Have Diversified Groups Failed In Generating Value In India Too?

Ram Kumar Kakani, XLRI Jamshedpur

Neelakantan Ramachandran, IIM Calcutta

Mantra for Success ...

Product Focus combined with International Diversification

- Successful MNCs – Microsoft, Lafarge, Nokia, Coca-cola

Conglomerates usually do not perform well

- Failed Groups – Daewoo, Hyundai, Astra, Pantham

Business Groups

Groups are -

- Formally independent firms (or affiliates)
- Single administrative & financial control
- Owned by trusts/families/foundations

Bound together

- by equity cross-ownership; and
- common board membership

More on Groups ...

Affiliates' decisions are taken as

- a single decision making unit
- in the aggregate interest of the group

We also observe

- Member firms helping each other
- Conflicts of interest between shareholders

Varied Institutional Context

- Developing countries have voids – *Misguided Regulations, Informational Problems and Inefficient Judicial Systems (by Khanna and Palepu)*

But ...

- *These voids have been blown out of proportion*
- *These voids create equal difficulties to diversified and focused groups*

Blown Out of Proportion

- Labor Markets – Scarcity of trained people

Large pool of skilled and unemployed manpower. Good higher education

- Equity Markets – Underdeveloped & Illiquid markets

Indian capital markets are comparable to many developed countries

More or Less Equal Difficulties

- Makes them vulnerable to Bureaucrats, Regulators and Political Parties – *Autoriders Group*
- Makes it very difficult to Exit Business Operations without consequences – *CK Birla Group [Hindustan Motors], Tata Group [TOMCO]*

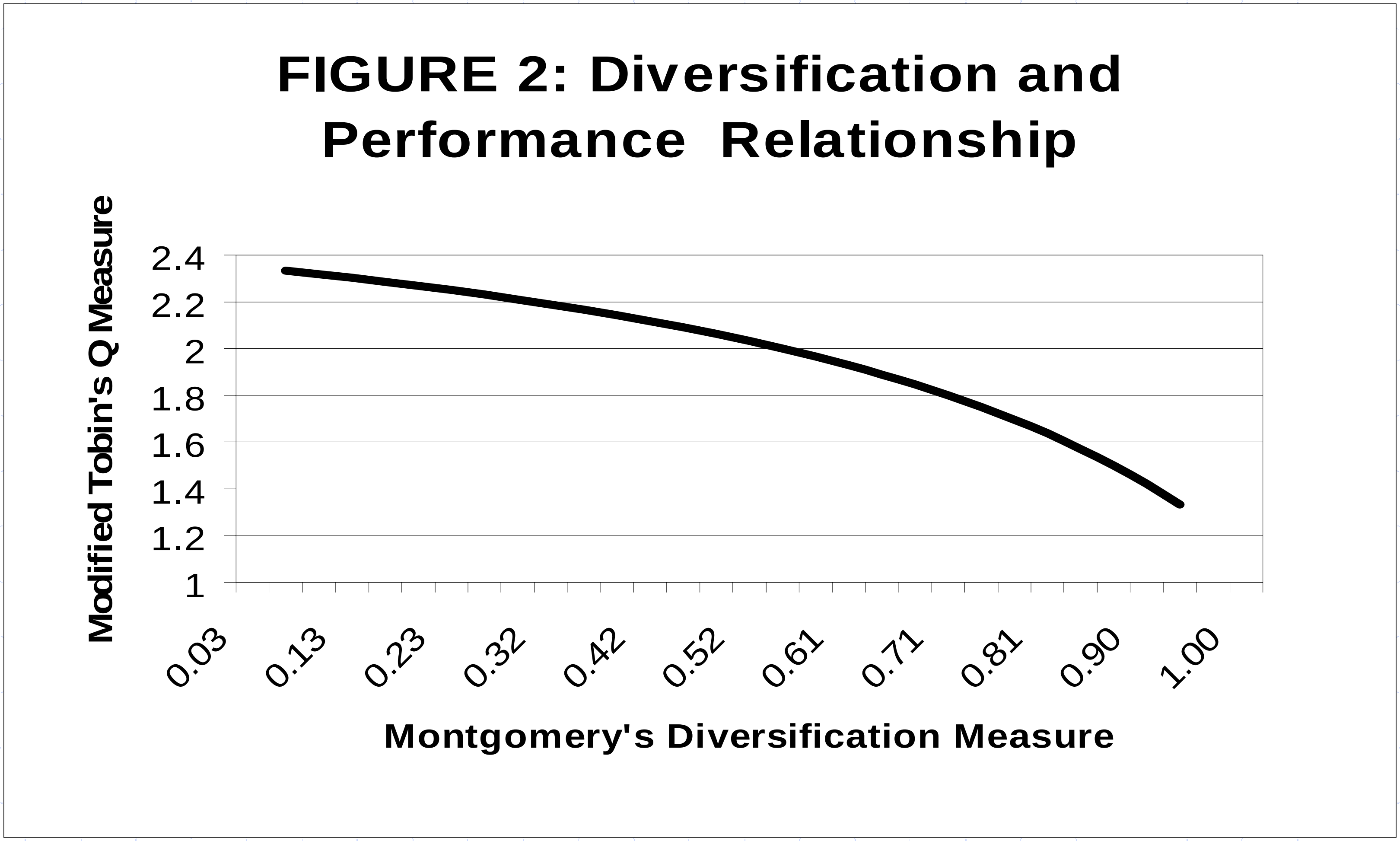
Conglomerates are Sources

- Diversified Groups are reluctant/choosy in revealing information – *Crossholdings and ownership stake*
- Jumbled dealings, weak disclosures, and poor treatment of minority shareholders implies bad reputation in factor markets – *Placement session of b-schools*
- Influences their standing in contract enforcement – *NEPC, Tata*

Our Research Method

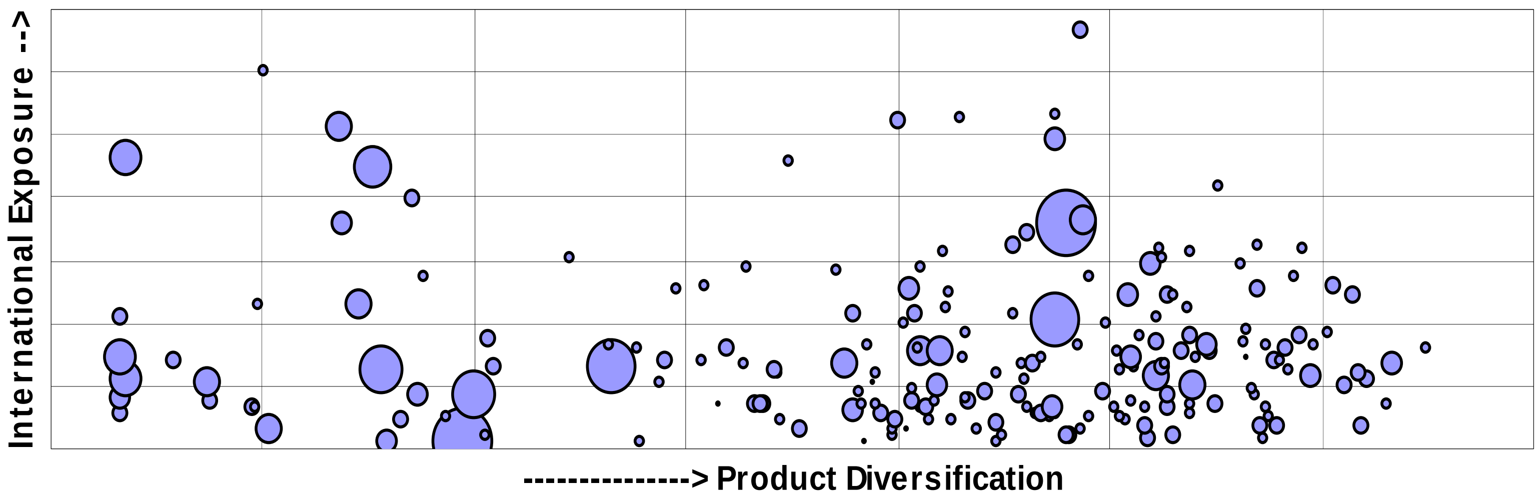
- Performed cross-sectional regression
- Sample size: 240 business groups
- Time period: 1987-99 (12 years)
- Multiple measures of performance
- Multiple measures of product diversification
- Used control variables including industry effects and international diversification

Our Main Results



Our Main Results

FIGURE 1: Product Diversification, International Exposure and Financial Performance of Indian Business Groups



Contrasting Industry Structures

- Integrating diverse affiliates performing in varied businesses and managing is a very tough task
- They have varied market structures – Whiles some are highly capital intensive; others need high intellectual capital
- Dynamics of world markets and changing technology make it more difficult
- Groups managed by families may not have such a wide range of skill set

Diversified Loose Value Due to ...

- Have complex structures hindering innovation
  - *Cement (GACL Vs Tata/AV Birla/BK Birla)*
- Misallocate capital and shield loss-making affiliates [some form of 'socialist' reallocation of funds across divisions] – *Birla Tyres of BK Birla*
- Poor governance resulting in investors (incl. foreign) disinterest – trade at discounts to peers –*Wipro*

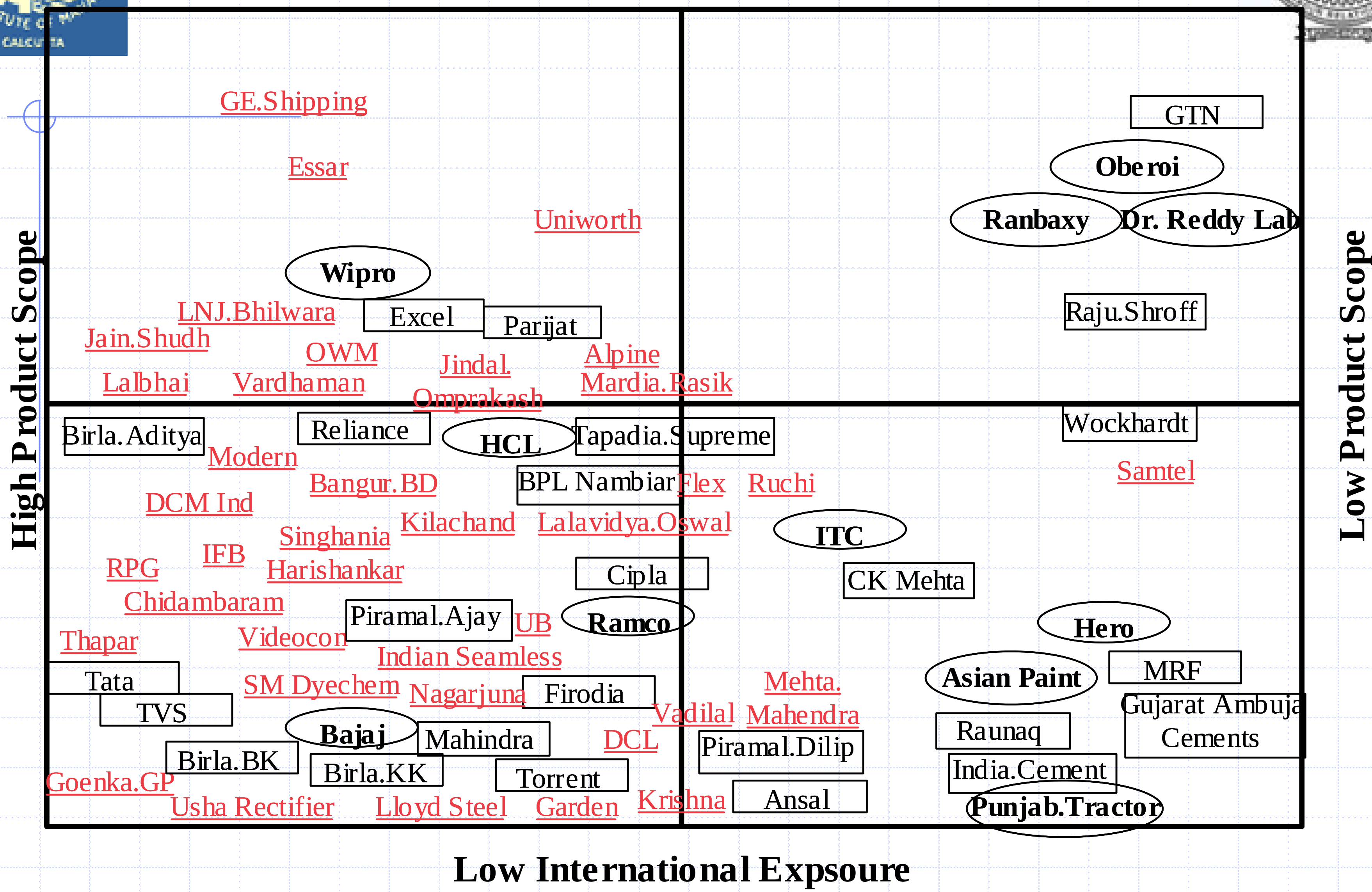
While International Exposure

- Allows exploiting of distinctive capabilities; Learn from international markets
- Provides broader base of markets for returns on innovation; Benefit from economies of scale
- Can take advantage of sops provided by Government incl. tax benefits, cheap finance
- Achieve higher investor fancy and higher discounting

Same Sector, Two Groups

- Videocon Vs BPL
- SM Dyechem Vs CK Mehta

Performance of Some Groups



Note: Groups in circles & bold were good performers. Groups in rectangles were average performers. Groups not covered, and underlined in red color were bad performers.

How they didn't do well

- Stretching Brands – Tata (Salt, Steel, Shampoo, and Software)
- Changing Direction Frequently – Alpine (Soya to Metal, Chemical), Indian Seamless (Steel to Airplanes)
- Lacking Success Formula in New Lines of Businesses – Videocon, GE Shipping

How they did well

- Cutting Unrelated Exposure – ITC (exit Agro-based, Financial Sectors)
- Concentrating on Core – MRF, Punjab Tractors, Ranbaxy
- Seeking External Markets – Dr. Reddy, Wipro, Ramco, Hero

Comparison of Capital Markets

Country	Companies	MC/GNP Ratio	Mkt.Turnover Ratio
USA	7651	210	124
Japan	2470	111	53
Germany	933	66	108
India	9871	85	245
China	950	36	134