, and let the investors suffer the downward slope of the cycle.
4. **Provide exit to early stage investors:** Often some early stage investors like VCs and PE funds look for exits from companies who have achieved a reasonable size and their investment has grown significantly. The easiest way to provide an exit is through public listing of the company.

When should companies go public?

So now that we have established that it’s good fun to take companies public, the next question is when should companies go public? Again, there are multiple reasons and we look at some of them.

1. **When the market is about to explode:** You are in a market that is on the upswing and may explode in a couple of years. While you have a strong brand, an explosion requires very fast expansion beyond your ~~management bandwidth~~ finances. You need to raise a lot of money fast and going public is a good solution. Many Dot Coms go public because they believe that their market is about to explode and it makes sense to expand and be better prepared for the imminent growth.
2. **When the market is booming but will imminently sink in the mid-term:** If the market is exploding and you have achieved a reasonable size, it may be the right time to cash in your chips. If it I a cyclical industry, a downturn in the mid-term is imminent and it makes sense to cash in and improve your size at the same time.
3. **When the stock markets have gone bonkers and people are buying ~~cow dung~~ bullshit at a premium:** If the market is irrationally discounting businesses and willing to pay abnormal premium on valuations, it is the right time to go for the kill.
4. **When you are a multinational sitting at the cusp of growth in a new market** and it makes more sense to attract local investor money than put your own dough into expansion.
5. **When you have the critical mass:** You cannot be too small at the time of listing else ~~operators will hijack your stock and treat you like shit~~ it would be a strain on the company to meet the listing expenses and investors would not take you seriously.

Which brings us to the main point of discussion. How come, when it is easy to list and the reasons to list are quite clear, no automotive manufacturer, barring Maruti-Suzuki, has listed on the Indian stock exchanges in the last twenty years?

We are also not counting Ashok Leyland, Tata Motors, Mahindra, Bajaj Auto, Hero MotoCorp and SML Isuzu, all listed many years prior.

Let’s do a roll call – Hyundai, GM, Volkswagen, Honda, Renault-Nissan, Ford, Daimler, BMW, and Toyota (and some more) have substantial Indian operations. Yet none of them has shown any inclination of going public.

If the growth in the target market is the main prerequisite for listing a company, the automobile market is not badly placed. In the last twenty years, the passenger vehicles market has grown by 935%, at a CAGR of 12.4%; the two-wheeler market has grown by 7.54%, a CAGR of 11.32% and the M&HCV market has grown at a CAGR of 5.89%, or overall 213%.

However, this strong growth has not been impetus enough for any global carmaker to raise funs in India through the IPO route.

Arguably, barring Hyundai India, most of the global carmakers have had a mixed run in India. So listing in the local stock exchanges may not have elicited an expected response. While GM and Ford have wiped out their net worth in the past, the entire Volkswagen Group’s balance sheet in India would be deep in the red. The same would be the case with Renault-Nissan in India while Honda and Toyota would be barely in the green, if at all.

Not really ideal candidates for listing then.

However, Hyundai India is an anomaly. The company would be decently profitable in India and, at many points in its India history, would have been at the cusp of explosive growth. Hyundai’s Indian innings started with the success of the Santro, a small hatchback that propelled the company into the clot of the second biggest passenger vehicle manufacturer in the country, a position that Hyundai has defended well.

However, the biggest growth came for Hyundai Motors India (HMIL) when its Chennai plant became the sole global manufacturing hub for the Santro / Atoz Prime hatchback. Manufacturing volumes swelled and kept on increasing as Hyundai bestowed HMIL with the same responsibility for the i10 hatchback and also threw substantial export volumes for the i20 hatchback.

There then were ample opportunities for Hyundai to step back and list HMIL on the Indian stock exchanges through an IPO. Only, the Korean manufacturer never showed any inclination. Had it done so, the investors might have grabbed the HMIL stock eagerly. The company’s conservative approach to spending money (not investing in a diesel engine plant, not investing in another vehicle manufacturing plant) would have worked wonders for its bottom-line and the stock price would have benefitted as well.

Leaving passenger cars aside, Honda has been super-successful in India with subsidiary company Honda Motorcycles & Scooters India (HMSI) delivering high double-digit growth year-on-year. Again, throughout its history in India, there have been multiple instances when the company has been on the cusp of explosive growth and could have easily bamboozled investors to shell out extra money for high valuations.`

When Honda exited Hero Honda and decided to focus its energies on HMSI, this was an opportune time for attracting small investors through an IPO. Again, when the Scooters segment was being forecasted to take off rapidly, it was another opportune moment to go public.

Yet, Honda abstained from doing so. The company used the alimony from the Hero-Honda divorce settlement to fund HMSI’s expansion in India. For the future, regular cash from operations would be sufficient to fund Honda’s future onslaught in the Indian market.

In a way, Hyundai and Honda could have targeted the Indian market even more aggressively by using the IPO route. However, that is not the case and it seems that there is an inherent reluctance amongst global players to stay away from the Indian stock exchanges.

Why don’t companies list?

There are multiple benefits of listing, as we have discussed above. At the same time, listing entails a lot of responsibility and demands greater transparency from the company.

In many ways, being listed on the stock exchanges requires maintaining clean underwear, as analysts would be constantly pulling down your pants to check them.

That is difficult for any multinational, especially car manufacturers. While not many of them would object to transparency in accounting (we have no reasons to believe their accounts are not transparent), there are always embarrassing holes like how much royalty per vehicle is being paid back to the parent company on every program.

In many other cases, manufacturers won’t like to publicly disclose how much money is being paid to the parent company as India’s share of development in a global platform. Even issues like the price at which the Indian company is billing export-units can be contentious for small investors.

Listing on the stock exchanges also requires extra management bandwidth and is often a distraction for senior managers, something that a global passenger vehicle manufacturer would like to avoid, especially when the global operations can easily fund India through the growing years.

Another reason why listing doesn't make sense for a global passenger car manufacturer is because, fundamentally, none of them has plans to revolutionise the Indian market with their offerings. To illustrate, say in a regular car market like India, no car manufacturer is planning to offer autonomous cars with the idea that they would account for 20% of the market in 2020. That ~~wild idea~~ ambition is not there and this makes any global car manufacturer far less attractive for Indian small investors.

However, the biggest reason why global carmakers and even many other global organisations shun from listing on stock exchanges is that it ends intra-organisation flexibility and also makes the organisation answerable to pesky investors.

Most global organisations would like to treat their operations in individual countries as parts of the same pot. So if the operation in Pakistan (mischievously theoretical) needs investment, excess funds should be siphoned off from the Indian operations, routed through the global headquarters and invested into Pakistan. No one should object, as everyone is part of the same global organisation.

Except this is something that most pesky small investors and some (awake) institutional investors often catch and object to, if the Indian operations were listed. If the intra-group lending is not providing the maximum benefit to the Indian company (and Indian investors), investors would raise their concerns and even block the move. Recently, Life Insurance Corporation (LIC) – an institutional investor – did this with Vedanta Resources, which planned to loan USD 1.25 billion from its Indian listed subsidiary Cairn Energy to the global operations at LIBOR rates. This rate was significantly lower than the prevalent bank fixed deposit rates in India and Cairn Energy would be losing money by loaning it to Vedanta.

Even innovative recirculation of money within the group is frowned upon by small investors as MSIL learned when it wanted to hand over its Gujarat plants to an unlisted Indian subsidiary of Suzuki Motor Corporation, Japan. Suzuki had to eventually take it to the small investors for ratification.

Senior Executive perks is also something that investors keep an eye out on. Tata Motors recently learned it the hard way when investors refused to ratify perks given to three senior executives / Directors and asked for the money to be recovered. With most global carmakers overpaying their under-performing senior management, this aspect becomes an avoidable distraction for management.

So why did Maruti List?

Maruti-Suzuki was earlier a joint venture between Suzuki and the Indian government. The company went for an IPO and listing in 2003 to provide an exit to the Indian government in the cleanest possible way. In retrospect, the IPO has been a good idea even though the government exited too soon. MSIL's share price on opening day hovered around INR 160. The same is trading at INR 2650 today, a jump of 1550% in the stock price.

So who should list?

Let us again tick the checklist needed for a successful listing.

1. The company should be a strong brand in a small segment.
2. The segment should likely witness explosive growth in the future.
3. The growth should end up helping the company the most and increase its size manifold.
4. The nature of the business should be high-margin and with the scope of volumes to multiply in the medium-term.

There are not many companies in the automotive OEM space that can meet the above criteria. Not many can successfully list and even fewer can become investor darlings if they hit all the targets successfully.

Heck, in all our scrutiny we found only a single company who could tick al the boxes, barring one. The company does not yet have the critical mass needed to go public. However, it should be there in a couple of years.

The company is (in true WhatsApp forward style…)

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