Analysing the Adani Debacle*

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It comes close to a fairytale as one starts narrating the meteoric rise and fall of the Adani Group in terms of its changing fortunes or valuations in the market. I think history will reckon this as a singular event, at least for India, given the scale as well as the velocity of the changes – both during the spectacular ascent as well as in the downhill path ever since Hindenburg Research, a short seller agency, levelled serious accusations about the use of wide-ranging illegalities by the group.

The speedy route to the top

The road to success began in 1999, with Adani as a trader of imported palm oil in collaboration with Wilmar of Singapore. Seven key companies of the Adani group very quickly acquired ownership of most of India's infrastructure assets – including seaports, highways, airports, data storage, defence supplies and even jewellery. The Adani Group's valuation, according to Hindenburg Report, was at $218 billion, with Gautam Adani's share at $120 billion, mostly through share price escalation, i.e. market evaluation, since 2020.

All this leaves us with the big question as to how, on earth, the rise was made possible. And then what all were behind the fall, just like a pack of cards, as several people have remarked.

The actual rise

The rise of the Adani conglomerate was possible with the help of publicly owned financial institutions. Those included, first, loans from publicly owned institutions (SBI and LIC plus others like PNB) which seemed to have readily complied by using the high-priced (or overvalued) shares as collateral. Funding infrastructure projects mostly amounted to acquisitions of assets having long gestation periods and not greenfield projects.

Almost 75% of loans taken by the Group were from foreign banks and markets abroad and inflated stock prices would have greatly helped in being able to pledge shares as collateral.

With small or negligible sums obtained from equities and mutual funds, the ratio of debt to equities crossed the safe limit of 2:1. The high value of the collateralised shares were allegedly manipulated by using undisclosed shell companies – most probably owned by the conglomerate, as the Hindenburg Research report suggests. Those possible manipulations could have ended up working as the second channel of funding for the Adanis.

Operations in stock trading gave a third opportunity of gathering money. Use of margins provided unofficial credit sources. While generally open, those channels, if allegations are to be believed, may have proved more lucrative for the Adanis by dint of the sheer scale of their operations.

The rising turnover, made possible, adds to capitalisation and further profits. These routes could have provided lucrative business for the business tycoon.

Fragile edifice versus real expansion

That the edifice was rather fragile was the main accusation levelled by the Hindenburg Report on January 24 this year, which the Adani Group has strongly denied. But there has been a loss in Adani's wealth, down from $120 billion on January 24 to below $50 billion less than a month later.

Financial gains booked in the market on transactions do not originate from productive activities in the real economy. Thus stock market prosperity, as can be evidenced, does not necessarily generate real growth. If new stocks are sold in the primary market, those generate demand for real investments. However, when the same (old) stocks are resold in the secondary market, no contributions are made to real investments, even by pushing up the prices of stocks. Thus profits (capital gains) on the sale of old stocks relating to a firm (in the secondary market) do not necessarily lead to higher prices of new stocks and to their demand, as such stocks are launched by the firm. The mere expectations of higher stock prices generate larger demand in the stock market.

The Adani Group's steady advances were transmitted to India's major stock exchanges over the last two decades. But the gains remained within the financial circle, often reinvested in financial assets for speculation. The journey of the financial circuit, subject to market confidence, continued along a concentric circle which widened with rising asset prices, asset incomes and capital gains.

Asymmetry in downturn

However, there remains an asymmetry and financial sector disruptions do have some impact on the real sector and real economy. The explanation lies in the dual exposures of the real economy to the financial sector assets. First, with a drop in prices of financial assets held by the real sector having a second-round impact (wealth effect) via reduced real demand in the economy. Second, at a micro level, a proportionate decline in the net asset value for financial institutions having a similar effect.

Linked to the rising exposure of the real economy to the financial, there is evidence that the ongoing spate of output contractions and job losses in India as well as in different parts of the world does take place in the case of recurring financial crises.

Control fraud?

Let us get back to the notion of "Control Fraud" by the CEO or other "super-predators of the financial world", in William Black's classic book The Best Way to Rob a Bank is to Own One. The four privileges CEOs ostensibly enjoy include "suborn internal and external controls and pervert them into allies" (for example, to "shop" for an auditor that will aid their looting). The second is to "optimise the company by having it invest primarily in assets that have no readily ascertainable market value". Third:

"CEOs … to convert company assets into personal funds through seemingly legitimate corporate mechanisms." Fourth, their unique ability to "influence the external environment to aid".

Does not the above serve as a sketch of what has just happened in India?

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