



The Tata Group after the JRD Period: Management and Ownership Structure



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Introduction

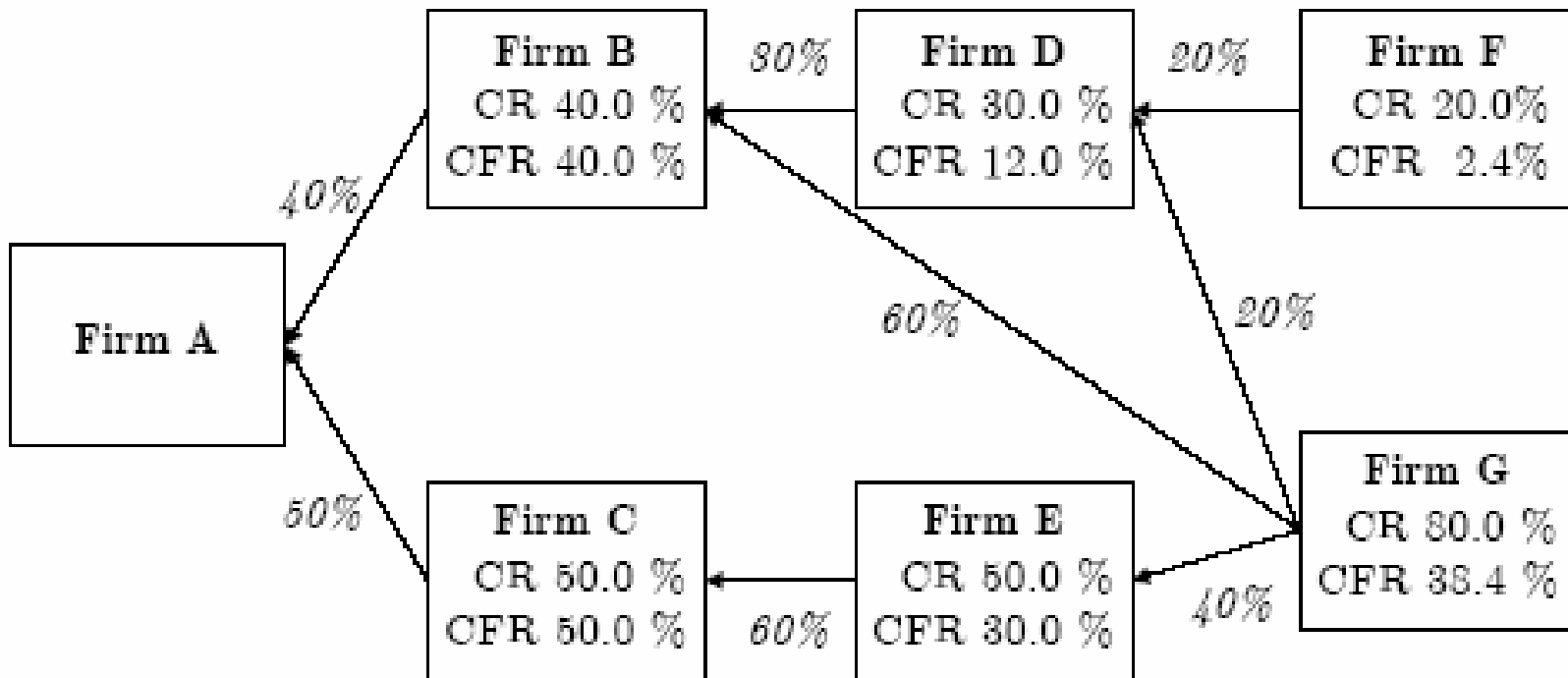
- This case study is an interpretational journey on the changing ownership structure of a well known business group (the Tatas) passing through a restructuring
- We examine the interaction of ownership structure, corporate strategy, and external forces for a large conglomerate
- Common Structures of ownership (Bebchuk et al., 1999):
 - Dispersed Ownership (DO)
 - Controlled Structure (CS)
 - Controlling Minority Structure (CMS)

CMS ... three basic ways

- ❑ Control rights measure the degree of control given by a ownership structure
- ❑ CMS is possible by separating the Control Rights (CR) from Cash Flow Rights (CFR) in three basic ways:
 - Differential voting rights structures
 - Pyramidal structures
 - Cross-ownership structures
- ❑ Note: Both the size of the rights themselves as well as the degree of their separation matter for shareholders incentive and behavior (Jensen and Meckling, 1976; and Faccio and Lang, 2002)



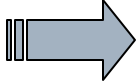
Example of CMS



- Control rights are concerning with respect to the holding company, herein, Firm A



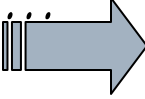
Literature and Motivation

- ❑ Many theoretical models especially in last decade 
- ❑ Not many empirical studies and case studies
- ❑ Patel et al. (2002) studied 19 emerging markets. They found, negative correlation between cross-holdings and Transparency & Disclosure (T&D), whereas correlation between Tobin's Q and T&D was positive.
- ❑ Bansal: *The Tata's have started doing ...*
- ❑ Note: Usually the data & information available within the public domain on such issues is very limited. In fact, a similar work on any other large business group is more difficult to execute.

Tatas ... Historical Overview

- ❑ Established by Jamsetji Tata in the 19th century (2nd half)
- ❑ Operated through a holding company, Tata Sons
- ❑ In 1938, JRD Tata took over. Over the next 53 years, the group expanded & diversified. Breaking with the Indian business practice of having members of one's own family run different operations, JRD pushed in professionals. (Lala, 1995; and Piramal, 1995)
- ❑ Tata affiliates became legally independent under the dismantling of the managing agency system in 1970
- ❑ A semblance of unity was maintained by using cross holdings; cross-company directors' meetings; and JRDs charm and moral force.

The JRD Days ...

- ❑ In 1990, JRD once commented on his role: *“My being chairman today is very different ... the companies are free to operate independently. ... I do not wield any kind of executive authority. But because I am senior in age, I operate more on the basis of influence & confidence ...”*
- ❑ He further stated *“... there is something absurd in so far as we have no more interest than any other shareholder in most of the companies. We get nothing extra for managing them. ...”* 
- ❑ Given the community structure (Todd, 1985) and ageing patriarch, the group’s decision process became slow and there was rising internal friction [may call, unmanageable business federation].

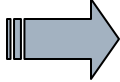
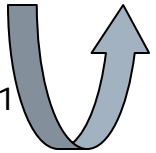
Ratan joins the Tatas ...

- ❑ Ratan Tata, son of one of JRDs cousins, was called back from the US in 1962, in order to work for the Tatas.
- ❑ In 1981, he was elected as chairman of Tata Industries Ltd (TIL), a small company. In 1983, Ratan submitted "Tata Strategic Plan." It would place TIL as the group's vehicle for growth in high technology businesses in four emerging areas and would exit 'sunset' businesses. Other goals included increasing ownership in affiliates.
- ❑ However, the implementation of the plan was held back – the various Tata affiliate chairmen, were unwilling to support.

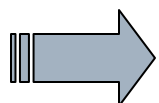
Ratan Tata takes over ...

- ❑ In 1991, Ratan Tata was nominated by JRD to lead.
- ❑ One Tata director described Tata Group as *“no longer existing as a group except in their culture and name ... ”*
- ❑ Ratan’s first challenge was to consolidate a group of individual companies which, under powerful chairmen were going their own way.
- ❑ Ratan Tata, the strategist, made a few smart moves:
 - reduced the retirement age for affiliate CEOs
 - sold 20% stake in TIL to Jardine Matheson (1995)
 - promoted a unified brand with strict entry norms

Ratan Tata makes moves ...

- ❑ After taking over, Ratan said, “... *we were in many more areas than we should have been in and we were not concerned about market position in those businesses ...*”
- ❑ It exited cosmetics, cement, textiles, pharmaceuticals, etc ... entry into cars, retail, telecom, insurance, etc.
- ❑ Tata Sons held minority shares in affiliates. To increase its stake in its affiliates, Tata Sons made a rights issue in 1995. The findings are ... 
- ❑ While it was legal for group companies to purchase Tata Sons shares and vice versa, the media and the foreign investors admonished the move.
- ❑ Creeping acquisition route was followed by Tata Sons 

Tata Sons Structure



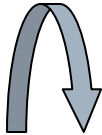
| Ownership Structure of Tata Sons | | |
|----------------------------------|----------------|-------------|
| Stakeholder | Stake FY 94 | Stake FY 05 |
| Tata Trusts | 78.0% | 65.9% |
| Tata Group Affiliates | NA (but << 1%) | 12.8% |
| P. S. Mistry | 17.5% | 18.4% |
| Tata Family | 3.5% | 2.9% |

| Increase in Cross Holdings after the Tata Sons Rights Issue in FY96 (Rs in million) | | | | | | | |
|---|--------|--------|-----------------------|---|------------------------------------|-------|-------|
| Tata Sons Financial Numbers (in Rs. Mn) | | | Major group companies | Value of Tata Sons shares bought by companies (in Rs. Mn) | Tata Sons stake in group companies | | |
| Parameter | FY 96 | FY 05 | | | FY 96 | FY 95 | FY 96 |
| Book value | 8,990 | 80,350 | Tata Steel | 688 | 2.3% | 8.5% | 19.8% |
| Market Value | 19,900 | n/a | Tata Motors | 688 | 1.8% | 2.7% | 21.9% |
| Paid up Capital | 179 | 404 | Tata Power | 370 | 5.6% | 6.3% | 28.7% |
| Reserves | 6,236 | 79,286 | Tata Chemical | 569 | 7.9% | 8.2% | 11.2% |
| | | | Tata Tea | n/a | 7.6% | 8.6% | 14.7% |
| | | | Indian Hotels | 250 | 13.3% | 13.3% | 12.3% |

Cross Holding Increases ...

- Pyramidal Structure Existed:
 - The Tata family owns equity in core affiliates (i.e. Tata Industries and Tata Sons which are not publicly traded firms, majority of the stake in these firms are held by 66 philanthropy trusts headed by family members, 74 & 83).
- The rights issue was a crucial step in the overall strategy to increase the cross holdings. For instance,
 - Tata Investment Corp holds 10% in Tata Chemicals, and 6% in Tata Tea, while Tata Chemicals holds 15% in Tata Investment Corp directly.
 - Tata Tea holds 4% in Tata Chemicals, and Tata Chemicals holds 8% in Tata Tea.

Cross Holdings Increases ...

- ❑ In sum, affiliates have cross investments in each other by owning them singly or jointly (or other means) and the group has control over all these entities with lesser investment of its own.
- ❑ It does provide Tatas a lot of comfort by helping in creation of a good management control system 
- ❑ But, the Tata group was using the independent company shareholders money (herein, affiliates) to increase Tata Sons stake in the company itself. Consequently, Tata Sons used this money to increase their stake in these affiliates.

Changes in Holding Size & Structure

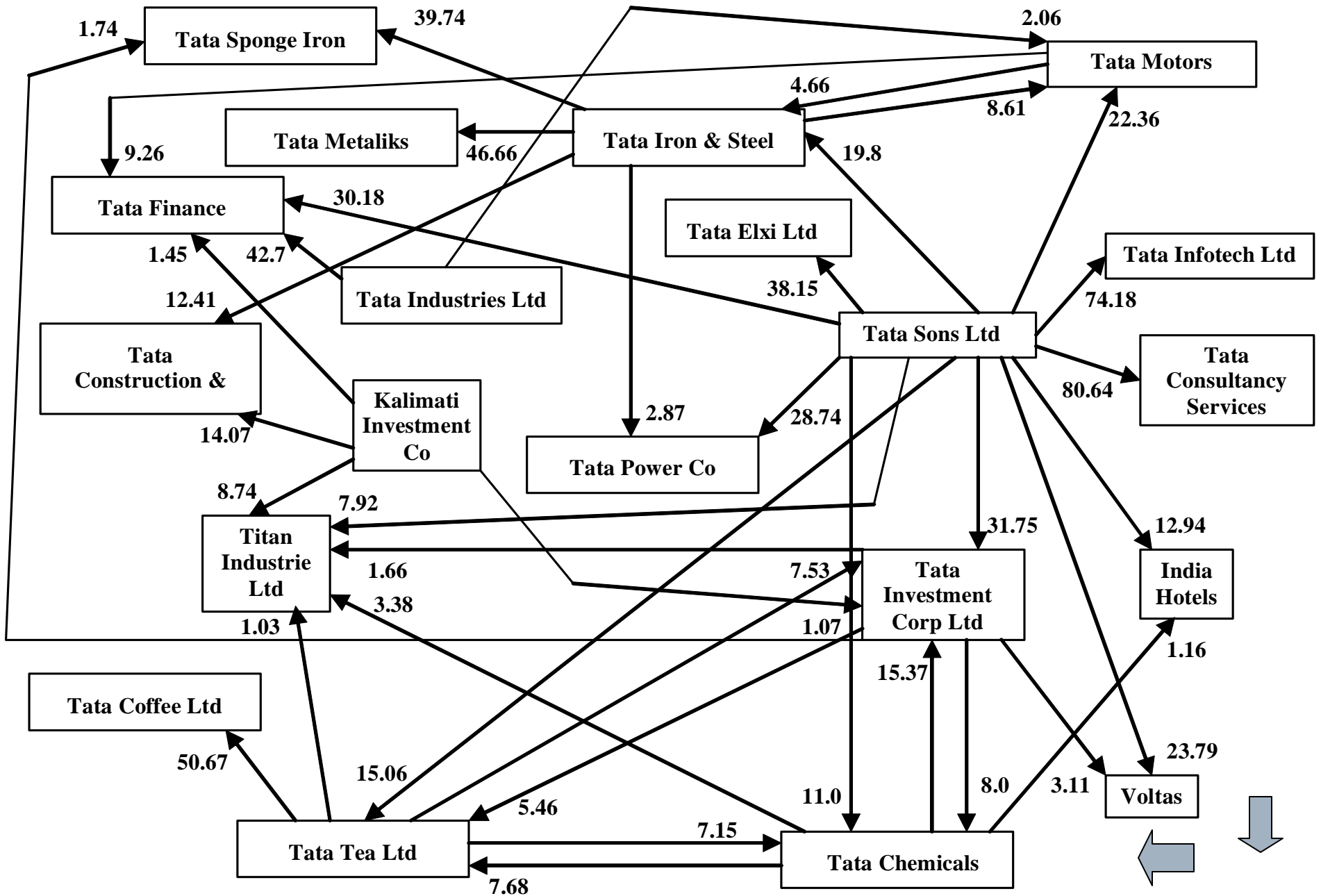
| Number of Holding Cos. for each Member and their Total Stake | | | |
|--|-------------------|-------------|--------------------------|
| Company | Total Group Stake | | No. of Holding Companies |
| | 2000 | 2005 | |
| Tata Sponge | 39.7 | 41.5 | 1 → 2 |
| Tata Constructions | 26.5 | 27.2 | 1 → 2 |
| Indian Hotels | 16.6 | 30.0 | 3 → 5 |
| Tata Tea | 28.9 | 28.6 | 3 → 3 |
| Tata Chemicals | 24.2 | 28.6 | 3 → 3 |
| Tata Investment Corp | 62.5 | 60.6 | 3 → 6 |
| Tata Power | 31.1 | 32.3 | 2 → 2 |
| Tata Steel | 24.5 | 26.7 | 2 → 2 |
| Tata Motors | 23.3 | 34.2 | 2 → 3 |

- Both, Tata Motors and Indian Hotels are close to the CEOs future plans for the group but have high investment requirements (see, Almeida and Wolfenzon, 2006)

Some Interpretations ...

- ❑ The group has increased its indirect holding over its affiliates (esp. during 2000-05). It has also consolidated firms in similar business into one.
- ❑ The ownership pattern of key affiliates is becoming more dispersed i.e., number of holding companies is up
- ❑ Apart from the primary holding company (Tata Sons), there are many other group controlled entities which are part of this complex holding pattern
 - Firms: Tata Industries, Kalimati Investments, Aftab Investment Corp, Ewart Investment, Tata Investment, and Sheeba Props
 - Others: Jamsetji Tata Steel, Navajbai Ratan Tata Trust, Sir Dorabji Tata Trust, and Lady Tata Memorial Trust

Ownership Structure of Tata Group Listed Firms in 2005



Affiliates Activities Change ...

| Group Dealings of Tata Motors (Rs. in millions) | | | | |
|---|-------------|-------------|-------------|-------------|
| | 1991 | 1995 | 2000 | 2005 |
| Receivables from group companies | 27 | 724 | 3,771 | 5,468 |
| Investment in group companies (mainly Tata Steel and erstwhile Tata Finance) | 0 | 1,909 | 2,874 | 19,422 |
| Sales | 25,508 | 56,403 | 87,309 | 202,765 |
| Profit before Depreciation, Interest, and Tax | 3,704 | 7,527 | 9,243 | 23,369 |
| Receivables from group cos. as a percent of Sales | 0.1% | 1.3% | 4.3% | 2.7% |
| Investment in group cos. as a percent of Assets | 0.0% | 4.6% | 3.2% | 13.9% |
| Investment in group cos. as a percent of Shareholders Funds | 0.0% | 13.4% | 7.7% | 47.2% |

- Tata Motors has performed well in sales growth. Its investments in group companies has risen phenomenally over the period.

Affiliates Activities Change ...

| Group Dealings of Tata Steel (Rs. in millions) | | | | |
|--|---------------|---------------|---------------|----------------|
| | 1991 | 1995 | 2000 | 2005 |
| Receivables from group companies | 106 | 60 | 330 | 6,900 |
| Investment in group companies (mainly Tata Motors, Tata Power & Tata Constructions) | 405 | 2,057 | 6,077 | 13,897 |
| Sales | 21,922 | 45,487 | 74,988 | 167,270 |
| Profit before Depreciation, Interest, and Tax | 4,861 | 7,909 | 12,919 | 61,659 |
| Receivables from group cos. as a percent of Sales | 0.5% | 0.1% | 0.4% | 4.1% |
| Investment in group cos. as a percent of Assets | 1.2% | 2.6% | 5.0% | 8.3% |
| Investment in group cos. as a percent of Shareholders Funds | 2.8% | 7.7% | 11.4% | 19.7% |

- Tata Steel has generated substantial amount of internal funds. Receivables from group companies have risen, which may be seen as leeway to group companies.

Group Dealings Increase ...

| TATA POWER | | | | |
|--|--------------|---------------|---------------|---------------|
| | 1991 | 1995 | 2000 | 2005 |
| Sales | 4,740 | 10,599 | 14,046 | 39,565 |
| Receivables from group cos. as a percent of Sales | 0.0% | 0.5% | 14.7% | 2.7% |
| Investment in group cos. as a percent of Assets | 0.0% | 8.9% | 10.0% | 21.5% |
| TATA CHEMICALS | | | | |
| Sales | 2,994 | 4,983 | 15,194 | 30,979 |
| Receivables from group cos. as a percent of Sales | 2.8% | 1.5% | 0.0% | 0.0% |
| Investment in group cos. as a percent of Assets | 0.0% | 4.3% | 5.7% | 8.4% |
| TATA TEA | | | | |
| Sales | 2,943 | 3,991 | 9,133 | 8,930 |
| Receivables from group cos. as a percent of Sales | 4.7% | 3.0% | 0.1% | 4.0% |
| Investment in group cos. as a percent of Assets | 6.3% | 22.1% | 44.3% | 50.7% |
| INDIAN HOTELS | | | | |
| Sales | 1,563 | 2,983 | 6,186 | 8,880 |
| Receivables from group cos. as a percent of Sales | 2.2% | 0.7% | 33.0% | 72.5% |
| Investment in group cos. as a percent of Assets | 1.3% | 8.4% | 21.5% | 21.5% |

Some insights ...

- ❑ The picture is very similar for companies which are making profits but for companies which are struggling we find that there are no investments in group affiliates
- ❑ Turnaround companies such as Tata Tinsplate, Tata Metaliks, and Tata Sponge Iron (which have just started having good numbers) have also made a modest beginning by investing in group companies.
- ❑ Businesses / Firms with low investment requirements and immediate cash flows are being held by the primary holding company with large ownership concentration (see, Almeida and Wolfenzon, 2006)

Two Explanations ...

- Need to move from Tata Model to Birla Model (Hazari, 1966):
 - Differing leadership personalities led to realization of earlier errors and making amendments.
 - Change of regulatory environment (LPG) → Threat of hostile takeovers + acquisitions, private equity, and LBOs are the in-thing → so opacity is most welcome.
- When investor protection is poor, asset return correlation affects ownership structure in a positive way. Higher return correlation lowers the benefits of diversification which causes a higher investment by a controlling shareholder in his asset and a lower investment by the non-controlling shareholders (Parigi and Pelizzon, 2005)

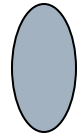
Results on Control ...

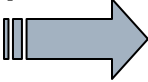
- During 1990-95, a large number of internal battles were fought (see, Khanna and Palepu, 1998; and Sampath, 2001)
- From 2000-05:
 - There have been zero internal battles fought in public (based on print media search). Even differences within the group affiliates seem to have been well managed.
 - Tata Sons GEO executive members and a few key men often act as the groups spokesmen (even managing the Tata group affiliates board meetings)
 - There has been no new and independent initiative by any Tata group affiliate on their own

Conclusion

- ❑ A key theme in the last two decades has been the restructuring effort of corporate houses in countries going through liberalization.
- ❑ We undertook to study the Tata group.
- ❑ Prior to restructuring and under JRD, in 1991, the Tatas used to manage their affiliates with very small equity. As a result, the chairmen of group affiliates had grown accustomed to ruling independently (no control)
- ❑ Ratan Tata, the strategist, decided to change the group to make it more cohesive and controllable. The group restructuring involved various steps along with strengthening ownership using cross-holdings.

Conclusion



- ❑ An increase in cross holdings by affiliates combined with pyramid structure provides a mechanism to control firms without needing significant investments.
- ❑ The group indeed achieved higher management control and created enough defenses against takeovers.
- ❑ An increase in indirect control may exacerbate agency costs as it provides private benefits and increasing incentives to CMS. 
- ❑ This can be done by tunneling of assets and earnings (see, Marisetty, 2005).
- ❑ Cross holding (as in Japanese keiretsus) can also result in a state of quite life equilibrium (Bergloff & Perotti, 1994)²⁵.

Limitations

- ❑ Our study has all the limitations of a case-based study
- ❑ We depend only on the publicly available data ...
- ❑ We depend on published interviews, anecdotes, pieces of evidence (often mined from data), and snippets of conversation with few key executives
- ❑ Reasons for not approaching private sources ...
 - Private information is enmeshed in conflicts of interest
 - There are noises in private data
- ❑ Scope:
 - Deeper analysis; One can also look at alternate strategies that could have been adopted.
 - Compare with others (untangling their cross holdings)

Thank You

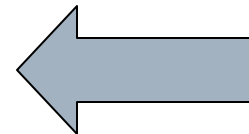


A few take homes ...

- ❑ Large shareholders control a significant number of firms in many countries, including developed ones ...
- ❑ What is the structure of ownership of a business group?
- ❑ How is it related to the strategist objectives?
- ❑ What are the means by which owners gain control rights in excess of ownership rights?
- ❑ We detail an arrangement in which a controlling shareholder (Tata) is able to maintain a complete lock on the control of a conglomerate while holding less than a majority of the cash flow rights associated with its equity.
- ❑ We discuss the consequences, agency issues, potential agency costs, and managerial implications!

Size of Control Rights

- ❑ La Porta et al. (1999) designed a now widely accepted standard methodology
- ❑ It is represented by the lowest percentage in the control chain
- ❑ There exists alternative definitions in the literature ... see, for example, Grob (2007).
 - Edwards and Weichenrieder (1999) define control rights as votes exercised at the last annual shareholder meeting (to proxy the voting power).



Tata Ownership Structure in 1980s

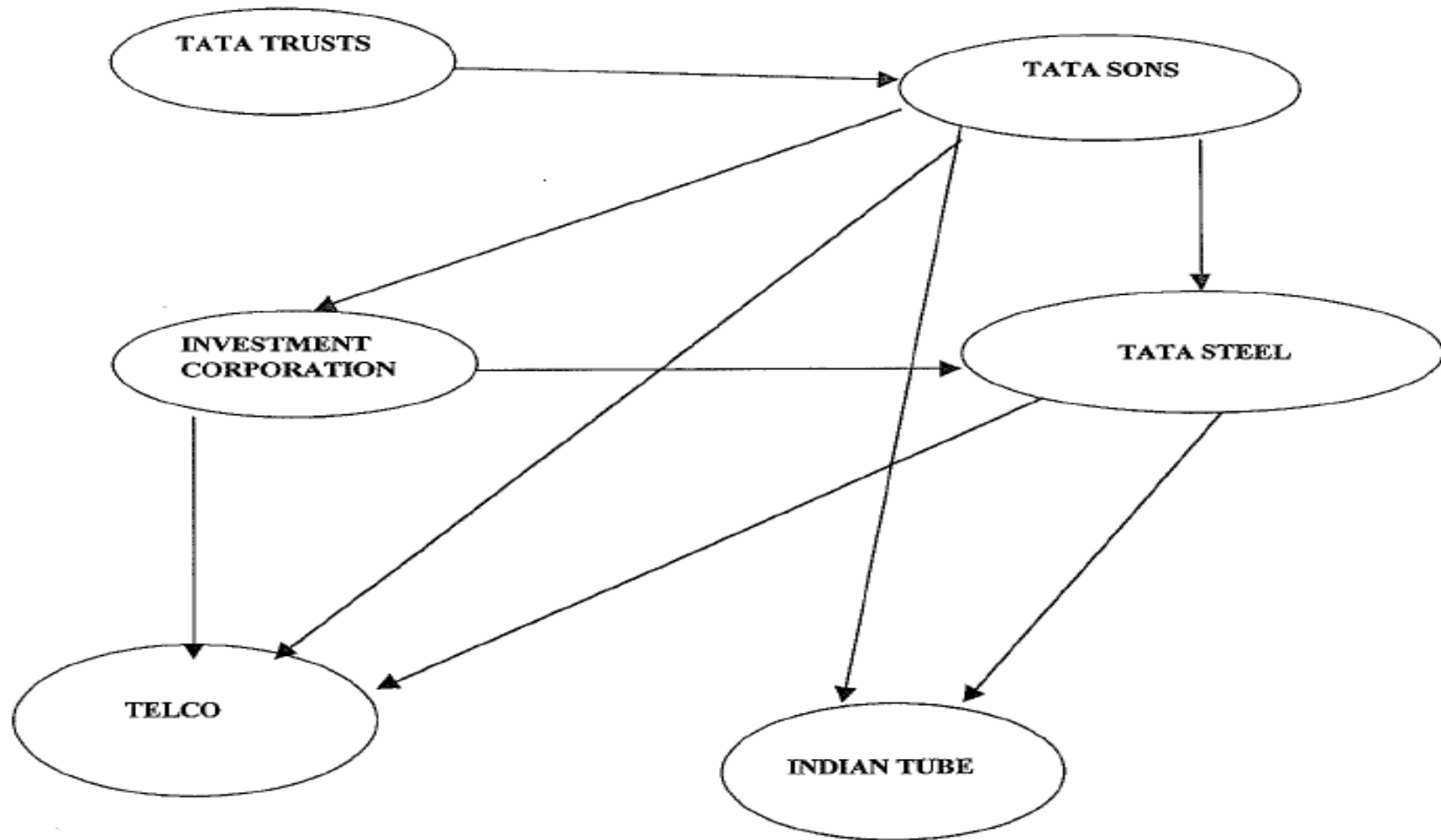
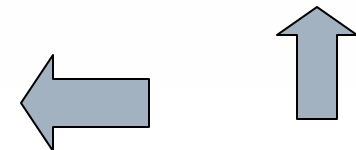
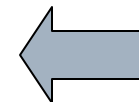


CHART I : Inter Corporate Investments in Tata Group



A few private benefits to Shapoorji (Tata Sons Key Investor)

- ❑ Shapoorji's firms get all the Mumbai-based groups construction projects. The Tata group has awarded many of its prestigious contracts – Taj Intercontinental, Titan Factory, and Forbes Resilens Factory – to Shapoorji's construction company.
- ❑ Shapoorji also owned one of the biggest Tata Motors dealerships through United Motors.
- ❑ In addition there are a lot of non-monetary benefits. For example, both his sons are on the board of a few Tata affiliates. One of the family members is also a board member of Tata Sons.



How has Control Increased?

- Through increased monitoring of affiliates by creating the GEO and BRC
 - The Group Executive Office (GEO) under Tata Sons provides group focus to affiliates and looks at restructuring, acquisitions, and new forays. It has two full-time executive directors
 - Each Tata affiliate will have a Business Review Committee (BRC) for interaction between Tata Sons and the management of the company. CEOs will also have to present their plans and strategies before BRC. It will meet thrice a year to look at strategy and operational performance. Its recommendations will be sent to the company boards.



Issues with CMS

- ❑ CS resemblance: A CMS insulates controllers from the market for corporate control
- ❑ DO resemblance: It places corporate control in the hands of an insider who holds a small fraction of the firm's CFR
- ❑ As the separation between control rights and cash flow rights increases, agency issues (private benefits), and moral hazard issues increase (Morck, 2000)
- ❑ CMS can radically distort their controllers incentives; put great pressure on non-electoral mechanisms of corporate governance, ranging from legal protections for minority shareholders to reputational constraints on controlling families.

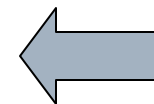
Pyramids & Cross Holdings

- ❑ In a pyramid of two companies, a controlling minority shareholder holds a control in a holding company that, in turn, holds a controlling stake in an operating company.
- ❑ [Trusts → Tata Sons (81%) → Tata Steel (20%) → Tinsplate Co. (34%)]
- ❑ In a cross-ownership structure, companies are linked by horizontal cross-ownerships of shares that reinforce and entrench the power of central controllers. Thus, voting rights to control a group remain distributed over the entire group.
- ❑ [Titan Industries is held by Kalimati Investments (9%), Tata Sons (8%), Tata Chemicals (3%), Tata Investment Corp. (2%), and Tata Tea (1%) among others].



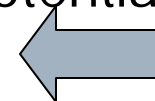
Pyramids & Cross Holdings

- ❑ In a pyramid of two companies, a controlling minority shareholder holds a control in a holding company that, in turn, holds a controlling stake in an operating company.
- ❑ Li Ka Shing Group (Hong Kong), Godrej Group
- ❑ In a cross-ownership structure, companies are linked by horizontal cross-ownerships of shares that reinforce and entrench the power of central controllers. Thus, voting rights to control remain distributed over the entire group.
- ❑ Chareon Pokphand Group (Thailand), Samsung (Korea), Garware Group



Theoretical Models

- ❑ Bebchuk et al (1999): In a CMS, as the size of cash-flow rights held decreases, the size of agency costs increases, not linearly, but rather at a sharply increasing rate.
- ❑ Project choice: Given controller's choice of investment projects, a CMS firm chooses a lower value project (with more private benefits).
- ❑ Decisions on scope: CMS firms have a very strong tendency, all else equal, to expand rather than contract, to retain cash flows, and to hold back distributions.
- ❑ Control transfers: When the initial controller enjoys significant private benefits, even transfers with large potential efficiency gains are unlikely to occur.



Theoretical Models

- Almeida and Wolfenzon (2006): When a business group sees an opportunity and decides to set up another firm then poor investor protection renders the pyramidal structure more attractive. Due to
 - payoff advantage; and
 - external investors anticipate the diversion and toughen financing terms → it becomes optimal for the controlling shareholders to use internal funds. This makes the owners ability to use existing firms in a pyramid valuable.
- Certain firm characteristics also influence the choice of group structure. Firms with high investment requirements and/or low profitability are likely to be set up in pyramids.

