

JSPL in Bolivia – A Case of Failed Foreign Statement

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Abstract: *Jindal Steel and Power Limited(JSPL), one of the big-shots in Indian steel scenario ventured into Latin America in 2007 by winning a contract of iron-ore mining and integrated steel plant in Bolivia. The scene was jubilant for JSPL as it had the better of Lakshmi Mittal in the competition of bagging the contract awarded by the Government of Bolivia. But soon things started falling apart. Several problems cropped up between the company and the government. First being the land allotment issue where the Bolivian government could not hand over the agreed area of land to JSPL for starting the work. Next being the gas supply which the government should have made available to the company after the signing of agreement but failed to provide the supply required for operating the plants. Adding fuel to the fire, JSPL did not make investments on-time citing infeasibility of operation due to unavailability of land and gas supply. These problems led to Bolivian government invoking the Bank Guarantee for the first time in 2010 alleging the losses in revenue that it has faced because of inactivity of JSPL. The trust was completely breached when the government invoked the Bank Guarantee for the second time in 2012. Soon after, Jindal announced that it no longer can continue the contract and decided to terminate it. The government retaliated by filing cases against Jindal's employees, arresting them and seizing their machinery assets on-site. Jindal exit from Bolivia. Though the government called for reconciliation talks, the talk did not happen as JSPL management feared that its diplomats would be arrested if they land in Bolivia. JSPL moved to ICC for arbitration and for recovering its assets and investment*

JSPL-The Company Background:

Jindal Steel and Power Limited (JSPL) is an Indian steel and energy company headquartered in New Delhi with a turnover of US\$ 3.56 billion. The flagship entity of industrialist and Parliamentarian Naveen Jindal, JSPL is a part of about US\$ 17 billion Jindal Group⁶. The company is a leading player in steel, power, mining, oil and gas and infrastructure in India. The company produces steel and power through backward integration from its own captive coal and iron-ore mines. In terms of tonnage, it is the third largest steel producer in India. The company manufactures and sells sponge iron, mild steel slabs, iron ore, mild steel, structural, hot rolled plates and coils and coal based sponge iron plant. JSPL has an aggregate capacity of 5.5 MTPA in India and 2 MTPA outside India. It plans to augment its capacity to 11.5 MTPA by 2015-16. It mainly exports steel in West Asia, Africa, Southeast Asia, Taiwan and the Arabian Peninsula. The exports contribute 20-25 per cent of total steel products.

JSPL floated a fully-owned subsidiary for the project Jindal Steel Bolivia, with a debt-equity ratio of 60:40. It raised the required amount, of which it would have to invest \$1.5 billion in the initial five years, from banks and other financial institutions in the international market, also hinting at issue of FCCBs.

About the Steel industry:

The Indian steel market is valued at US\$ 57.8 billion in 2011 and is expected to touch US\$ 95.3 billion by 2016. The final steel produce output has been growing at a CAGR of 6.6 per cent and 4.2 per cent over FY08-11 to reach 69.6 million tonnes (MT) and 66 MT respectively. PSUs like SAIL, RINL and private players like Tata Steel, Essar, JSW are the major competitors in the industry. It is expected that consumption of steel will grow at 6.8 % to reach 104 MT by 2017 as other sectors like automobile and construction pick up.

Sector wise market share of Steel Companies in 2010-11(in %)

	SAIL	Tata Steel	JSW Steel	Essar Steel	Others (including imports)
Construction	11	6.3	4.3	1.6	76.8
Automotive	3.5	23.6	14.8	7.1	51
Power plant equipment and construction	25.5	0.2	1.7	3.3	69.3
Other capital goods	17.6	4.2	27.4	7.7	43.1
Oil & gas, water transportation	0.3	0	7.5	10.4	81.8
Railway wagon	73.3	3.5	0	0	23.2
White goods	4.8	25.4	7.3	13.5	49
Tube making	36.5	16.3	15.9	5.6	25.7

Source: SAIL

The infrastructure sector is India's largest steel consumer, accounting for 63 % of total consumption in FY11. The Government of India (GOI) has allowed 100 % FDI in the steel sector through automatic route. Nowadays, Indian companies are eyeing resources abroad in order to put in place their strategic growth plan.

Why Jindal ventured into Bolivia?

As per its long term strategy, Jindal Steel & Power aims to generate 50% of its revenue from the overseas markets within the next eight years. Currently, it generates only around 20% from Africa and West Asia markets. In order to scale up its share of revenue from overseas markets, JSPL has been scouting for assets in iron-ore and coal businesses in the Africa region⁸. This strategy is based on the risks involved in infrastructure business in the country where proposals for land acquisitions and environment clearances takes a lot of time. The company has also faced similar problems on all its steel and power projects and sees an opportunity to expand global operations also to de-risk its domestic operations. In Mozambique, it has set up a 10 MTPA coal mining operations and 2640 MW thermal power plant. In Oman, it commissioned a 2 MTPA plant, which the company claims would be the largest steel plant in the Gulf region. JSPL acquired 32.5% stake in Gujarat NRE Coke's Australian subsidiary which has two producing coking coal mines in Australia, which are estimated to have reserves of 125 million tonnes (MT) and resources of 651 MT.

On similar lines, JSPL found it a good catch when Government of Bolivia came up with a call for tender for setting up mining operations in El Mutun near Santa Cruz, Bolivia (Refer to Exhibit-1). El Mutun mines have an estimated 40 million tonnes of iron-ore deposits¹⁰. The entire iron ore deposits in India sum up to 28.5 million tonnes only. Considering the huge potential behind the iron-ore resource base and the opportunity to enter the Latin American market, JSPL decided to fight it out with other competing firms to get the mining contract⁹.

The Mining Agreement:

JSPL overcame competitors including the Mittals to finally get the contract after company representatives had several round of talks with the Bolivian government. The contract was signed with Government of Bolivia in the year 2007 for investing US \$ 2.1 Billion in Iron Ore Mining, Pelletization plant (10 million ton per annum), Sponge iron plant (6 million ton per annum) and Steel plant (1.7 million ton per annum) a Power plant of 450 MW and a rail or road link to the nearest river port². Till date, this was the single largest foreign investment in Bolivia.

The conditions were that Jindal will have to pay a royalty of 8-9 per cent for iron ore, 10 per cent for concentrate (pellets), 7 per cent for sponge iron and 5 per cent for steel, all on exports. Another clause was that the surplus production will be exported only after catering to the domestic market there. The investment was planned to be \$300 mn every year for 5 years, then \$200mn every year for next 3 years planned and the land allotted for the integrated steel facility was 5000 acres⁹.

Political and Investment climate in Bolivia:

Bolivia was a poor economy in South America. Evo Morales, the President of Bolivia has been at the helm since 2006. He was a friend of Cuban Fidel Castro and Venezuelan Hugo Chavez. This clearly showed his socialist inclination. But he was very concerned about his people. He shifted his stance¹ to handover the mining rights to a foreign company. Also, this project was the biggest foreign direct investment made in history of

Bolivia. The government expected to earn \$ 200 million annually out of it and it is expected to provide direct employment to 2,000 people and indirect employment to 10,000 people. This showed how much trust and expectation Evo Morales and his government had on the Jindals.

But there were several cases of nationalisation that happened in Bolivia¹². Recently in 2006, Bolivia nationalised Petro-bras operations. There were rumours of many multi-nationals planning to exit Bolivia because of the nationalisation drive and anti-market reforms(Refer to Exhibit-3). This El Mutun project was so personally close to Morales that he wanted to usher in a new era of investment driven growth in the country.

Well Begun:

Jindal Steel Bolivia came into existence soon. It had set up offices and deployed manpower soon and started developing the project. The company expected to earn an internal rate of return of 15-20 per cent on the investment. The project would start production of pellets in 2009 and long steel in 2011. The maximum revenue would start flowing from the fifth year.

It deployed around 300 people for its operations and even sent 15 Indians there. Senior JSPL executives fled in and out of Santa Cruz frequently². The company subsequently set up a guest house and even stationed two Indian cooks there. To earn goodwill from the locals, it conducted medical camps and distributed free medicines. They even held vaccination camps for pets and street animals. They sponsored hygiene campaigns and donated movable infrastructure to 200 schools.

The First Hiccup:

Everything was going smooth for Jindal until it hit the first roadblock. The Bolivian government did not transfer the entire allotted land for preliminary work. For the initial stages, only 1000 acres were accessible to Jindal. The rest of the land was caught up in litigation. The government did not do much to clear up the issue. In the meanwhile, rumours that Jindal was going to scale down the investment was doing around. A Jindal spokesperson had reportedly told few media persons that since land available in hand is just a fraction of what is required, the investments cannot be made as was planned earlier. At this point, the opposition parties in Bolivia and other rivals of the government started playing into the minds of people and the leaders and exploited the opportunity by creating a grey area between the government and Jindal⁹.

Jindal invested around \$90 million for the preliminary work and then held up the work citing non-availability of land.

Real Blow – Insufficient gas conundrum and the Arbitration:

The supply of natural gas is crucial for operation of the power plant and the integrated facility. As per the initial agreement, the government had to sign a contract for supply of 10 million metric standard cubic metres a day (mmscmd)of natural gas for the plant operations within 180 days of signing the agreement. The government never made that commitment. The officials earlier had said there are 27 trillion cubic feet(tcf) of gas reserves. So Jindal repeatedly called for government to provide access to gas reserves. But it was in vain. Till 2010 there was complete inaction from the government. In March2010, government invoked the bank guarantee(BG) of \$18 million citing no further investment from Jindal since 2008. It alleged that the company should have invested atleast \$600 million till now². It accused the company of causing potential loss of \$200 million⁴ in revenues by keeping the mines idle which it would have otherwise sold to other companies. In response Jindal moved to International Court of Arbitration(ICA) saying that due to non-availability of land and gas, it was not able to proceed further with the work and it had invested \$90 million till now.

Later in June that year, an advanced survey by a US company revealed that the gas reserves were just 9 tcf and the initial estimates were completely faulty. The company alleged the government of foul play and said that invocation of bank guarantee was completely uncalled for.

JSPL's argument: "The project got stuck when the Bolivian authorities did not provide gas linkage to the project. The fuel was crucial to the project because Bolivia does not have coal and even its import and burning in the country is not allowed. The Bolivians were trapped when they came to know that reserve estimates were faulty. They had signed gas supply contracts with Brazil and Argentina on pay and take basis. For fresh exploration another it would have taken five to six years. They could not tell us of the problem because their Constitution states that gas should first be provided for domestic projects but by exporting they were earning money, which they did not want to lose. They wanted to reduce our supplies from 6 MCM per day to 2.5 MCM."

At this point, misunderstanding between the government and Jindal was really peaking with heated statements being exchanged from both sides

Growing Ill-will:

In August 2010, Government handed over 3000 acres³ of land in addition to 1000 acres and Jindal resumed work on the land. Jindal had also made commitments to the tune of \$600 million on machinery assets and other payments till 2012. Then in November, the government made charges against Jindal for failing to achieve the export commitments to Paraguay and few other nations. JSPL Vice-chairman Vikrant Gujral, who headed the company's global ventures, had said that iron ore was shipped out of Bolivia through barges on the rivers and canals; with the onset of winter water levels had fallen very low, and as a result, exports were suspended. Of the order of 10,000 tonnes from Paraguay, he said, 7,000 tonnes had already been shipped. Gujral also said that the company would invest \$600 million³ by April this year.

The government accused Jindal of failing to bring in more investment. It promised 2.5 mmscmd of gas to Jindal from 2014 only if the company brought in more investments. It maligned Jindal's reputation by saying that company is incapable of doing such investments and managing such projects².

Complete breach of confidence –Invoking the second BG:

In April 2012, the government delivered another blow by invoking the second bank guarantee of \$18 million as there were no enough investments on ground as promised. Jindal accused the government that it was incapable to supply gas and took to ICA for the second arbitration. Government officials began to complain about the inexpensive gas promised to Jindal — \$3.9 per million metric British thermal units (mmBtu) for the steel factories and \$1.9 per mmBtu for the power plant — at a time when prices were on fire worldwide (over \$5 per mmBtu). Since the project wasn't progressing, the tension escalated.

End of the Honeymoon:

Realising that the project is going nowhere without the support from Bolivia, JSPL decided to terminate the contract in June 2012. It sent a letter to Govt. of Bolivia on 08th June 2012 conveying its intension to terminate the contract for investment of US \$ due to non-fulfilment of the contractual obligations on the part of Govt. of Bolivia⁵. It gave the government of Bolivia a 30-day window to resolve issues failing which JSPL can terminate the contract within 7 days thereafter. "In case Govt. of Bolivia comes out clean and informs as to how much gas it can actually supply and agrees to reconfigure plant capacity and investment and amend the contract JSPL can consider staying back and continue investing in Bolivia."

Nothing was done to sort out the issues, rather there were continuous altercations on both sides⁷. In July, JSPL had announced to its shareholders, employees that it is quitting Bolivia.

Bolivian reprisal—From bitter to sour:

Soon after the government heard of JSPL announcing its final decision, it arrested two Jindal's employees, filed cases on few others and seized the plant site in Porto Suarez and the machinery assets. JSPL took the issue to Indian Home Ministry for help. Bolivian Mines minister Mario Virreira offered a reconciliatory talk² at Indian Embassy in Peru for resolving the conflicts even as Bolivia accused JSPL of cheating. But JSPL wanted to have the talks in a neutral venue as it feared that its employees may get arrested. But the talks never happened.

Accusation: Bolivia accused JSPL that JSPL employees escaped out of Bolivia and transferred the investments to Cayman Islands. The govt. also complained to Interpol to track the JSPL employees.

Preliminary audit reports released by the directorate of legal affairs, ministry of mines, Bolivia, show that JSPL's investments have not even touched 3% of the commitment made under the contract. The Jindals seem to have invested merely \$12-15 million, while under the contract, they were supposed to invest \$600 million in the first two years. The company also seems to have defaulted on rentals due to suppliers of machines, including rented crusher (stone crusher), trucks and cranes as well as furniture and stationery. As per the contract, JSPL was required to invest \$5 million towards buying heavy machinery for the operations. Three local companies have reportedly complained to the Bolivian government over the debt contracts with the Jindals. JSPL owes these companies anything between \$200000 and \$650000 for rental of these machines. Some of these heavy duty machinery could have been leased from Brazilian companies because Puerto Suarez borders that country. To prevent these equipment to be transferred back to Brazil, the Bolivian local government has asked the police to guard the area.

Unconvincing Rebuttal: Vikrant Gujral said that “the company's investment worth \$100 million is stuck in the country along with other physical assets. JSPL exported some 22,000 tonnes of iron ore from the mines since September 2011 and around 70% of the earnings from this also went to the Bolivian authorities as part of taxes and royalty. The International Court of Arbitration had appointed an arbitrator to look into the issue. We will make sure that the investment does not go down the drain and is recovered” JSPL said that employees had left Bolivia as per Indian External Affairs Ministry’s orders as Bolivia had wrongfully filed cases against the employees⁵.

Mistakes and Lessons:

The fundamental problem was the negligence of the absolute political risk by the Jindals before deciding on taking up this project. In 2006, Evo Morales became the first-ever native Indian president in Bolivian history. Morales wanted to help the native Indians and he wished to show the first-ever steel plant project as a monument of his glorious government. His opponents wanted to bring Morales down and return to power. But Morales was frustrated by the slow progress of the project. Since the falling of iron ore prices coincided with the slow progress, it was thought to be the reason for the delay. But as time progressed, Morales thought that JSPL is not serious enough about the project and the investment commitment. At the end, Jindal could not give any excuses and could not justify its stance. But the allegation that it made helped the opposition parties.

The entire episode tells us that Jindal failed on the following few areas:

FAILURE #1: Understanding of the nature of the incumbent government: The nationalistic-leftist Morales knew how previous corrupt governments did business with western firms¹. By handing over the contract to an Indian firm, he was sure that they would not use their bargaining power or political influence of their governments, in executing the project. He also understood that India did not have a track record of supporting Indian companies abroad. In any case, Morales was already disappointed with the Indian government which had failed to honour its commitment of providing a line of credit for the supply of Dhruv helicopters.

FAILURE #2: Risk behind the huge investment: Investing \$2.1 billion in the poorest country of the region was way too risky. In addition it became the focus of the public and media in Bolivia. If the investment was in the range of a few hundred million dollars, the issue may not have exploded⁹.

FAILURE #3: How an easy catch: In their eagerness to get the contract, Jindal failed to detect something fishy: Why El Mutun with its huge deposits, at such a low price, stayed so long without being captured by the global players such as Rio Tinto, BHP and Vale – which operates mines in nearby Brazil? Nobody knew why, but there were rumours that it was a conspiracy by Vale and Brazil to prevent competition from Mutun.

FAILURE #4: Geo-political risk: Santa Cruz’s provincial govt. has not been in good terms with Morales’ federal govt. The El Mutun mine which is located in the Santa Cruz province, has always been a ground for the tug of war between the governments. Santa Cruz, controlled by the European-origin elite contributes to 35% of Bolivia’s GDP and attracts 40% of foreign direct investment. The threat of Santa Cruz separating from the central govt. dominated by the poorer native Indians who comprise 60% of Bolivia’s population was always there¹¹. The Santa Cruz politicians and businessmen used every opportunity to attack Morales and manipulated and used the Jindal project. Had the mine been located in an Indian-dominated province, it would not have had this fate.

Lesson-1: An all-round analysis of the people, culture and their sensitivities is more important than an exquisitely designed business plan when venturing into Latin America¹¹, a continent where people matter more than systems, rules and regulations.

Jindal was not the first Indian company to fail in Latin America.

- i) Dr. Reddy’s Laboratories’ JV in Brazil failed because DRL did not understand Brazilian management culture properly. Later they entered into Mexico with a 60 million dollars investment and tasted success.
- ii) TCS failed in Brazil during the same period; its contract with a local bank was terminated for alleged unsatisfactory execution. TCS too learnt from its mistake, and is now a success story in Latin America. Its key learning: hiring the right regional manager from Latin America who understood well both the Latino and Indian mindset.

Deploying Indian employees, as many Indian companies do, often fails; they do adjust but unable to get the best out of their investment as skilled local staff. Understanding local politics and culture is critical.

Lesson-2: Huge investments in small countries are a huge risk.

i) London-based Indian metals commodity entrepreneur Pramod Agarwal also made the same mistake. He invested \$2 billion in iron ore project in Uruguay, a small country of 3 million people. Later, a storm erupted between government, opposition, environment activists, farmers and vested interests. At one stage Uruguayan President Mujica even talked of holding a referendum on the project but fortunately did not. The company is now working with the government on the environmental impact. Rumours made rounds that Agarwal wanted to sell his project to Jindal, but the latter, busted in Bolivia, wisely declined the offer.

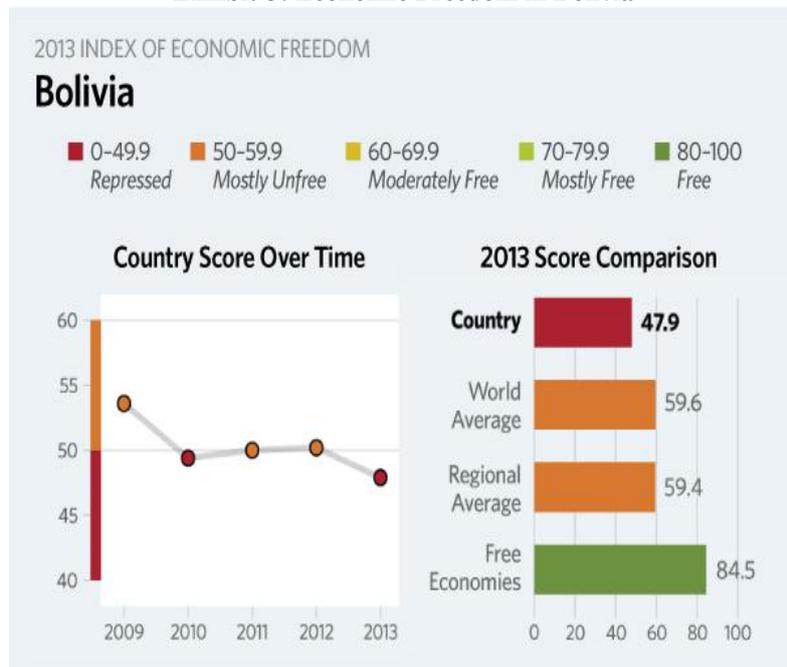
Exhibit-1: El Mutun location in Bolivia



Exhibit-2: Timeline of Events

Date	Event
2007	Agreement signed
2010	Bolivia invokes bank guarantee of \$18 million; Jindal goes for arbitration; Survey indicates gas reserves only upto 9 trillion cubic feet as against the earlier survey which showed 27 tcf
August 2010	Govt. allots another 3000acres; Jindal to resume work
Nov 2010	Bolivia chides Jindal for not meeting export commitments; Indian company promises to invest \$600 million by April 2012
April 2012	Bolivia invokes another bank guarantee; Govt offers to Jindal Steel 2.5 mmcmd
June 2012	Jindal tells employees and suppliers their contracts will end in September
June 16, 2012	Jindal announces exit from Bolivia; serves its intent to terminate the contract,
July 16, 2012	Contract terminated by JSPL
July 20, 2012	Proposed meeting to salvage the project doesn't happen; Bolivia acquires the assets of Jindal, takes control of the mines and arrests two employees

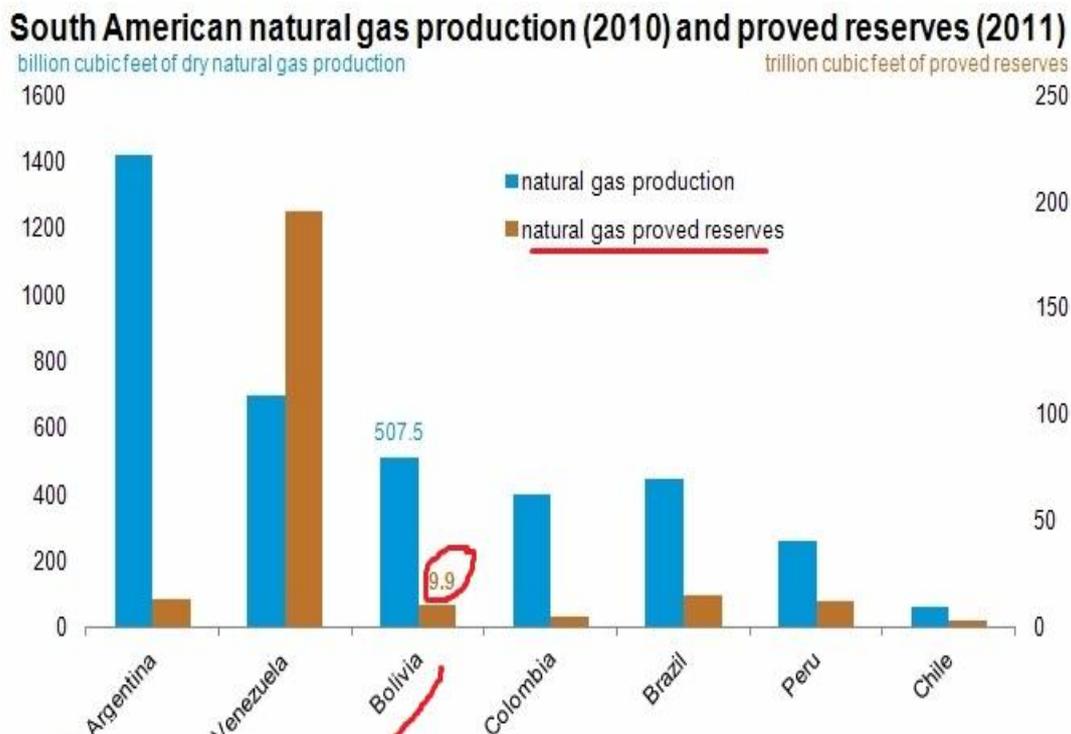
Exhibit-3: Economic Freedom in Bolivia



Source: Heritage.org

The Index of Economic Freedom is an annual index and ranking created by The Heritage Foundation and The Wall Street Journal in 1995 to measure the degree of economic freedom in the world's nations. It measures trade freedom, business freedom and investment freedom

Exhibit-4: Proven Natural Gas reserves in Bolivia



Source: International Energy Statistics, Oil and Gas Journal

Exhibit-5: Unaudited Financial Results of JSPL for the Quarter ending June 30, 2013

SEGMENT WISE REPORTING OF REVENUE, RESULTS AND CAPITAL EMPLOYED FOR THE FINANCIAL YEAR ENDED ON 30 th JUNE, 2013								
(Rs. In Crores)								
PARTICULARS	Standalone financial result			Consolidated financial result			Standalone Consolidated	
	for the quarter ended on			for the quarter ended on			Financial results for the previous	
	Unaudited	Audited #	Unaudited	Unaudited	Audited #	Unaudited	Audited	Consolidated
	30 th June, 2013	31 st March, 2013	30 th June, 2012	30 th June, 2013	31 st March, 2013	30 th June, 2012	31 st March, 2013	31 st March, 2013
1	Segment Revenue							
	a) Iron & Steel	3,152.20	4,032.16	3,056.31	3,606.74	4,840.63	3,678.18	13,968.43
	b) Power	491.05	550.78	576.61	1,086.38	1,130.06	1,275.01	2,255.59
	c) Others	169.18	79.68	85.91	234.39	126.67	136.02	347.92
	Sub Total	3,812.43	4,662.62	3,718.83	4,927.51	6,097.36	5,089.21	16,571.94
	Less: Inter-segment Revenue	387.24	448.92	387.74	387.24	448.92	387.74	1,617.24
	Net Sales/Income from Operations	3,425.19	4,213.70	3,331.09	4,540.27	5,648.44	4,701.47	14,954.70
2	Segment Results							
	(Profit+)/Loss(-) before Tax and interest from each segment							
	a) Iron & Steel	537.58	654.62	801.44	660.89	794.46	959.31	3,233.43
	b) Power	137.31	210.86	233.69	531.15	552.68	642.96	898.30
	c) Others	46.35	14.15	9.89	45.50	(23.28)	(15.90)	37.10
	Sub Total	721.24	879.63	1,045.02	1,237.54	1,323.86	1,586.37	4,168.83
	Less : Interest	231.79	236.87	218.57	267.53	238.73	186.10	920.90
	Other un-allocable expenditure (net off Un-allocable income)	170.95	15.70	232.27	300.73	143.76	328.42	445.31
	Exceptional Items	-	-	574.12	-	-	574.12	574.12
	Total Profit Before Tax	318.50	627.06	20.06	669.28	941.37	497.73	2,228.50
3	Capital Employed							
	(Segment Assets - Segment Liabilities)							
	a) Iron & Steel	12,095.20	11,521.72	9,526.34	15,718.77	14,955.84	12,704.73	11,521.72
	b) Power	5,695.56	5,706.27	4,528.12	8,595.64	8,474.22	7,021.86	5,706.27
	c) Others	588.00	545.33	544.15	2,179.31	2,118.58	1,763.39	545.33
	Total Segment Capital Employed	18,378.76	17,773.32	14,598.61	26,493.72	25,548.64	21,489.98	17,773.32

The snapshot of the statement shows Other Un-allocable expenditure as INR 574.12 crore, which was nothing but the writing off of assets by JSPL after the fiasco

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