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THE FUTURE OF BUSINESS

REBOOTING INDIAN CONGLOMERATES

THE EVOLUTION OF FAMILY OFFICES

INDIA AS THE NEXT INNOVATION HUB

THE FUTURE OF CONGLOMERATES... IS CONGLOMERATES

ARE CONGLOMERATES MAKING A COMEBACK OR HAVE THEY COMPLETELY LOST ALL RELEVANCE? THEY'VE NEVER REALLY GONE AWAY, AT LEAST IN INDIA. HERE'S WHY THEY ARE UNLIKELY TO VANISH IN FUTURE EITHER.

BY AVEEK DATTA

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A FEW WEEKS AGO, the world was united in watching the nail-biting efforts of a small group of cave divers, spelunkers, and the Thai Navy, to rescue a group of boys trapped in a cave in Thailand. Divers from Britain coordinated the rescue with the Thai team. Meanwhile, in far-away Los Angeles, tech wunderkind Elon Musk had put his research team to work on a small submarine that could help save those boys. That the successful rescue happened without the submarine is a different story, as is the flak Musk took for his efforts. What's fascinating is Musk's seemingly seamless transition from outer space to underwater research.

Actually, it's not such a leap. Musk is not just the man behind SpaceX and Tesla. He also founded The Boring Company in 2016, to create a network of transport tunnels to solve Los Angeles' growing traffic problem. Then, last year, Musk set up Neuralink, a brain-computer interface company. He is also the principal investor in a motley group of companies, ranging from solar panels to online payments to brain research. For all that he belongs very much to the present (and to the future, his fan club insists), Musk seems to be carrying on the legacy of the great American conglomerates of the 1960s such as ITT. And he's not alone. Companies like Alphabet (that's Google to those who haven't kept up) and Amazon are being fashioned, consciously or otherwise, as the great conglomerates of our time.

Here's why it matters. In the U.S., over the past couple of decades, conglomerates have taken a bad rap. After their meteoric rise in the 1960s, they've now become something the market shies away from; there's even something called a "conglomerate discount", where the whole is valued at far less than the sum of its parts. Judging by the way the market is treating them, you'd think conglomerates are on their last legs. Sure, there are large groups still flourishing, but will the future belong to small, focussed companies? As with many things, business is rarely binary. But before looking ahead, it may be a good idea to look back to understand why this question even matters. Let's start in 1892.

That was the year two electric companies (including one founded by Thomas Alva Edison) were merged, forming General Electric (GE). Almost since then, GE has been the gold standard of American capitalism. A shining example of American manufacturing prowess, GE made everything from light bulbs (of course), to aeroplane engines, X-ray machines, and power turbines. It even offered services such as home mortgages.

Till recently, it looked like GE could only go up. But the behemoth, which raked in $122 billion in revenue in 2017, appears to be collapsing under its own weight. Unbridled expansion into unrelated businesses at inopportune times (such as the acquisition of a home mortgage company just before the financial crisis of 2008) has led to a problem of sub-optimal capital allocation, resulting in the erosion of around $150 billion in market value since January 2017.

Remember, GE flourished during the glory days of conglomerates—and even after. In the 1960s, widely seen as the golden age of conglomerates, GE was already a star. And after the 1970s, when interest rates tightened and the market began seeing conglomerates as unnecessarily complex, GE was still shining. In fact, GE's success was often mentioned by those who believed conglomerates were being written off too soon; that was in the 1980s, when GE was headed by the legendary Jack Welch.

Cut to 2017 and the spectacular disaster faced by GE's investors in the U.S. The questions of the 1970s and 1980s are back—this time without GE's success as a rebuttal. Are conglomerates relevant, and even necessary, any longer? Or is the model broken and is

[redacted]

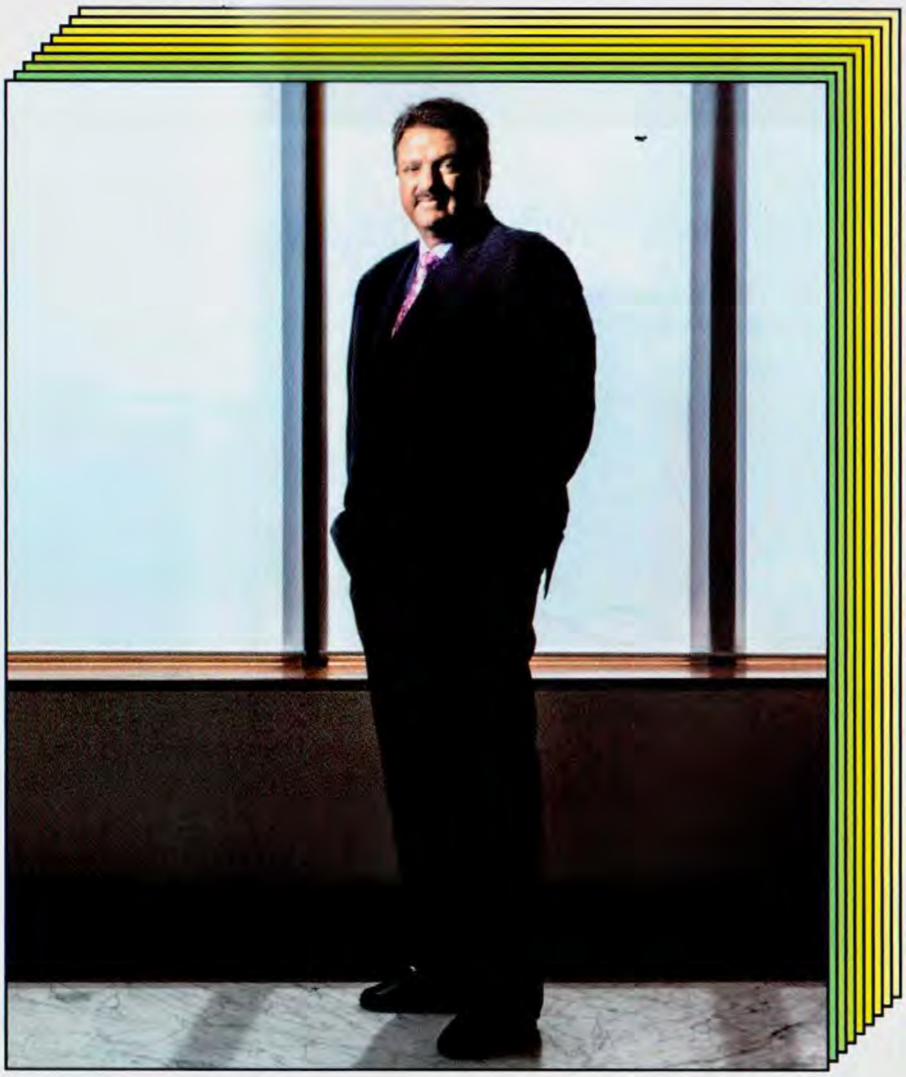
it better for businesses to be divided into smaller, nimble-footed companies?

Also, does all this even apply to Indian business? It's all very well to talk theoretically about the pros and cons of conglomerates, but does this matter at all here? While we may not have seen a similar rise and fall as the U.S., we do have a long history of conglomerates in India. And at a time when global forces do impact local decisions, what's happening in the U.S. could well affect our very own companies.

WHEN WE FIRST began discussing the future of conglomerates, or indeed, if there was a future for them, there was much furore in office. Some colleagues believed that conglomerates were here to stay; others said that there was really no such thing as a classic conglomerate in Indian business. Others were somewhere in between. The thing is, with so much dissent within a small group, I realised it would be necessary to first define a conglomerate and then see where Indian companies fit in.

So, to start at the very beginning, what is a conglomerate? The *Oxford English Dictionary* says a conglomerate is "a large corporation formed by the merging of separate and diverse firms". Succinct, but not detailed enough. Investopedia offers a little more: "In a conglomerate," it says, "one company owns a controlling stake in a number of smaller companies, which conduct business separately. Each of a conglomerate's subsidiary businesses runs independently of the other business divisions, but the subsidiaries' management reports to senior management at the parent company."

So now we know. But are Indian companies conglomerates then? Some, like L&T, are classic conglomerates. The $17 billion firm (13 on the 2017 *Fortune India* 500) has various divisions including infrastructure development, hydrocarbon engineering, metro and civil construction, shipbuilding and defence, IT, financial services, and real estate. Others like the $103 billion Tata group are structured more like business houses, with one flagship holding firm (Tata Sons) serving as the lead promoter of over 100 operating companies (many of them separately listed on the bourses) engaged in businesses as diverse as salt, steel, automobiles, and software. Then there's the Piramal Group (financial services, pharmaceuticals and real estate) and the Adani Group (ports, power, infrastructure, edible oil and real estate)—with various listed and unlisted businesses—and other family-controlled businesses.



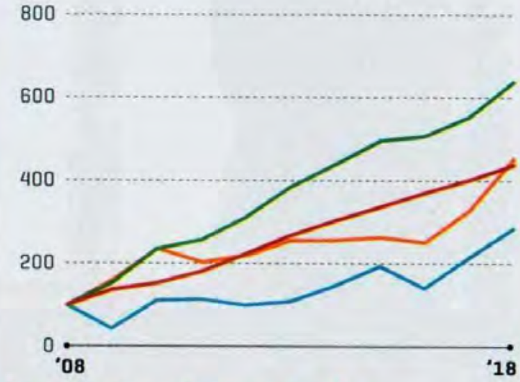
O Ajay Piramal, chairman of the Piramal Group, says that by functioning like a business group with the promoter holding a significant majority, Indian firms sustain business and create long-term value.

Classic conglomerates or not, the fact is most large Indian companies are diversified entities, and most of them identify as conglomerates. Most of them have a single owner, the family, and most power is centralised there. One of the big reasons for this, says Tarun Khanna, Jorge Paulo Lemann professor at Harvard Business School and director of Harvard's Mittal Institute, is the lack of large institutional players in business. Like most other emerging markets, India's network of independent intermediaries providing supporting services—market research firms, consultancies, and capital market advisory services—is still in its early stages; Khanna calls this an "institutional void" in his book *Winning in Emerging Markets*, co-authored by Krishna Palepu.

"When you don't have such external sup- ▷▷

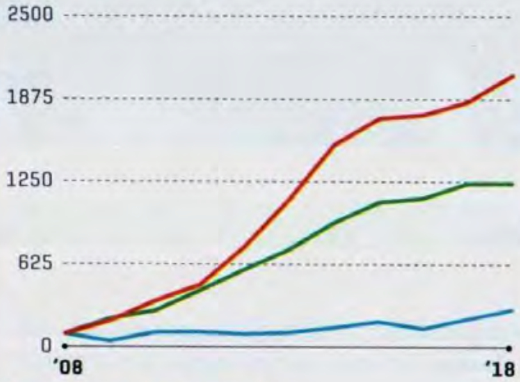
L&T GROUP OVER THE DECADE

How the markets reacted to the group's fundamentals



Group operating profit; group net profit; group revenue; group market capitalisation

How the markets reacted to the group's leverage



Group interest outgo; group debt; group market capitalisation

How the markets reacted to the changes in assets of the group

Group total assets; group cash & bank balance; group market capitalisation

ALL VALUES [IN Rs CRORE] ARE REBASED TO 100; AUDITED CONSOLIDATED FINANCIALS OF GROUP COMPANIES USED; 2017-18 VALUES ARE ANNUALISED, WHERE AUDITED NUMBERS ARE NOT AVAILABLE; MARKET CAPITALISATION IS ANNUAL AVERAGE FOR RESPECTIVE FISCALS [APRIL 1 TO MARCH 31]

SOURCE: CAPITALINE; *FORTUNE INDIA* RESEARCH

▷▷ port mechanisms, it becomes much harder for a standalone entity to survive the ravages of competition, uncertainty and turf wars," says Khanna, who serves on the boards of many Indian companies. "So business in India has taken the shape of a group structure where other group members can help out."

Ajay Piramal, chairman of the $2 billion Piramal Group, explains that functioning like a business group with the promoter holding a significant majority aids sustainable business and long-term value creation. A business group, which has delivered robust return on equity and capital over years and enjoys a stable credit rating, will always be the first to attract capital.

Speaking about the power of the group structure, Piramal says that when his group sold its domestic pharmaceuticals business to Abbott in 2010 for $3.7 billion, there was intense pressure on him to return the cash to shareholders. But he knew the promoters could create greater value with the capital generated.

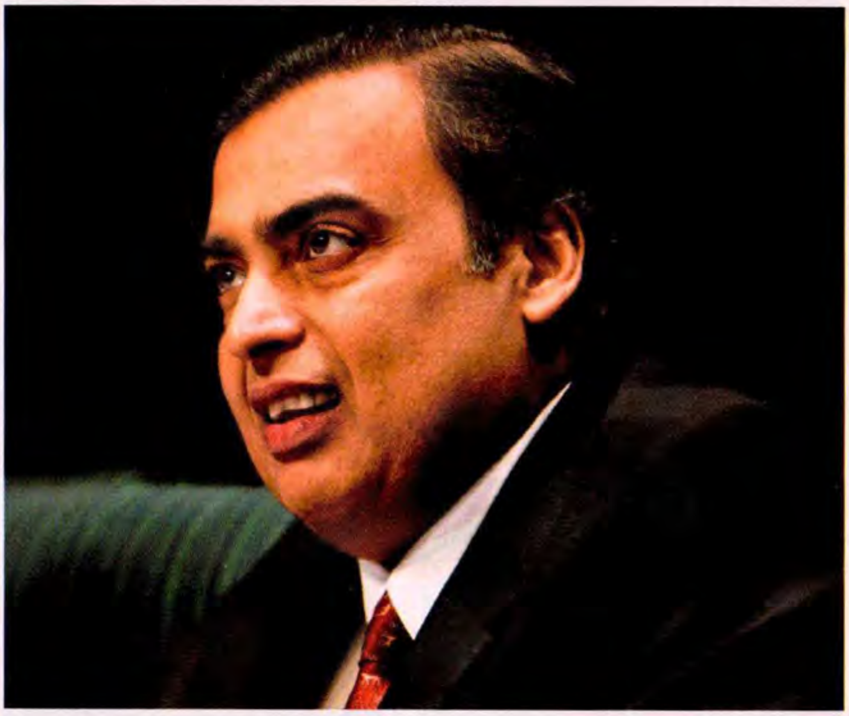
"We took a conscious decision to retain the cash in the company and generate further value, which would also be in our best interest," says Piramal. "Over the last six years, we have created more than 40% annual [market] value year-on-year and beaten every index. Since we are a conglomerate, we had cash available with us and other advantages like a brand name and the ability to recruit high-quality people."

Indian conglomerates have not had a similar history to their counterparts in the West. Here, diversified conglomerates were not so much because of strategic thinking as necessity. Harsh Mariwala, chairman of consumer goods giant Marico, explains that the Indian entrepreneurial landscape is dominated by business families, which started with modest standalone businesses. These enterprises did well and the promoter families decided to reinvest the cash from them into newer businesses. In the post-Independence; pre-liberalisation years, the government handed out licences for manufacturing goods that it believed were necessary. So, a company manufacturing toothpaste could end up with a licence to make light-bulbs. For companies with cash to invest, this was a good way to expand and diversify.

The story of the accidental conglomerate is undoubtedly fascinating. But even more fascinating is the story of how these con-

"HISTORY HAS SHOWN THAT MANY CONGLOMERATES THAT HAVE TRIED TO EXPAND INTO BUSINESSES THAT DON'T HAVE CLOSE LINKAGES WITH THEIR EXISTING ONES HAVE FLOUNDERED."

HARSH MARIWALA
Chairman, Marico



glomerates have managed to hold on to their markets and even consolidate and grow in the face of challenges.

TAKE THE TALE OF the 149-year-old Tata group. Just like GE entered the home loans business before the subprime mortgage crisis of 2008 and got singed, Tata Steel, too, made an audacious $11.7 billion purchase of Anglo-Dutch steelmaker Corus in 2007, just before the global financial meltdown. Tata Steel Europe (as Corus is now called) is bleeding cash to keep operations running every day. Tata Steel has now decided to run the European business in an equal joint venture with German firm Thyssenkrupp. (The Tata group declined to comment for this story.)

Tata has also faced challenges with other group companies like Tata Motors, Tata Teleservices, and Indian Hotels. Though a leader in the commercial vehicles market, Tata Motors' domestic passenger vehicles business has floundered over the years, losing market share to the likes of Maruti Suzuki, Hyundai, and Mahindra & Mahindra. Moreover, the Nano, a small car, once touted to be the cheapest in the world, has been a failure, with just one car made this June.

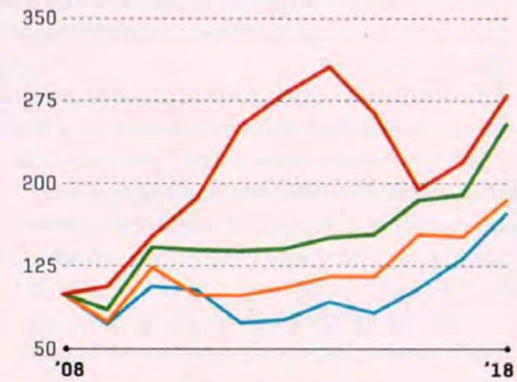
Elsewhere, after years of incurring losses ▷▷

Mukesh Ambani, chairman and managing director, Reliance Industries, says by the end of the group's fifth decade, its consumer-focussed businesses like Reliance Retail and Reliance Jio would contribute nearly as much to overall earnings as the energy and petrochemicals businesses.

AMBANI: GETTY IMAGES

RELIANCE INDUSTRIES THEN AND NOW

How the markets reacted to the group's fundamentals

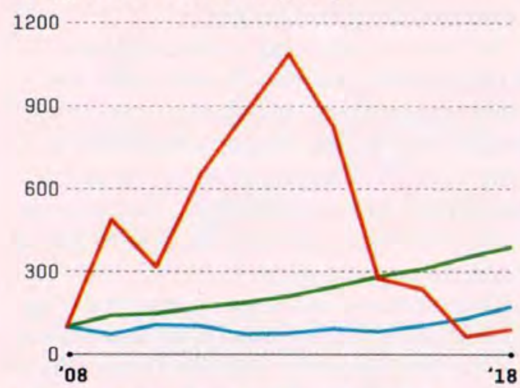


Group revenue; group operating profit; group net profit; group market capitalisation

How the markets reacted to the group's leverage

Group interest outgo; group debt; group market capitalisation

How the markets reacted to the changes in assets of the group



Group total assets; group market capitalisation; group cash & bank balance

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SOURCE: **CAPITALINE; *FORTUNE INDIA* RESEARCH**

▷▷ and fighting a battle with its Japanese partner, NTT DoCoMo, to offer the latter an exit, Tata Teleservices is being given away to Bharti Airtel. The loss of Rs 27,500 crore it posted in FY18 (on account of massive write-offs) was the largest loss in a single fiscal year reported by any Indian company ever.

Then there was the bruising boardroom battle between former Tata Sons chairman Cyrus Mistry (who was sacked in October 2016), and Tata Trusts, a clutch of philanthropic entities that control 66% of Tata Sons, including the trusts' chairman and Tata Sons' former boss Ratan Tata. The much publicised row, now mired in litigation, brought several troubling issues out of the closet, including allegations of mismanagement and corporate governance lapses. For the first time, Tata Sons and Tata Trusts had different heads, which led to a lack of alignment between the interests of the two sets of stakeholders in the Tata empire.

The larger issue that the Tata-Mistry feud points towards is the potential pitfall of having a complex organisational structure with cross-holdings between various group entities. Tata Trusts holds 66% of Tata Sons, which then owns the single largest stake in most Tata group companies.

Add to this a quest to raise capital for shoring up its holding in group companies, thereby getting greater dividends and protecting them from attempted hostile takeovers, which has led to a complex web of cross-holdings, which is confusing to say the least. While Tata Sons holds a direct stake in all operating companies, some of them like Tata Power, Tata Global Beverages, and Indian Hotels hold stakes in the parent company as well. Also, various operating companies hold stakes in each other.

But here's where being a diversified conglomerate helps. Despite the challenges, the Tata group's market capitalisation rose close to fourfold over the last decade to Rs 9.36 lakh crore. And information technology company Tata Consultancy Services (TCS), the proverbial jewel in the crown, accounts for close to 82% of the group's market value.

Tata Sons has announced its intention of acquiring stakes held by group firms in listed entities like Tata Chemicals and Tata Power, which will also help these companies to pare debt. Tata Power is selling its stake in Tata Communications; Tata Steel and Tata Motors are also paring their holdings in each other. Tata Sons, the buyer of these stakes, has mobilised resources to fund the purchases by issuing debentures to raise Rs 3,300 crore; it has also sold 2% of TCS for around Rs 9,000 crore, which again serves as an example of how the business group structure helps.

o Gautam Adani, chairman of the Adani Group, says the technology revolution has provided India the opportunity to leapfrog development cycles and solve some of the hardest problems.

IF COMPLEXITY is the hallmark of the Tata group, remember that this is not the only conglomerate we have. The Adani Group, founded by Gautam Adani, has grown into a formidable empire with interests in everything from mining to ports. The group is very clear that it doesn't want a complex web of cross-holdings.

Adani Enterprises is the flagship, and, in many ways, the 'holding' company, in the sense that it incubates new businesses and lets them go when they are capable of managing themselves. As and when these new ventures mature, they are spun off and listed separately, each with its own board of directors. Over the years, various companies like Adani Ports, Adani Power,

[redacted]

Adani Green Energy, and Adani Transmission have been carved out of Adani Enterprises.

"We don't have any cross-holdings. Adani Enterprises nurtures businesses till they are large enough to be independent," says Pranav Adani, director, Adani Enterprises and Gautam Adani's son. "If an investor wants to invest in a particular business and not others, he should be allowed to do so."

THIS STRESS ON SIMPLER structures is something the U.S. is also looking at. One of the reasons conglomerates there are getting a bad rap is because of the sheer complexity of holdings, something like the Tata group. Like most conglomerates, the Tatas too seem to be gearing up for change. The present chairman of Tata Sons is N. Chandrasekaran, who headed TCS before this. He has set himself the task of disentangling the complex web of shareholding that characterises the Tata group. Like Pranav Adani, Chandrasekaran wants to make the structure far more transparent, so investors will not be intimidated.

Simplifying structures is one of the more obvious ways in which Indian conglomerates are changing. Monetising assets and capital

"MY ROLE IS THAT OF A TRUSTEE FOR MY STAKEHOLDERS... THE ROLE OF A CHAIRMAN IS NOT TO RUN ALL BUSINESSES BUT SELECT THE BEST PERSON TO RUN THEM."

AJAY PIRAMAL
Chairman,
Piramal Group

[redacted]

allocation is another.

Piramal, who is also an independent director on the board of Tata Sons, says it is important for leaders of large organisations to take a hard look at their business portfolio from time to time and dispassionately decide on which business to let go of.

Citing his own example, Piramal says that his group decided to divest the textiles business when it became clear that homegrown textile mills won't be able to stand up to foreign competition. Then again, even as Piramal's domestic pharma business was doing well, it was sold to Abbott in 2010.

"My role is that of a trustee for my stakeholders. When we got the value that we did for the pharma business—9.5 times of sales and 30 times the operating profit—we realised there was no way that we could get to a similar value ourselves," says Piramal. "We also predicted that the industry was going to go through some difficult times from a pricing and regulatory standpoint."

Piramal emphasises that in diversified business groups, the group chairman cannot —and should not—be in charge of running all operational businesses. "The role of a chairman is not to run all businesses but select the best person to run them; ensure the values of ▷▷

[redacted]

TATA AT THE BOURSES

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SOURCE: **CAPITALINE; *FORTUNE INDIA* RESEARCH**

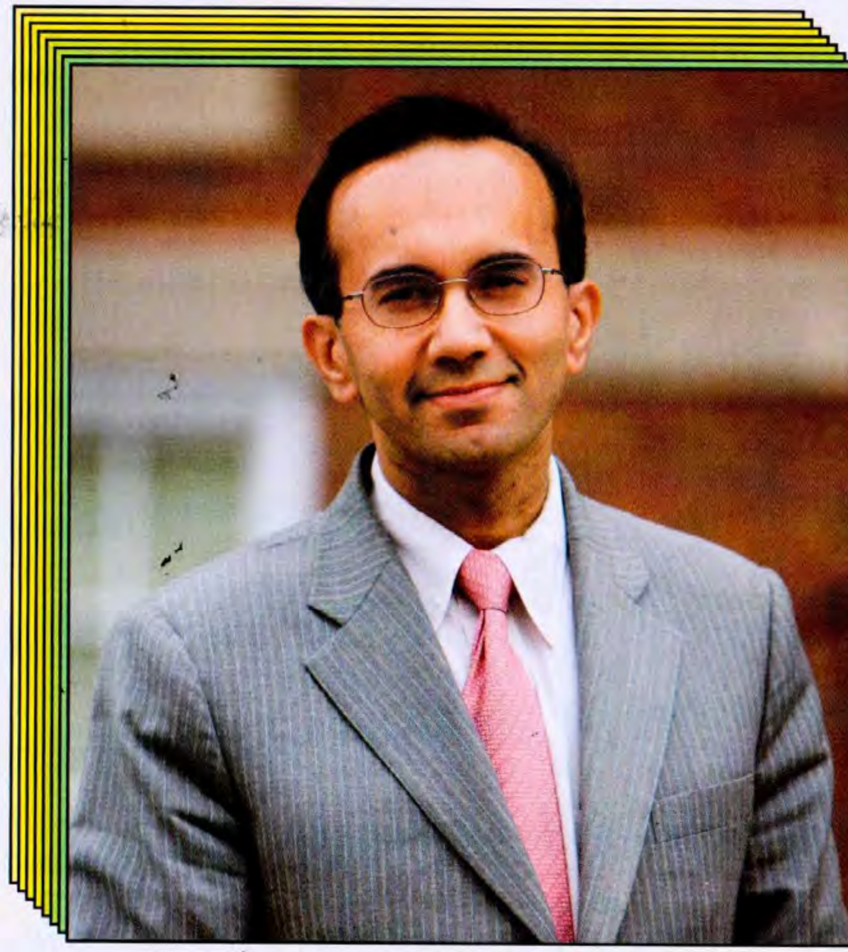
▷▷ the group are applied uniformly; make the right capital allocation and keep the image of the group intact," he adds.

L&T is another conglomerate that has decided to divest non-core assets to deleverage itself, focus on its key competence areas of construction and engineering. The new philosophy is part of a five-year business plan called 'Lakshya' (meaning target), through which it seeks to double its revenues to around Rs 2 lakh crore by 2021. In May 2018, L&T announced that it had agreed to sell its electrical and automation business to Schneider Electric for Rs 14,000 crore. L&T declined to comment for the story.

THERE ARE, OF COURSE, some calls for caution in this journey to make conglomerates simpler and nimbler. Harsh Goenka, chairman of the $3.6 billion RPG Enterprises, says that the success of a conglomerate also often depends on the nature of its promoters. Citing his own example, Goenka says that RPG, whose businesses include tyres, infrastructure and information technology, has always been cautious not to diversify too much and overleverage itself. "When there were tailwinds in the economy, we weren't seen as bold enough. But when the headwinds came, we were proven to be judicious. Business decisions are ultimately a call of the respective boards of operating companies."

That leads to the quicksand of corporate governance and the role of boards in conglomerates. "The most telling criticism of business groups used to be the cross-subsidies involving affiliated companies. Fortunately, increased regulation in India has led to greater minority shareholder protection and related-party transactions now have to be above board," says Nirmalya Kumar, Lee Kong Chian professor of marketing at Singapore Management University. "This has dramatically lowered the practice of forcing companies to buy uncompetitive inputs from other group companies, of having poorly performing companies subsidised by better ones, and of tunneling, which refers to moving profits from companies where the business group had a lower holding to those where its shareholding was higher."

Yet, Indian business houses have consistently failed to attract strong independent directors of global stature, says Khanna of Harvard Business School. This is due to low compensation and high legal risks. There is also greater consciousness among Indian promoters about evolving corporate governance standards and how that can be good for business.



[From left] Tarun Khanna, author and economic strategist; and Nirmalya Kumar, Lee Kong Chian professor of marketing at Singapore Management University

"Many promoters have realised that rather than siphoning off some money, you get a much bigger multiple if the money remains in the business," says Piramal.

Kumar adds that market scrutiny is also a mechanism to keep large companies alert. According to data, he says, listed companies affiliated with business groups in India performed better than listed firms unaffiliated with business houses and unlisted companies associated with business groups. This, he points out, was established in 2015 through a study conducted by Phanish Puranam, Raveendra Chitoor, and Prashant Kale.

"Listing a business group-affiliated company protects its performance against the frequent criticisms levied against business group-affiliated firms. Market scrutiny reduces the secu-

rity given to managers who do not perform, the nepotism of placing relatives in important positions, and costly group functions that do not add value to individual group enterprises," Kumar says.

"BUSINESS DECISIONS ARE ULTIMATELY A CALL OF THE RESPECTIVE BOARDS OF OPERATING COMPANIES."

HARSH GOENKA
Chairman, RPG Enterprises

ALL OF WHICH IS, no doubt, important to the survival of conglomerates. But the elephant in the room, so far, has been the tricky issue of core competence versus diversification. By definition, a conglomerate is diversified, and thanks to the licence raj, it was virtually forced upon Indian companies. But investor thinking today seems to be more towards depth in one area.

"The days of rampant diversification are completely gone," believes Mariwala. "History has shown that many conglomerates that have tried to expand into businesses that don't have close linkages with their existing ones have floundered while doing so."

An example of this is Aditya Birla Group's foray into food and grocery retail through a chain of stores called More, which barely survived against competition from the likes of Big Bazaar and Reliance Retail. It was reported in June that Aditya Birla Retail had decided to divest More to Samara Capital for an enterprise value of Rs 4,300 crore.

But then, equally, there are examples like Piramal and even L&T. Perhaps the answer is in L&T's legendary A.M. Naik, who told a newspaper a couple of years ago that the "core changes every three or four years". Now that's a way to get around the core competence argument.

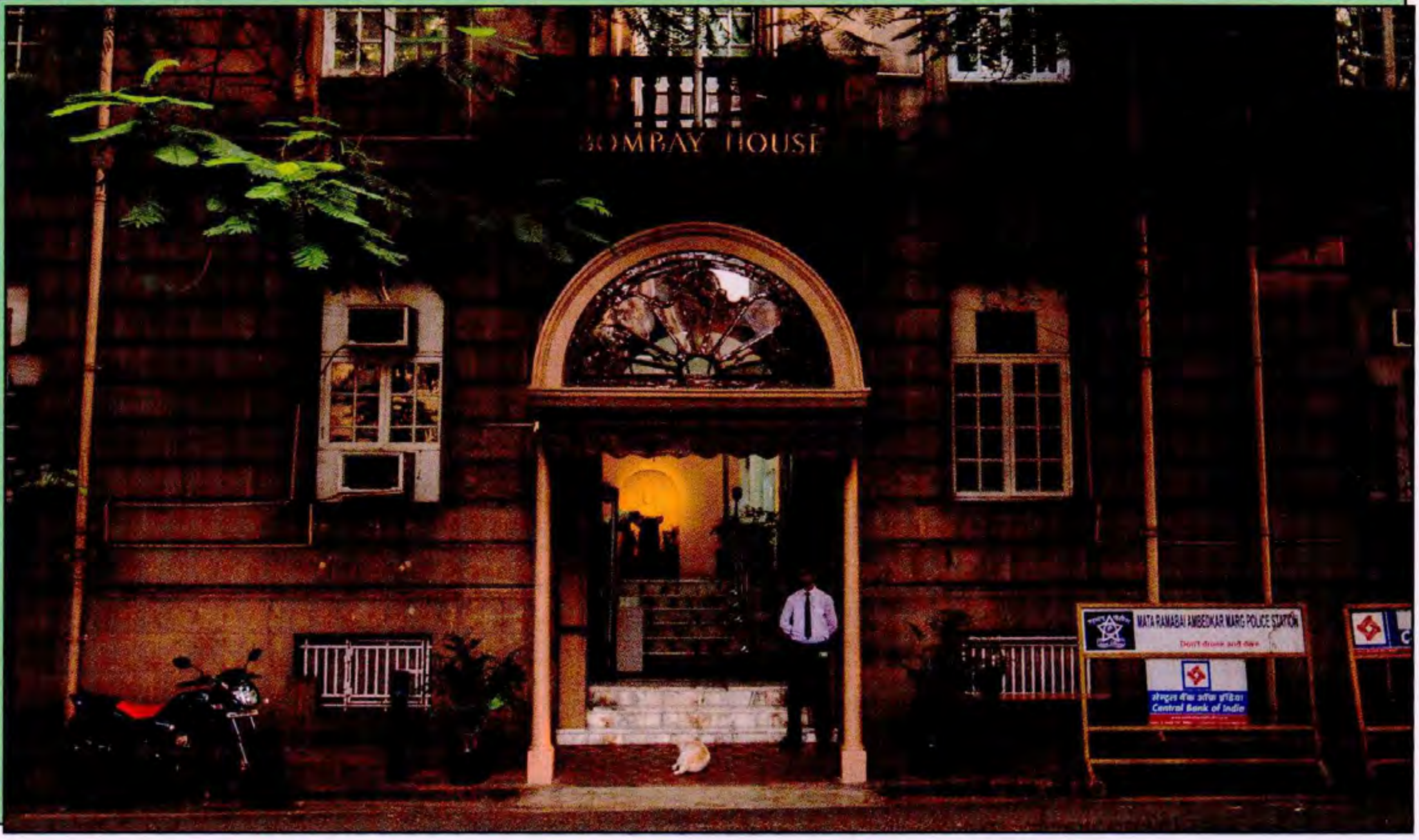
Naik is actually pointing to something fundamental to the change we see in conglomerates today: sticking to a core business but being flexible enough to change it depending on market forces. Take L&T itself. Its proposed divestment of the electrical and automation business for Rs 14,000 crore signifies that it wasn't a very small business for the engineering giant. But "the core changes" and today, the focus is on hi-tech manufacturing, projects, and services. If a future market demands something else, the core will shift again.

Piramal has a slightly different take. He points out that when his company divested the pharma business and decided to enter financial services, detractors pointed out that this wasn't a core area of strength for the company. "But the core of our business is entrepreneurship. Not characterised by any one person but the whole group," he adds.

For a company like Reliance Industries Ltd (RIL), there are new core areas emerging. Since its listing in 1977, the $63 billion company has predominantly relied on backward integration in the hydrocarbon chain. It started as a textile manufacturer, but digressed from its peers to get into petrochemicals, then crude refining, and eventually oil and gas production. But over the last two-three years, a new core has emerged for the company in terms of its retail and telecom businesses.

At its 41st annual general meeting in July, RIL chairman Mukesh Ambani said that by the end of RIL's fifth decade, its consumer-focussed businesses like Reliance Retail and Reliance Jio (the broadband wireless and digital services company) would contribute nearly as much to the overall earnings of the company as the energy and petrochemical businesses.

It is the oil-to-yarn-to-retail-to-telecom ▷▷



Bombay House, the headquarters of the Tata group, which is engaged in businesses as diverse as salt, steel, automobiles, and software

▷▷ conglomerate's massive balance sheet that gives RIL the scale to realise its ambitious plans. It is impossible to fathom how RIL, if it were a smallish standalone company without multiple businesses, would bankroll Jio, a venture in which it has already invested Rs 2.50 lakh crore. Not only does RIL have Rs 78,000 crore of cash on its books, it is also leveraging its robust credit rating to raise cheap debt from local and international markets. Even with a total debt of Rs 2.18 lakh crore, its debt to equity ratio stands at 0.75 and debt service coverage ratio stands at 2.06. Scale clearly matters.

Harvard's Khanna says one of the problems in India is not too many people appreciate cutting-edge technology. "I was giving a keynote address in India a year or two ago. There must have been around 200 people in the room and when I asked how many had a real conversation with scientists in the last year, not even one hand went up," Khanna says.

While technology may be a new line of business for RIL, for other business houses it is an enabler of efficient operations. The Adani Group, for instance, spends Rs 80 crore to Rs 100 crore on its IT platform each year and is also looking to make investments into startups.

"While business will feel the impact, more importantly, the technology revolution gives nations like ours the opportunity to leapfrog development cycles and solve some of the hardest problems we as a nation otherwise would not have been able to overcome," says Gautam Adani. "This will in itself result in massive new business opportunities for us to tap into."

Whether it's technology or human resources, strategy or corporate governance, it is increasingly clear that the modern Indian conglomerate is not planning to die anytime soon. The heads of these large organisations are taking all possible steps to ensure that they are around for many more years than that—like the powerful *chaebols* of South Korea. At the same time, they know that GE's example serves as a grim reminder that, if mismanaged, no conglomerate is too big to fail. ■

Additional reporting by Ashish Gupta, Debabrata Das, Rajiv Bhuva, and Sourav Majumdar