



The ISB Annual B-School Fest
2005



ΤΣΜΡΕΣΤ

... an Entrepreneurship and Venture Capital Club Event

Case – Gadhvi's Collaboration¹

Gadhvi Chemicals Limited (GCL) was a closely held company, promoted by the *Gadhvi* group which had diverse business interests that included financial services, real estate, agricultural commodities, ice-cream, and frozen foods in Western India. GCL marketed Ammonia, Argon and Argon-base gas mixtures. Another group company namely *Gadhvi Gases Ltd.* (GGL) had a plant to fill argon or gas mixtures in cylinders near Vadodara. Argon or gas mixtures were first sold by GGL to GCL which then sold them to customers. The eldest brother RV Gadhvi from the fourth generation of the family had promoted these companies and managed them independently, for the family. The Board of Directors comprised the three brothers with their father as the Chairman. GCL had been into the chemicals and industrial-gases business for almost two decades and had grown to become the third largest distributor of Argon in the western part of the country with a network of operations in Maharashtra, Rajasthan, Madhya Pradesh and Andhra Pradesh. GGL had another bottling plant getting ready near Pune. GCL had distribution outlets in Hyderabad, Jaipur, Vashi, Pune, Indore and Ahmedabad. GCL sales turnover for 2000-01 was Rs. 180 million including Rs. 100 million generated from the ammonia business, which has had a slow growth in recent years. The sales turnover also depended on the cost of input gas. GCL and GGL had about 9,500 cylinders and 10 trucks to transport industrial gases to customer premises. Besides, they had two tankers for bulk transport. GCL employed 70 people. For the ammonia business, GCL had about 7500 cylinders and 40 transport trucks. The organizational culture popularly known as *Seth* culture has been strongly influenced by the brother managing the business – RV Gadhvi. Though Gadhvi himself was hard working and a visionary, a team has not been built which could convert his vision into reality. Very few systems were in place and the business was run more on oral instructions originating from Gadhvi.

The rapid developments on the competitive front, forced Gadhvi to look for an overseas collaboration to build competitiveness in GGL. They approached Liquid Gold, a multi-billion dollar company that was the largest industrial gas company in the world at the turn of the 20th century. There were a number of uncertainties both on the business and family fronts.

Industrial Gas Industry in India

Industrial gases were used in large quantities by steel, paper, electronics, chemical, foundry, petrochemical and refinery industries. In gas industry, there were two types of markets: *Tonnage and Merchant*. When the gases were

¹ Professor K. Ramachandran, Indian School of Business, Hyderabad and Mr. Shyam Taneja, Consultant, Ahmedabad, prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.



The ISB Annual B-School Fest
2005



produced for a customer across the fence and delivered through pipelines, it was termed Tonnage sale, while sales through cylinders (gas) and tankers (liquid) were known as Merchant.

BOC (Earlier known as Indian Oxygen Ltd) was the only MNC operating in India (for more than four decades) and was the industry leader. BOC has been active in the eastern and western parts of the country. Industrial Oxygen (INOX), the market leader in western India and BOC together controlled about 80 percent of the merchant market of this region. INOX had sales turnover of Rs 1000 million annually with an asset base of Rs 1,500 million with 20,000 cylinders and 20 tankers. Yet another competitor was AIMS, a Rs. 180 million turnover family-owned company based in Vadodara selling several industrial gases; it had 18,000 cylinders and 3 gas plants. GCL was ranked fourth in Western India following INOX, BOC, and AIMS.

An indirect effect of globalization and growing competition was that the user industries were forced to focus on their core businesses and procure the required gases from outside. The total market size was estimated to be Rs 2,000 million in the western region which has been growing at 15-20 percent since the late 90s. Besides, concentration of petroleum based industries in Western India, and also rapid industrialization of Gujarat and Maharashtra with estimated investments of more than Rs 500 billion during 1995 - 2000 made the region very attractive for investing in this business. With the arrival of international players, it could be assumed with fair degree of certainty that a battle was due between giant companies on the strength of technology and marketing skills. Indian companies, especially family owned, were bound to have a difficult time.

GCL's Efforts to Grow

Both the major products sold by GCL namely, ammonia and argon have been in short supply in the country. In fact, shortages in supply impeded the market development which had potential to grow. The organizational response over the years has been slow that maintained the shortage.

The government opened the LPG market to the private sector in late 90s, and Gadhvi planned to exploit the opportunity by importing it, and identified a jetty to be acquired for this purpose in Jamnagar, Gujarat. Energy Ag-Tech, promoted by an experienced technocrat turned manager KL Tanga was appointed as consultant for the project. The proposed project had a number of loose links and uncertainties and consequently made very little headway. Tanga was asked if he would join GCL which he did as its executive director on January 1, 2000.

Tanga, who believed growth to be imperative for survival for any Indian company, started realizing that GCL would not be able to attain any significant position in the industry by trading alone, suggested that consider owning GCL a gas manufacturing plant. Such a plant would also enable GCL to expand its product range as also geographical area of operation. Since a new plant entailed large investments and gases produced were not likely to be competitive in the market, GCL commenced search for a second hand imported plant. Gadhvi and Tanga visited Europe in May / June 2000 for procuring a second hand air separation plant as also to feel the international scenario for the gas industry and to explore possibilities of a tie up with a major gas company. Such a tie-up was considered as panacea by most Indian industrialists then.



The ISB Annual B-School Fest
2005



Liquid Gold (LG)

Gadhvi and Tanga visited a number of companies in Europe, including a second hand plant in Spain, which belonged to a subsidiary of the world's largest gas company, Liquid Gold. Gadhvi, Tanga and their UK based consultant Narain visited the head office of Liquid Gold in Europe and made a presentation to Adrien Tesse their Group Vice President, International Business. It was known later that LG's earlier efforts to form a joint venture in India with INOX, did not fructify when INOX refused LG's demand of holding 51 percent of the shares. Though LG had one of the best technologies and was flush with funds, it lacked detailed information on Indian market and a base to take-off. It would be worth mentioning that LG was not new to India, for they had a collaboration having majority share holding in a company in Secundrabad to manufacture gas manufacturing plants and cryogenic vessels. LG had realised that to become a leader in India, as was its position elsewhere; it had to partner with someone to compress time.

The presentation covered Indian economic scene, potential of the state of Gujarat for investments, and growth prospects of gas industry in view of the proposed large investments in Western India. Tesse appeared informed about Indian gas industry. During the conversation he commented, "LG has plans to enter India which will be the 62nd country of operation. There is nothing negative at the moment with GCL and therefore our LG representative would visit GCL later and discuss the matter further". On the issue of the Spanish plant he commented "LG does not believe in selling the cow, it will sell milk".

Liquid Gold India Holding (LGIH), a 100% subsidiary of LG, was registered in India to channel investments. LG achieved major success when a Gujarat based float glass manufacturing company; set-up by a US multinational awarded a contract to supply nitrogen to LG, after discarding its existing suppliers INOX and BOC. LG had to source nitrogen till its plant was set up at the premises of the glass manufacturer which was likely to take at least a year for completion. For this, LG located a steel major in Hazira which had installed an air separation plant for its captive use. There was, however, a possibility of augmenting the capacity with addition of some equipment. A contract with the steel company saw another partnership developing for LG according to which LG was required to bring liquefaction technology and funds, whereas the steel company was to commit its plant and invest additional funds. This was an equal partnership. The liquefier once installed would add a capacity of 150 tonnes per day of liquid oxygen, nitrogen, and argon. This arrangement would give LG substantial volume of gas for merchant marketing at very low cost compared to a stand-alone plant.



The ISB Annual B-School Fest
2005



Talks with Liquid Gold

Brute Baken who headed the LHH's merchant market operations in India visited Ahmedabad in July 2000 and held discussions with Gadhvi, Tanga and finance manager Shah. They agreed to know each other better without commitment on either side. Baken clarified that LG always held majority share holding, did not have public listing, and had very little dependence on debt. Baken also mentioned that since they found it almost impossible to find a single partner for the whole of India, he was looking for partners in each region. He said that there could be an amalgamation of the regional companies at a later date. LG would prefer a partner who would have: large gas requirement contract, market strength, long term potential to develop market, financial stability, credibility, and similar philosophy of work as LG on people and safety. Baken also revealed that as part of restructuring in LG, Colman Kenses was to move from Australia to Europe to look after world wide services and would be responsible for Indian operations. He promised to discuss the matter with Kenses and Tesse. During informal discussions he said that in five to ten years, only international players would remain in Indian gas industry, as was the case all over the world.

In September 2000, Gadhvi and Tanga met with Baken, Tesse and Kenses. Kenses revealed that LG was having a dialogue with another company for tonnage business in Gujarat, and for merchant joint venture, GCL was identified for further discussions. It was decided that Baken would visit GCL plants and have more interaction with people. Subsequently, Baken visited the Vadodara plant of GCL in October and a prospective customer in Bombay the next day. LG, by now, had realised that GCL could offer them, as a partner, experience of trading in local market, distribution network and contacts. In turn LG could offer its technology, name, and international experience. Moreover, LG would have one less competitor by having GCL as partner.

Baken gave a draft Letter of Intent to Tanga in Delhi in November for an association between LG and GCL. The key points in it were: LG would hold 51% in the joint venture and geographical area of market operation would be limited to Gujarat. A modified Letter of Intent was drafted by GCL in consultation with a management expert, a leading company law practitioner, and financial advisor to the Gadhvi group. According to it, the geographical areas would cover Rajasthan, Madhya Pradesh, Maharashtra, and that the share holding of the parties would be equal. GCL also felt that a Memorandum of Understanding (MOU) should be signed in place of the Letter of Intent which would enable them to form a joint venture quickly. A draft MOU was prepared by GCL in December which stipulated that the positions of Managing Director (MD) and Chairman of the joint venture should be shared between the two companies. The share holding pattern was kept blank. During a meeting the same day Baken and his colleagues insisted on their having 51 percent share holding and their nominee as MD in the proposed joint venture. He also offered to let GCL to visit any of their other joint ventures to assess the relationship LG had with its partners. It also offered to show its technological strength. GCL appreciated their gesture but showed no hurry in pushing the discussion further.

However, LGIH wanted to close the deal early and met GCL people in Ahmedabad in early January 2001. This meeting was attended by Kenses, Baken, and Mistry for LG and Gadhvi, Tanga, Khevi (daughter of Gadhvi) and Patel for GCL. Kenses mentioned then that they were talking to other possible partners too. Kenses said, it was very difficult for LG to agree to anything less than 51% share holding as also giving away management control. He,



The ISB Annual B-School Fest
2005



however, offered chairmanship of the joint venture to GCL with cylinder business responsibility and position of MD to LG with responsibility of new business development.

GCL deliberated internally and offered three alternate options:

- Option I:
- a) GCL 51% LG 49%
 - b) Executive Chairman / MD to be shared but both executive; 4 directors each.
 - c) Only merchant business.

- Option II:
- a) GCL 50% LG 50%
 - b) Merchant + Tonnage (less than Rs. 5 Cr investment)
 - c) Other terms as per Option I

- Option III:
- a) GCL 35% LG 35% Public 30%
 - b) Other terms as per Option I

LG made it clear that it was not interested if a third party was to be brought into the joint venture. The meeting was inconclusive.

Europe visit for contacts and assessment

A visit to LG Europe was organized for Gadhvi, Tanga and Khevi for technology assessment and interaction in mid February. Gadhvi did not visit, while Tanga and Khevi had a full exposure to technical capabilities of LG. On one of the days, Louis Gerald, CEO, LG invited them for lunch and had informal discussions. On a question on policy of LG towards its partners, Gerald said LG treated its partners with respect. He also said that it was difficult for LG to agree for anything less than 51% share holding and that management control has to be with LG in view of the sophisticated technology involved.

Baken handed over another draft MOU to Tanga in Europe. It said that LGIH would hold 51% and have its nominee as the MD; the area of operation would cover Gujarat, South of Jaipur and Bikaner in Rajasthan, Gwalior (in view of another joint venture of LGIH in Delhi) and “limited” areas of Maharashtra. During separate discussions Tanga and Khevi had with Kenses, he shared his vision of becoming a leader in Western India in line with the trend world-over, and investment possibility of Rs.100 million by the merchant joint venture in the next five years. Tanga noted that this figure differed from the Rs. 500 million previously mentioned by Kenses in Ahmedabad.

Further negotiations

Tanga again met Kenses in early March when the latter visited Delhi, when he expressed Gadhvi’s concern of losing an active role for himself in business once the joint venture took off. Kenses offered two modified alternatives:



The ISB Annual B-School Fest
2005



Option I

GCL and LGIH were to have an equal joint venture with GCL's nominee as chairman and LGIH's nominee as the MD. Also, both would have 3 directors each. He also agreed to the constitution of an executive committee comprising LGIH, GCL, and MD to take key decisions below the board level and developing a system to share information to ensure transparency in dealings.

Option II

Form two companies with 60 percent holding for GCL in one and 40 percent in the other with LG holding the remaining equity. Tanga spoke to Gadhvi on telephone who did not like Option II as he was apprehensive of any role for GCL after about three years. Later Kenses also said that he also preferred Option I. Kenses added, "Each partner should have a right to follow growth but not the capacity to refuse."

Discussion at Home

R V Gadhvi was the eldest of the brothers who took care of the management of GGL, while the other brothers had independent charge of other family owned companies. Their father was the chairman of all the companies, and all the brothers were members of the board of all the companies. While some of the companies were in a comfortable position and did not face major competition, some others were threatened with competitive forces. This included GGL. All the sons were on the board of each of these companies, and the shares were held equally by all including the father, each of them focused their attention on the companies managed by them. Their understanding of the strategic issues faced by the other companies was limited.

The Gadhvi family was well known in Gujarat and was respected for their entrepreneurial zeal and business acumen.

From time to time, Gadhvi briefed his father and brothers on the series of discussions he has been having with LG. Very often these were one-to-one interactions. Gadhvi wanted to ensure that he had the backing of his family members, who like him, wanted to do anything to preserve the family name and social standing. All of them said that since the gas business was running profitably with substantial market share and brand equity, they should not meekly surrender themselves to any MNC. Being the eldest, Gadhvi also did not want to create road blocks from the family later.

Signing of MOU

In the meantime, Gadhvi had a full fledged meeting of the entire board at home when he got clearance from his family members for the option in which LGIH and GCL would have equal holding and three directors each including LGIH's MD and GCL's chairman with casting vote. Gadhvi told the family that he expected financial institutions to have nominees on the Board at a later date. Tanga informed Kenses their agreement on management terms but with a request that Chairman should have a casting vote keeping in view the prevalent practice.



The ISB Annual B-School Fest
2005



The final draft MOU from LGIH came towards the end of March. It had incorporated 50:50 equity; geographical areas clearly defined except that areas of Maharashtra were left undefined; Liquid Gold Gadhvi (P) Ltd as name ; purchase of only assets of GGL by the joint venture company; initial equity of Rs. 20 million; 4 directors for LGIH and 3 for Gadhvi; Chairman from Gadhvi but without casting vote ; MD from LGIH, and an Executive Committee of 2 persons to work as conduit between MD and Board.

Tanga suggested Baken to consider the following: Name as Gadhvi Liquid Gold (P) Ltd, in view of awareness of the Gadhvi brand in this part of the country; define areas of Maharashtra as was done for Madhya Pradesh and Rajasthan; acquisition of GGL shares rather than purchase of assets to avoid taxation; LG spelling out technology transfer charge payable by joint venture company.

LGIH agreed to acquire shares rather than purchase assets of GGL which was located in a backward area. The technology transfer cost was estimated by then to be 2% of turnover as was generally done world over. The matter of casting vote by chairman was deliberated in April 2001 and MOU was signed at Ahmedabad by Kenses and Gadhvi in the presence of Mistry, Baken, Tanga and Patel. It had by then incorporated the following: Joint venture to have authorized capital of Rs. 200 million; initial issued share capital to be sufficient to finance first 12 months' activity of the joint venture without recourse to debt.; name as Liquid Gold Gadhvi (P) Ltd.; directors 7 (4 LGIH and 3 GCL) with a constant proviso for LGIH to have majority of directors.; Casting vote of Chairman agreed but with a condition stipulated that “ no resolution to be passed without LGIH directors constituting a majority of the directors present”. It was decided that LGIH would be allowed to carry out a due diligence of GGL within the validity period of three months of the MOU.

Post signing developments

Having signed the MOU, GCL asked LGIH to work-out investment plans and financial projections for the joint venture for the next five years. Baken visited Ahmedabad in early May to workout sales forecast. He wanted to take inputs from GCL since he knew very little about the market. During his visit Baken talked to Gadhvi about recruiting a metallurgist who was earlier selected by LGIH. He also informed that the person would be placed at Vadodara. Gadhvi asked him to go ahead as the joint venture was being managed by LGIH.

A fax message sent by Shah the next day to Baken requested him to give priority to due-diligence. The message also contained a question as to why the metallurgist be based at Vadodara and not Ahmedabad and suggested that the appointment should be withheld till the joint venture took off; Baken expressed his anguish over telephone to Tanga over this volte-face.

Tanga and Gadhvi decided to raise all possible issues which could at a later date cause strain in their relationship. These points raised through a fax message by Tanga to Baken were: Market valuation of shares of GGL, distribution of gases by GCL and not the joint venture, location of office of the joint venture, and appointment of key staff of the joint venture.

Baken and his company secretary met Tanga and Gadhvi in mid March and decided the following: due-diligence would continue; they would discuss further loss of turnover to GCL if distribution was done by the joint venture;



The ISB Annual B-School Fest
2005



Executive Committee to take decisions on key personnel appointment, investments, business strategies and performance, and issues relating to safety, competition and customers.

While talking separately to Tanga, Baken drew a sketch of the organization structure he had in mind. He felt it to be necessary to have an expatriate MD for the initial years. He also confided LGIH's intention to groom Tanga to be the MD when the expatriate left. They would also train Tanga abroad on the culture of management of LG. Baken appeared quite disturbed after his meeting with Gadhvi the same evening and left for the airport in a hurry. In his next visit he disclosed that Gadhvi had given quite a negative opinion on the idea of Tanga being taken for the joint venture.

Baken visited Ahmedabad again to further discuss the issue of distribution of gases by GCL and not the joint venture as desired by Gadhvi. He made his position clear that at no stage it would be possible for the customers of the joint venture to be serviced by GCL. The other issues to be discussed included forecast for five years, due-diligence of GGL and rates of purchase of gases from tonnage joint venture of LG. Baken had, by then, a clear idea that the merchant joint venture would not be profitable unless it sourced the gases from the tonnage joint venture at reasonably lower prices. The problem at hand was how to reduce interest burden arising out of huge investments in the tonnage joint venture. Being a cash rich company, LG could afford to bring larger equity but the Indian partner had limitations. One solution was to bring in loans from the merchant joint venture with low rates of interest with a bait of supplying gases at prices much lower than the market. Baken therefore proposed an increase in the investments to enable the merchant joint venture to offer loan to the tonnage joint venture. This meant larger subscription by GCL which had limited funds at hand; incidentally, the Gadhvi family was also contemplating other projects. The discussion generated two possibilities: GCL to match investments with LGIH or split the business scope into two; one for liquid and the second for gases and have joint venture for gases only. The road by then had taken many a sharp turns causing discomfort to both the parties bringing the mistrust they had with each other to surface. In subsequent discussions between Baken, Gadhvi and Tanga, they explored possibilities of keeping the cylinder business with the joint venture and the liquid business with LGIH independently.

The MOU already signed needed changes in view of the alterations in the scope of business. Baken suggested that Tanga draft one and send. A revised draft MOU was sent in the last week of June incorporating major changes such as; share holding to be GCL 51%, LGIH 49%, Directors equal numbers, LGIH to have MD and GCL to have the Chairman, concurrence of all present required for passing of any Board resolution and the name to be Gadhvi Liquid Gold Ltd.

Baken responded immediately that LG would not accept any holding of less than 51%, the name of the company should begin with Liquid Gold, customer control should be shifted from GCL to the joint venture within a period of two years, and the chairman should not have a casting vote. Baken visited Ahmedabad again in the beginning of July when the following three options were generated: GCL to accept the MOU signed earlier with the change in scope of business to cover cylinder business only, LGIH to consider subscribing to non-voting shares for the increase in capital, allow the MOU to expire on completion of three months stipulated. Baken subsequently expressed his regret for LG not accepting the second solution as also to hold 49% shares. He wrote, "Unfortunately this does not leave us with any option than allowing the MOU to expire". He, however, added that, "the possibility of resuming talks existed" and proposed to meet after three months.



The ISB Annual B-School Fest
2005



Gadhvi's dilemma at home

While Gadhvi realised that collaboration with LG would strengthen the competitive position of GGL, he was acutely aware that the rest of the family members did not appreciate the emerging competition scenario. He was not sure of the implications of the series of proposals from LG, as also the response of his family members. He had to formulate the strategies both for the business and family.

Questions

1. Why did the negotiations take so long?
2. Why did GCL keep changing its position? What were Gadhvi's concerns at business and family?
3. Why did Gadhvi insist on chairmanship for himself?
4. What should he do?
5. What are the key learnings?

