



Marsh News India

News for Marsh clients in India



Taking The Risk Out Of Buying Internet Sites

It takes a brave entrepreneur to reject a \$US1 billion (39.7 billion rupees) bid for an asset of unproven value. That is just what Mark Zuckerberg, the founder of the internet phenomenon Facebook, did last year, according to the *Financial Times*.

Facebook allows users to post photographs, messages and imaginary gifts for their network of friends. By dismissing the reported offer, Zuckerberg took the risk that Facebook could develop into something much bigger, and more valuable for him. Zuckerberg later sold a minority stake in the company to Microsoft for \$US240 million, which put an overall value of \$US15 billion on Facebook.

But what of the thwarted initial buyer? They would also have taken a big risk had the transaction gone through. The offer was almost twice the previous record set for purchasing a cyberspace asset. The internet's history is littered with search engines and online tools that once dominated their fields and then were quickly overtaken by competitors.

Presumably, the prospective buyer did their proper due diligence work on Facebook. But as heat builds for cyberspace real estate, there are likely to be buyers who lose their heads and ignore the risks of websites failing to reach values above their purchase prices.

In India, the website-trading markets (both business-to-business and business-to-consumer) are in their early stages of development. But several of the larger Indian websites are attracting substantial media attention when they are bought and sold. For example, the owner of the highly popular

(continued on page 2)

This issue

- **Speedy Responses Are Needed To Protect Reputations**
page 3
- **Column - The Risks After Detarrification**
page 3
- **Newsbites**
page 4

(from page 1)

	Population (2007 est.)	Internet users (latest data)	Internet users (2000)	Penetration (Proportion of Total Population)	Users in Asia	User Growth (2000-2007)
India	1,129,866,154	60,000,000*	5,000,000	5.3%	13%	1100.0%
Total Asia	3,733,783,474	510,478,743	114,304,000	13.7%	100%	346.6%

SOURCE: www.internetworldstats.com *September 2007

matrimonial website shaadi.com, People Group, made headlines in press reports last year for selling stakes to venture capital funds and announcing plans to list in 2009.

Other websites reportedly planning to list in India during the next two years include Cleartrip.com, Rediff.com, MakeMyTrip.com and Sify Technologies.

India could take lessons from the United States market about valuing websites, but website-traders in the US could also learn more, says John Taylor, the Managing Director in the Los Angeles office of Kroll's Valuation Services Practice.

"During the 1990s internet bubble, website valuations were often based not on how much money they made but on how many people visited the website. People came up with metrics that appeared to make revenue meaningless in the internet environment,"

Taylor says. "But then the smoke cleared and people realised if they could not make money from a person visiting the website, there is nothing in it."

Projecting future cash flows of websites can be extremely difficult. But buyers can reduce the risk of losing from the deal by structuring contracts so a portion of the payments are made only if revenue targets are reached, Taylor says. These are typically over periods of between nine months and two years. Taylor says in a recent deal, the buyer paid only 15% of the original asking price because the website failed to clear set revenue hurdles.

Website buyers would benefit from taking a "lattice model approach" to valuations, advises Taylor. This involves assigning probabilities for each of the likely outcomes that could occur after a website is bought, and then using these risk calculations to

derive a present value for the website.

"This includes estimating probabilities for it hitting a grand-slam, and for it failing, and the most likely outcomes in between," he says. "Most clients do not like to do this but people forget that there are costs for making bad calls in this business."

A benefit of using the lattice model approach is that buyers can use it to argue objectively for a discount on a website's selling price, particularly when negotiating earn-outs. Taylor estimates that buyers successfully negotiate discounts between 15-25% on average from this approach.

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Speedy Responses Are Needed To Protect Reputations



When there is a problem with a product, the company that provides it has to respond more quickly than ever before to avoid having its reputation damaged. Recent experience has shown that it is not solely due to governments tightening their regulations but also from heightened consumer activism.

An Indian powder manufacturer found this out to its cost last year when it had to recall one of its inedible ceremonial powders, sindoor, from being sold in the United States after several people mistakenly ate it and fell sick. The powder had high concentrations of lead, according to media reports. US officials blamed the labeling of the powder's packages, which carried the logo, "The Best Taste in Town", while on the back it read "non-edible".

Manufacturers are also coming under increasing pressure from regulatory authorities to act quickly. Last year, the United States Consumer Product Safety Commission ordered US toymaker Mattel to report all claims of potentially hazardous product defects within 24 hours of being discovered. Business have a range of means available for dealing with these risks, including obtaining product recall insurance, advice on risks in their supply chains and making plans for fast recalls.

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The Risks After Detarriffication

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The end is in sight in the removal of tariffs from the insurance market in India. But buyers of insurance policies will have to think carefully about their attitude to risk and insurance when policy coverage is expected to become deregulated on April 1, 2008.

In most cases, consumers have been the winners as the property insurance market has seen reductions of around 51% during 2007. The latest moves are likely to produce further reductions,

estimated by various insurance players to be between 15-25%.

However, when assessing the real costs in the longer term, the outlook for consumers may not be so rosy. This is because insurers are likely to scrutinise the risks that individual policies carry more closely after detarriffication.

It is in the insurers' interests to seek to cover well-managed risks with low incidences of claims. Those risks that are not managed well and have a history of frequent or large claims are likely to be rated poorly, and some may find it impossible to find appropriate coverage at acceptable rates.

It is also likely that insurers will either seek to impose higher deductibles or offer discounts

on premiums if the customer accepts more risk.

For large companies that annually spend substantial amounts on their insurance, it is going to become extremely important they take a structured approach to identify, quantify and treat their risks. A prudent approach would be to use their premium savings on such things as loss control and training in risk management strategies. They ought to also think about broader forms of insurance protection that they may not have previously considered.

Detarriffication is offering insurance customers an unprecedented opportunity which they would do well not to squander.

Newsbites

Detarrification Shakes Up Policies

Consumers will have to read their new policies extra carefully after the detarrification of general insurance is expected to cause policy re-writes from April 1.

Home owners could be the big winners from the re-writes. Home insurance policies are expected to include cover for theft, reportedly says Marsh India Vice President, P. Balasubramaniam. At present, home insurance covers burglary and not theft. A burglary is where items are stolen from an unattended house, and theft is where someone steals valuables while the owner is present without their knowledge.

Car insurance policies are also expected to change. Policyholders will now be held responsible if there is an accident though the lack of proper maintenance of their vehicle. "If an insurance company can prove the vehicle was not mechanically sound or the owner had not taken reasonable care to protect it from damage, it can refuse a claim," says Balasubramaniam.

Purchasers of fire insurance could be disappointed: they may need to pay more if they require cover for additional items over and above the standard insurance cover. The number of "perils" included in the standard fire insurance base cover could be reduced from 12 to six, predicts Balasubramaniam. Riot strike, malicious damage, storm, flood, and inundation are among those he expects to be excluded.

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Kolkata Fire Hits Insurance Companies

General insurance companies are expecting claims amounting to at least Rs 1200 crore following the inferno that engulfed Kolkata's commercial area Burrabazar in January, according to early estimates reported in the media.

However, the outcome of the fire could have been much worse for the insurers: it is expected only 50% of the approximately 2500 shops that were gutted had any insurance coverage, says S.K. Nasipuri of Oriental Insurance Company, which has a 15% share of the Kolkata general insurance market. Nasipuri estimates that each of the insured shops would be covered for Rs one crore on average, which could take total claims as high as Rs 1250 crore.

The fire started in a 13-storey building at the Burrabazar wholesale market on January 12, and took five days to extinguish. A state government-appointed committee is expected to submit its findings on the fire's cause by early March.

The inferno also left its mark on the local environment. The Regional Director of the National Environmental Engineering Research Institute, Anjali Srivastava, reportedly found substantially higher quantities of oxides of nitrogen than normal in the area's air quality, and was also concerned about high levels of toxic elements in the sewerage water.

Reinsurers Face Losses, Go Slow On Underwriting

Buyers of insurance benefited from a "soft" global market last year, according to preliminary estimates by the international reinsurer Swiss Re. In 2007, insured losses caused by disasters amounted to about \$US25 billion (Rs 99,313.3 crore), up 56% from 2006. While this result is below long-term trends, there are signs reinsurers may remain cautious with rates as the perception of weather risk increases due to changes in the global climate.

There were three insured losses running into the billions of US dollars in Europe, two in North America and one in Asia, according to a Swiss Re report. The large losses occurred in the first half of the year and were concentrated in Europe and the second half of the year was quieter.

Indian insurance buyers can benefit from the soft market as large risks (insured for over Rs 10,000 crore) are re-insured directly into the international market, leaving more room for smaller risks in the local market.

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