Family firms

The Bollygarchs' magic mix

Why India's soft state encourages family-owned firms and conglomerates

TO FIND RAJEEV PIRAMAL, the 35-year-old boss of Península Land, you go down a drive in deafening Parei, an up-and-coming business district in Mumbai that used to be the centre of the textile industry. A new tower block is zooming up on one side, and nets hang overhead to guard against falling debris. Mr Piramal's office is in an old mill building whose steel pillars are stamped with "Blackburn", the English town where they were forged long ago. This is a place where corporate death and rebirth is happening in real time; where derelict factories and workers' tenements are being demolished to make way for trading floors and media outfits with ping-pong tables in their lobbies.

The family firm isn't dying in this environment, it is thriving. Mr PiramaPs great-grandfather was a trader who made it big in textiles in Bombay, as Mumbai was once known. The family's mills were clobbered in the 1980S and early 1990S, but unlike some of Bombay's other famous textiles clans, such as the Mafatlals, the Piramals have not faded away. They turned to property, redeveloping their defunct industrial sites a decade ago, then taking on others' mill land and, most recently, evolving into a mainstream developer across the country, with book equity of some $300M. Rajeev's branch of the family also dabbles in engineering and entertainment. Another bit of the clan split off in 1981 and operates a luggage business, while yet another, which broke away in 2005, specialises in health care and glass. In 2010 it sold its domestic drugs operation to Abbott, an American firm, for a staggering $3.8 billion. This year it bought a 5.5% stake in Vodafone Essar, a big mobile-network operator.

Adaptable, ingenious and combustible, the family firm remains the backbone of India's private sector, not an anachronism. "This is politically incorrect," jokes Kumar Mangalam Birla, who runs Aditya Birla, the third-biggest family business house by sales, before going on to argue that the family, and the vim it brings, is an essential part of India's economy. There is no easy way to categorise these business houses, but vintage is one approach (see table). The oldest, such as Aditya Birla, Tata and Bajaj, stretch back over three or more generations and are wily survivors. Second-generation firms include Reliance Industries, India's biggest private firm, run by Mukesh Ambani, who split from his brother Anil in 2005, and whose late father's rise from petrol-pump attendant to billionaire is the stuff of legend.

First-generation firms include the winners from sunrise industries such as telecoms and computing, which boomed in the late 1990S and early 2000S-Bharti Airtel and **hcl**, a technology firm, being two fine examples respectively. More recently the ranks of first-generation firms have been swelled by the Adani group, big in ports and power, and **gmr**, an infrastructure firm based in Bangalore. The shift from export and consumer-facing industries towards "rent-seeking" sectors with more government involvement is an important and, some say, worrying trend.

A final category is the offshore Indian family group. The Hinduja brothers, who run everything from Ashok Leyland, a truckmaker in índia, to a Swiss bank, are partly based in London. Vedanta, a big natural-resources outfit, shifted there in 2003. Such firms mix Indian and foreign activities. It is tempting to include Mittal Steel, based in Europe and run by Lakshmi Mittal, in this group. But he is better regarded as an escapee from índia who made his fortune only after leaving the country as a young man.

Doingit vertically and horizontally

Most of these groups have two shared characteristics. First, complexity. Although many have simplified since 1990, most are still fiddly, with intricate chains of holding companies and subsidiaries. Second, they are conglomerates, often with one or two core activities and a long and growing tail of others. The holding chains are relatively easy to explain and are common in other countries such as Italy and Brazil. A cascade of companies means outside capital can be brought in at multiple leveis without weakening family control. In índia complexity is also sometimes a response to family spats, with rivais each given a distinct sphere of influence. India's regulators help, too; they talk a good game about corporate governance but do not require top-notch accounting and let firms build stakes in others without buying out ali minority shareholders. K.V. Kamath, the chairman of Infosys and of **icici**, a bank, believes governance will improve. "Companies will voluntarily change," he says. Others are less optimistic. Meanwhile, the Reserve Bank of índia, the central bank, frowns upon using bank loans to fund takeovers, so they rarely happen.

The causes of the complexity, then, are understandable. It is India's love of conglomerates that is the mystery. Some blame history: before independence in 1947, British companies often oper-

Top dogs 3

India's major private business houses

Name	2011* sales, $bn	Controlled by	Generation	Comment
Tata group	84	Tata family trusts	5th	Defies categorisation. A firm or a federation? Does control sit with independent trusts, outsiders or the boss?
Reliance Industries	58	Mukesh Ambani	2nd	Built on dad's epic tale of rags to riches, big in energy and chemicals. Strongest balance-sheet in India
Aditya Birla	35	KM Birla	4th	An early mover in professionalising, going abroad and doing deals. Metals, textiles, cement and mobile phones
Hinduja	25	Hinduja brothers	2nd	HQ moved from Mumbai to Iran and now Europe. Truckmaker Ashok Leyland and Gulf Oil are flagship firms
Essar	17	Ruia brothers	1st	Active in steel, ports, shipping and energy. Essar Energy arm is London-listed and leads expansion abroad
OP Jindal	14	Jindal family	2nd	Steel and power. Four brothers each have their own subsidiaries. Unclear if whole runs as an integrated entity
Mahindra	13	Mahindra family	3rd	Had a second wind in the past decade. Known for tractors and SUVs, but stretches to finance and hotels
Bharti	12	Sunil Mittal	1st	Biggest mobile firm. Diversifying into retail, TV and finance. Pricey African deal will test its global credentials
Vedanta	11	Anil Agarwal	1st	London-listed natural-resources group, tilting back to India with plan to buy Cairn Energy's Indian arm
Reliance Group	9†	Anil Ambani	2nd	Younger Ambani split off in 2005, taking capital-intensive power, infrastructure and mobile. Under pressure
Wipro	7	Azim Premji	2nd	Azim Premji turned the family vegetable-oil maker into a tech giant. Had a tricky year as it restructures

Sources: Companies; *The Economist*

*Year ending March †Estimate

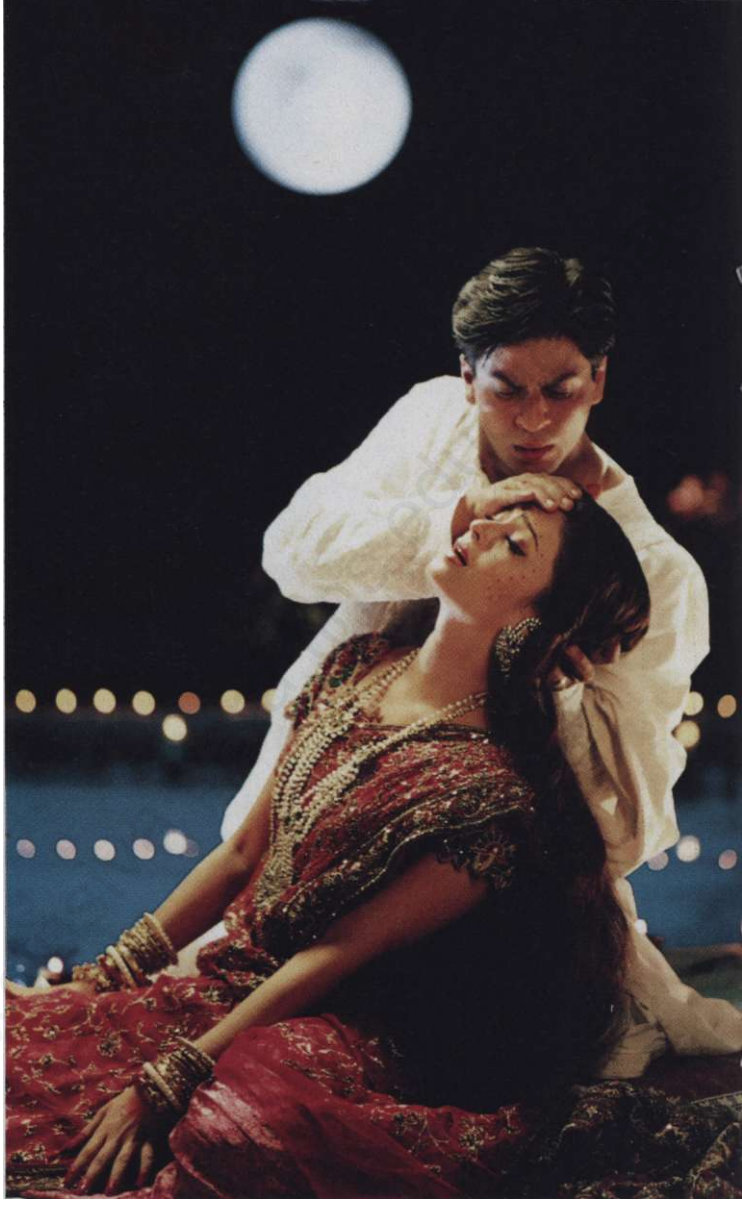
ated with a local managing agent who had his fingers in lots of pies. Alternatively, during the socialist era betweeni947 and 1991, Indian firms faced claustrophobic restrictions from the state and tended to expand in any direction where they could get air. Another explanation is cultural. Taking a sample of 16 of India's big houses, nine carne originally from the Marwari and Bania communities, famous for their trading nous. Perhaps these cultural roots come with a preference for how to organise firms. Even tax might be important: one baron says that capital controls make it hard to get family money abroad legally. If it has to stay at home, better to put money into a new business than a bank account that returns less than inflation.

Yet the best explanation is India's soft state. Courts can take years to make their minds up, so contracts are hard to enforce. Infrastructure is often poor, supply chains tricky, red tape a hazard, and markets for people, materiais and finished goods unreliable. Tarun Khanna and Krishna Palepu of Harvard Business School coined this idea in a 1997 paper. In these circumstances it makes sense to do things yourself. Such vertical integration even happens at Infosys, which generates much of its own electricity and tops up the education of new recruits. The Adani group will soon mine coal in Australia that is delivered to its own port in Gujarat and used partly to fire its own power stations.

Even Bollywood does vertical integration. In Film City, a leafy area north of Mumbai reserved for movie sets, Anil Arjun runs a new facility that will offer film-makers everything from sets and camera equipment to editing services. Outside índia, his firm specialises: its Los Angeles arm helped ensure the 3D images in "Avatar" were properly aligned. But inside índia it does the Full Monty, even owning cinemas. The company in question is Reliance Media Works, and it exemplifies a second kind of way of spreading out a conglomerate: horizontally, across unrelated industries. It is part of the Reliance Group, run by Anil Ambani and active in power, finance and telecoms, among other things. The benefits of this second kind of expansion may seem less obvious, but it is still wildly popular, suggesting that synergies flow from being part of a big group in terms of financial muscle, managerial talent, brand, technology and influence with officials.

A test of the soft-state theory is whether firms that are not in family hands also diversify vertically and horizontally. Very often they do. A good example is Larsen & Toubro **(l&t)**, an engineering firm founded by two Danes in Bombay in 1938 which is widely viewed as one of India's best companies. Although it has slimmed down in some areas, its activities are still very diverse, from making submarines to building roads. Physical assets comprise a small share of its balance-sheet, with minority investments, loans made to customers and working-capital balances making up the lion's share of its assets. This suggests it is in part a financial firm now, and that it uses its muscle to compensate for the lack of bank funding and bond-market financing for infrastructure investments. This year **l&t** floated a finance business, and it is considering applying for a banking licence. India's family bosses would applaud.

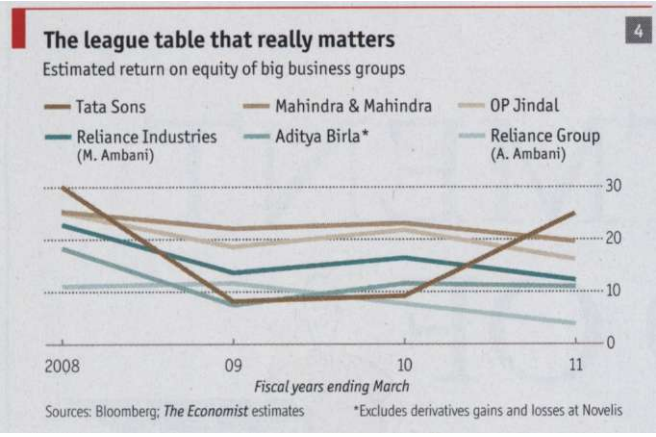
Family firms dominate the private sector in much of Asia and Latin America. But unlike in South Korea, where the *chaebol* act in close concert with politicians, India's firms only engage with the state opportunistically-it is their enemy as well as occasional partner. Nor should India's conglomerates, particularly family-owned ones, be slammed for rigging markets, as they are said to in other countries such as México and Israel. India's capitalism doesn't really work that way. The family houses go to war with each other and face new entrants: in industries such as retailing, power and mobile telecoms, profitability is poor as a result. In índia the institution of the family firm is entrenched, but there is constant turnover. Who is on top at any point "never stays the same", says Adi Godrej, the head of the Godrej group. The numbers back this up. For family firms in the top 100, overall returns on equity look similar to those of state-owned and institutionally owned firms, indicating that family firms are not making supernormal profits. This year an **IMF** study concluded that although such firms were as dominant as ever and the number of new entrants had fallen, competition was still lively.



Reliance MediaWorks knows ali about family dramas

India's family capitalism is dynamic and its patriarchs are the only people prepared to put billions of dollars at risk to build the new índia. It is, of course, possible to find other objections, from the crowding out of new entrepreneurs to inequality. But it is also worth considering whether India's family firms will fizzle out of their own accord. In other countries family conglomerates and corporate federations have been merely a phase of capitalism, and have declined on their own. This can happen in three ways. They can become flabby and lossmaking, as in the case of Japan's *keiretsu.* The need to raise outside capital to finance growth can slowly dilute the family's stake to insignificance. Or they can run out of credible heirs. The last two factors are common in America and Europe, where Hilton, Cadbury and others have evolved into companies run for institutional investors.

Will India's family firms fade of their own accord, too? To a Western eye, Tata is far along this path. It is bewilderingly complex, with at least 20 operating divisions, a couple of them heavi-



• ly lossmaking. After big foreign takeovers such as that of Jaguar Land Rover, a carmaker, and Corus, a steel firm, it is capital-hungry. And when Ratan Tata, its patriarch, who has no children, retires at the end of 2012, there is no obvious family heir-the firm has been trying to find an outsider to fill his shoes. The main holding company's shares are controlled by family trusts and Pallonji Mistry, a construction magnate. Those trusts are admittedly likely to retain Mr Tata as chairman even after he departs from Tata itself, but are supposed to operate independently. And already investors view the credit risk of Tata's subsidiaries differently, suggesting they are not convinced it is an integrated whole. Tata, then, might seem so disparate and so close to losing any family connection that it is ripe for a revolution.

The view from Bombay House, Tata's headquarters in Mumbai, is different. The end of family influence need not imply a change in strategy, the firm argues. Its biggest problem is to keep a sense of direction once Mr Tata departs-some outsiders say it now lacks much of a common culture. Its financial structure does not compel it to change, either. Take its overall profitability. Like ali Indian groups, Tata says it does not run the empire by monitoring its totted-up share of ali of the profits or losses of every subsidiary, as a Western conglomerate might. Yet unlike most, it does measure this, under an initiative by Ishaat Hussain, the finance director of Tata Sons, the holding company. So although some flaky businesses do shelter under the Tata umbrella, figures shown to *The Economist* suggest that Tata's overall profitability has recovered after a slump due to its acquisition splurge (see chart 4). Nor is the group short of resources. Its high profits help fund growth, and Tata Sons could raise almost $12 billion by reducing its stake in TCS, its technology arm, from 74% to 51%. Mr Hussain says the firm aims to raise its stakes in group firms where it owns less than 51%, not make them more independent.

Across Indian family groups there are pockets of pressure. Anil Ambani's Reliance Group needs to raise equity. And in the infrastructure industry, heavy upfront investment and project delays are leading to financial engineering. Family groups like **GMR,** which built Delhi's wonderful new airport, and **HCC,** which built the Sea Link bridge, Mumbai's only showpiece development, are experimenting with raising equity at multiple leveis of their business, creating structures that look fiddly and could in time prove fragile. But the finances of India's family groups as a whole do not contain the seeds of their own destruction. Reliance Industries is both profitable and has a rock-solid balance-sheet. The more complex Aditya Birla group, to the extent one can tell from the outside, is more indebted and scores less well on its return on equity, but is in serviceable condition. Some, such as Mahindra, refuse to tolerate sloppy and lossmaking divisions. Bharat Doshi, the group's chief financial officer, sounds as if he could work for **GE** when he says ali units must have a return above their cost of capital.

And when family groups do sell out, they often reinvest, rather than retiring to nightclubs in San Tropez. In 2008 the Singh brothers sold Ranbaxy, a third-generation pharmaceutical firm, to Daiichi Sankyo of Japan for $4.6 billion. They have ploughed almost $1 billion of their proceeds into their remaining healthcare business, Fortis, and Religare Capital, an emerging-markets investment bank they are bravely trying to build from scratch.

Leave those kids alone

The third threat, succession, looms the largest. In índia there is a lot of talk that the next generation of hereditary capitalists, after studying abroad (usually in America), might be more interested in becoming rock-climbers and rappers than industrialists. But in truth the lure of the family is still strong. Those barons with young children tend to say that they can do whatever they like. But at almost ali family groups where the children are adults, they have joined the firm. Kids are expected to work their way up, like their dads. Gautam Adani, the ports-and-power mogul, says of his eldest son: "For ten years he will go through the entire firm.. .we are grooming him."

The vulnerability this creates is twofold. First, there is the problem of rows as succession takes place. To avoid this, the current vogue is for family constitutions, often drawn up by expensive lawyers in London. These show a touching faith in the power of a contract to overcome sibling rivalry. Then there is the potential problem of credibility. Although India's family bosses are generally an impressive and engaged bunch, some of the current generation can seem semi-detached. In an interview with *The Economist* in May 2011, Naveen Jindal, a member of parliament and head of a steel firm worth $9 billion that is the biggest branch of the **OP** Jindal Group, seemed hazy about and reluctant to discuss the details of his firm.

In other countries family conglomerates have been merely a phase of ca pita lism, and have declined of their own accord. Will that happen in índia?

The biggest long-term risk for Indian family firms is not competition probes, rickety finances or lacklustre profits. It is that the kids aren't good enough. One widespread hope among families is a fudge, in which the next generation, even if uninvolved directly in the firm, still call the shots but employ professional managers to run things day to day. This seems unlikely to work: what chief executive would accept strategic direction from a chairman with no experience? And even if the family retains control, the amount of money outside investors have put into Indian firms means they may resist appointments based on surnames. To stay in control, Indian families will have to stay involved and be competent, particularly as their firms grow larger, more complex and more global.

Fonte: The Economist, London, v. 401, n. 8756, p. 6-10, 22-28 Oct. 2011.