



MANISH SABARWAL

The author is chairman of Teamlease Services

A time to return money

Microsoft's actions reaffirm the need for Indian companies to return cash to shareholders. The Budget may shift the vehicle from dividends to buybacks

Microsoft is 25 years old, but declared its first dividend last year. However, its \$75 billion payout to shareholders last month is impressive for its mature analysis of future prospects. Shareholder payouts should reflect industry lifecycles. Microsoft's payout is akin to graceful aging rather than desperately hanging onto youth with kingdom-building investments, diversification, or acquisitions.

A lack of coming to terms with return prospects may be reflected in the unjustifiable amount of shareholder cash held by many Indian companies. Does the future of the two-wheeler business justify a Rs3,600 crore cash hoard (75 per cent of its balance-sheet) for Bajaj Auto? Does Hindustan Lever believe it has positive NPV opportunities to deploy Rs1,670 crore (68 per cent of its balance-sheet)?

I also believe that of the three vehicles available for returning shareholder money (dividends, share buybacks, and spinoffs), recent Budget proposals around transaction tax make buybacks far more tax-efficient than dividends.

Corporate finance theory is divided. Opinions range from dividends are good (investors like them and they signal prospects), they are bad (tax-disadvantaged over stock appreciation), to the famous Miller-Modigliani hypothesis that dividends do not affect firm value. The M-M hypothesis suffers from two assumptions not valid in India: a) tax indifference between dividends and capital gains; b) excess cash is not used for bad projects.

As in life, the balanced view lies between the extremes. Finance guru Aswath Damodaran feels dividends or buybacks are good if the company has cash and not enough investments (with time-weighted, cash-flow-based, incremental returns reflecting all side costs and benefits) that earn honest hurdle rates (reflecting risk and financing mix), and bad if there is no excess cash and/or good projects ($NPV > 0$).

Despite the overwhelming bias to dividends as a payout vehicle, the reasons that will drive a shift in India towards buybacks include:

a) The new transaction tax regime (15 basis points) is negligible relative to the dividend distribution tax (15 per cent borne by the company). The transaction tax, subject to a widely expected clarification around buybacks and open offers, makes buybacks overwhelmingly attractive over dividends for listed companies.

b) Companies around the world fear raising dividends because of the negative performance signalling implied by any future reductions. This "stickiness" is strongly reflected in a 30-year study to the mid-1990s in which the standard deviation of earnings (14.09 per cent) was much higher than that of dividends (5.13 per cent). Exceptional shareholder paybacks, what India needs, are better handled by buybacks since they do not "distort expectations".

Increased shareholder payouts also help the principal/agent issue. The "private benefits of control" in India have been high and often led to diversification and asset-obsession. Are Tata Power shareholders happy with their VSNL holdings? Wouldn't Indian Rayon be better off buying Lenzing of Austria (the second-largest viscose producer in the world) rather than its current portfolio of Idea Cellular, PSI Data systems, Birla Sun Life Insurance, and Transworks?

An article in this magazine last month profiled corporate treasuries. The use of "profit centre" for the function is on the wrong side of history. It is unlikely that returns on cash lying in Indian companies are even zero net present value. More importantly, shareholders didn't opt for the embedded interest rate, equity, and credit risks these "treasuries" thrust upon them.

The unofficial story line from Bajaj Auto brands the cash hoard as a strategic defence against a Japanese major ramping up Indian operations. With all due respect to a great company and its 250 per cent dividend, this is hardly consistent with a large insurance diversification, treasury profits exceeding operational profits for 2000, and the proposal to demerge a chunk of money to subsequently merge with Bajaj Auto Finance.

The growth and MNC potential of tech companies has them rightly tanking up on cash as a percentage of their balance-sheets; Infosys (86 per cent), HCL (71), Satyam (70), i-flex (60), and Wipro (56). However, any long delays in "transforming" acquisitions should get them thinking *à la* Microsoft.

Most businesses, like humans, believe they are immortal and have limitless investment opportunities with returns exceeding their cost. But, as sure as night follows day, all businesses age. Microsoft has shown tech companies how to handle middle-age; time for some Indian companies to take the cue.