Role of industry relatedness in performance of Indian acquirers—Long and short run effects

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Cross Holding Strategy to Increase Control: Case of the Tata Group

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Abstract

Crossholdings is a common phenomenon across Asia. Within a business group, cross-holdings amongst group affiliates are often used to fund a group's (unstated) empire building objectives. There has been a large amount of international empirical work focusing on the various aspects of crossholdings strategy adopted by international business groups. In the Indian literature, we found little work, especially with respect to case studies. In this paper, we use public information of a well known business group (the Tatas) going through a decade long restructuring and we attempt to document their cross holdings strategy. While the increased cross holdings does benefit a business group through increased management control yet the findings hold enough water to conclude that these moves are contradictory to the interests of the minority shareholders in the individual operating companies (i.e., its own affiliates).

Key Words: Business Group, Business House, Business Network, Cross Holding, Governance, Indian, Management Control, Ownership Structure, Pyramidal Structure, and Shareholders.

[1] The authors would like to express that the discussion and analysis mentioned herein is purely for academic purposes with no other intentions whatsoever.

Cross Holding Strategy to Increase Control: Case of the Tata Group

1. Introduction

A pleasant December evening breeze blew through the Jubilee Park of Jamshedpur[2]. Reputed businessman, S. Bansal[3] was on his usual evening walk, part of his life style for over four decades. S. Bansal, a retired Tata Steel employee had come to Steel City after graduating in Metallurgy from the illustrious Indian Institute of Technology (IIT) Kharagpur. Thus, began his life long stint with the Tata Group, and his affection for Steel city which made him take a decision to settle here.

S. Bansal was a member of the old guard and had seen winds of change at the helm and across the group during his career. He had seen the successes, failures, achievements and controversies that had encircled the group for over half a century. During the walk, Bansal was chatting and the discussions spanned a array of topics ranging from politics to the Tata Group. Invariably, Bansal was a storehouse of insights into the Group, its culture, its philosophy and anecdotes of course.

But this December evening was slightly different, in the sense of the experiences Bansal was sharing. His voice had a serious and nostalgic undertone to it. He was sharing his perspective on the transition of the Tata Group; on what he felt was not the same about it as before. As the sun set past the horizon, Bansal smilingly said,

"The Tata Group has just <u>started doing business</u>"

Perhaps this statement had a deep rooted meaning that probably S. Bansal put forward in a very subtle manner. Did he mean that the group had started deviating from its corporate values and ethical standards for which it was respected for over a century? We had been reading news articles about the Tata Group changes for quite a few years now. There was definitely something more to it than met the eye. We decided to take this in more detail especially at the changes the group had undergone in the last decade.[4]

We use the following path to discuss our case analysis based research work: In section 2, we briefly review the existing literature on crossholdings. Section 3 gives an overview of the Tata group; it also describes the recent changes and the restructuring exercise under the new leadership. In Section 4, we present the empirical data and an analysis-cum-discussion of the findings. The data and information we use has been obtained from various websites of stock exchanges[5], the Tata Groups website, CMIE-PROWESS package, and ISI Emerging Markets database. All these

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[2] Jamshedpur is a beautiful city in the eastern part of India, created by the Tata group.
[3] Names have been changed to protect confidentiality.
[4] Also an investigation on whether there was a lack of synchronization between what the Tata Group projected in the media as its high standards of corporate values and between their actions.
[5] Websites of the National Stock Exchange (www.nseindia.com), the Mumbai Stock Exchange (www.bseindia.com), and the securities regulator, SEBI website (www.sebi.gov.in)

databases have been used extensively by researchers in India and hence are highly reliable. We end our paper in Section 5 with our conclusions and limitations of the study.

2. Literature Review

Sinha (1998) argued that cross holdings have economic significance and must be taken into account in both equity investment and lending situations. Cross holdings and the stability of relationships that result, probably allow Japanese and Korean companies to adopt a longer-term perspective in their decision making, than is possible in the US. They concluded by stating that cross holdings increase the debt bearing capacity of firms and should not be completely eliminated during credit analysis.

Khanna and Palepu (2000) presented an empirical analysis of diversified Indian business groups in relation to corporate scope and institutional context. The performance of firms affiliated with diversified business groups with unaffiliated firms in the emerging economy of India is compared. The authors interpret their findings to suggest that concentrated owners generally do not seem to affect performance positively, as evocative evidence that groups might have settled into quiet life equilibrium.

Commenting on Japanese *keiretsus*, Tam (2001) stated that the new accounting standard puts a dent in corporate cross holdings – the glue holding many of them together. It mentions how cross holdings have traditionally provided companies with a base of stable shareholders; preventing takeovers and shielding management from shareholder pressure. This has contributed to Japanese companies' low emphasis on dividends, shareholder meetings and investor relations in general along with less float in issues leading to illiquidity and price volatility. Companies are under pressure to revalue cross holdings and sell off those cross holdings whose stock prices have underperformed in order to improve their balance sheets.

Using a twelve year empirical study on 240 Indian business groups, Kakani (2002) found that diversified Indian conglomerates destroy shareholder value and have poor financial performance compared to the focused business groups. The work commented on the complex web of cross holdings of diversified conglomerates and resulting lack of transparency being some of the reasons behind the results.

Patel et. al. (2002) studied the relationships between Transparency & Disclosure scores and cross-holdings for 19 emerging markets including India. For most of the countries including India, correlation between cross-holdings and Transparency & Disclosure (T&D) score is negative, whereas correlation between price-to-book ratios and T&D scores is positive. This might imply that groups with complex cross holdings are not as transparent in their dealings and so their stocks may be lower priced in the marketplace by the investor community as compared to those of independent firms.

Clark and Wojcik (2005) using German corporate data found a significant negative relationship between ownership concentration and the average daily rate of return (as measured by closing stock market prices). A reason mentioned in the paper for this was that the portfolio investors are concerned about the potential for exploitation – that is, the likelihood that their place as minority shareholders and largely passive owners at that may be exploited by other better placed owners with greater access to private information.

One can conclude the above literature discussion has an overwhelming support on the negative effects of Cross Holdings. If we combine the above literature review with the statement made by S Bansal then it raises a storm of questions in ones mind. Suspicions on the concurrency between the words and actions of the most revered business house in India need a very objective method of evaluation.[6]

3. The Tata Group

The House of Tatas is one of the oldest business groups in India. Not many Indians would need an introduction to the House of Tatas. The group is largely operated through a holding company, namely, Tata Sons. We provide a brief historical overview and then proceed with describing the recent restructuring exercise and other changes made.

Established by Jamsetji Tata in the second half of the 19th century, the Group has grown into one of India's biggest and most respected business organizations, largely due to the entrepreneur's vision, their commitment, and its fortitude in the face of adversity (Lala, 2004). Of the ventures that did bear fruit while Jamsetji was alive, the Taj Mahal Hotel in Bombay has to rank highest. Legend has it that Jamsetji set his mind on building it after being denied entry into one of the city's hotels for being an Indian. His sons, friends and business associates were sceptical. His sisters chided him by asking, "Are you really going to build a eating house?" The Taj turned out to be a bit fancier than that. Soaked in luxury, it was the first building in Bombay to use electricity and the first hotel in the country to have American fans, German elevators, Turkish baths, English butlers and whole lot of other innovative delights.[7]

In 1938, JRD Tata was elevated to the top post in the Tata Group, taking over as chairman from Sir Nowroji Saklatvala. He was the youngest member of the Tata Sons board. Over the next 50-odd years of his stewardship the group expanded into chemicals, automobiles, tea and information technology. Breaking with the Indian business practice of having members of one's own family run different operations, JRD pushed to bring in professionals. He turned the Tata Group into a business federation where entrepreneurial talent and expertise were encouraged to flower.

JRD Tata[8]

JRD Tata's was born in Paris in 1904, the year Jamshetji died. JRD's education was constantly interrupted and at twenty-one when he came to settle in India, his father, a director of Tatas, took his son to the room of John Peterson, who was then director in-charge of Tata Steel. Thus began JRD's training and his tryst with business. At the age of thirty four, he was made chairman of Tata

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[6] One also needs to appreciate the researchers' constraint regarding access to information and data. Usually the data and information available within the public domain about such controversial issues is very limited. In fact, a similar work on other major groups is much more difficult as most of the data is kept in a veil of secrecy.
[7] Refer to www.tata.com for more details.
[8] Harvard Case Study: House of Tata, 1995: The Next Generation and Creation of Wealth by R M Lala

Sons. Right from the beginning JRD stamped his style of working on the organization. He started the process of devolution of power for the democratization of the Tatas. JRD hand picked many of the Tata company chairmen. He was also at the helm during the nationalization of many Indian businesses like Tata Airlines (1953) and the insurance arm of the Tatas, the New India Assurance Company (1971).

Even as the Tata companies became legally independent under the dismantling of the managing agency system in 1970, a semblance of unity was maintained by a network of intercorporate shareholdings, weekly cross-company directors' meetings and JRDs dynamic personality and moral force. JRD once commented after the abolishment of the managing agency system, on his role as chairman of the company:

> *"My being chairman (of Tata Sons) today is very different from what it was before 1970, when the managing agency system operated … Today the companies are free to operate independently and in fact they do. Today, except in Tata Sons I do not wield any kind of executive authority. But because I am senior in age, I operate more on the basis of influence and confidence …*
>
> *… 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. For example, till 1978, 90 percent of my time went between Air-India and Tata Steel as the chairman of both, and what did Tata get out of it? In Tata steel we are only shareholders like any other and … we get nothing."*

JRD encouraged his hand picked chairmen to operate their companies autonomously within the perimeters of the Tata philosophy of professionalism and ethical business practices. As a result, chairmen of larger Tata affiliates had grown accustomed to ruling their domains without interference from the Tatas for decades. Although these affiliate commanders all traded on the Tata name – one of the most respected brand names in India – they cherished their independence and vehemently protected their empires. Under JRD Tatas leadership the group professionalized management to a degree that a few other indigenous business houses had done. JRD Tata was a consensus man, and the emotional glue which held all the group companies together.

Ratan Tata[9]

Ratan Tata, the son of one of JRDs cousins was an open trusting man and a shy soft spoken individual. He was called back from the US in 1962, where he worked as an architect, in order to work for the Tatas. In 1981, he was elected as chairman of Tata Industries Ltd (TIL), which he was to turn around from a small company into a group strategy think tank.

Ratan's 1983 "Tata Strategic Plan" would place TIL as the group's vehicle for growth in high technology businesses in four areas (advanced electronics, biotechnology, advanced materials, and alternative energy) and would gradually phase out 'sunset' businesses like textiles and cooking oil. Other goals included increasing Tata ownership in group companies, and exploring joint ventures

[9] Harvard Case Study: House of Tata, 1995: The Next Generation and Creation of Wealth by R M Lala

in the government. However the implementation of the "Tata Strategic Plan" was held back by the Tata culture of independence – the various Tata company chairmen, who collectively held TIL's entire share capital, were unwilling to fully support Ratan's plans.

In March 1991, Ratan was nominated by JRD to the Tata Sons chair. Ratan found himself as the head of a conglomeration of companies, that were described by one Tata director as *"no longer existing as a group except in their culture and name. …It is only because of the financial institutions which are the major shareholders that Tata management is allowed in these companies."* Ratan's first major challenge was to consolidate a group of individual companies which, under powerful chairmen or managing directors were going their own way. Ratan changed the retirement age for the chairmen and managing directors to tackle this issue. His victory against Russi Mody reinforced his position as the man in command of the situation and won him the respect and trust of many of the group company's stalwarts.[10]

Ratan Tata's Strategies[11]

Ratan Tata implemented a number of strategies to unite, refocus, and modernize the group. We shall have a brief look at five significant strategies:

- **The revival of Tata Administrative Services (TAS)**

TAS, a department of Tata Services Ltd. had been recruiting talented individuals for management career acceleration in group affiliates since the 1950s. TAS had been successful compared to other domestic companies in retaining people but the prestige had waned somewhat in recent years. Ratan promoted TAS as a 'premium career' and elevated the program's status among up-and-coming business leaders through media exposure. TAS was to become a group talent resource by enlarging the program and improving the mobility of TAS participants among group companies. New TAS recruits (mostly MBAs) were to work in a range of industries in the group. The compensation packages offered to TAS recruits were also redesigned to match the market rates. These efforts to revive TAS and make it a destination of choice for talent paid off well for Tata Sons and all the group companies which opted to participate in the TAS program.

- **The Jardine Matheson deal**

Ignoring the concern of many experts over the entry of foreign firms into the Indian industry, Ratan sold a 20% stake in Tata Industries Limited (TIL) to the colossal Hong Kong based Jardine Matheson group for Rs. 1.26 billion. Ratan planned to use this capital influx to fund venture start ups promoted through TIL. Although Jardine probably would not receive a dividend for 5 years it had the same rights as the other Tata companies: to occupy a TIL board seat, to be involved in project planning and to invest in new projects promoted by TIL. Ratan anticipated that Jardine would contribute expertise in a wide range of businesses activities, such as retailing and distribution, real estate, hotels, engineering, construction, and financial services. A Jardine associate described Ratan as a careful planner and thinker.

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[10] http://www.indiareacts.com/columns/full_column5.htm
[11] Harvard Case Study: House of Tata, 1995: The Next Generation and Creation of Wealth by R M Lala

❖ The Tata Brand

Ratan Tata decided that the group needed a stronger collective identity. The principal move Ratan considered was to undertake the responsibility of promoting a unified Tata brand which could be used by all companies which would subscribe to the Tata Brand Equity scheme. Each company that subscribed to the scheme would derive the benefits of the centrally promoted Tata brand. Ratan proposed that the subscribing Tata companies each pay a contribution, the amount of which would depend upon each company's association with the brand. Contribution would range from 0.10% to 0.25% of each company's net income excluding taxes and non-operating.[12]

Participating companies would require subscribing to a code of conduct ensuring uniformly high standards of quality and ethical business practices.[13] Tata Sons planned to use the fee money to build a national and later international group brand image by emphasizing on the core values and ethics, largely through advertising. Tata Sons estimated that meaningful domestic brand promotion would cost around Rs 300 million per annum, much more than the commission collected. The board of directors of various Tata companies passed a resolution in 1995 in accordance with this arrangement. However the scheme generated debate in the media. Some Tata shareholders resented Tata Sons' attempt to assert itself beyond the limits of an ordinary shareholder; and a few others went so far as to say that the Tata name had not necessarily been the reason for the success of their companies.

❖ Restructuring

Ratan's views on restructuring, shortly after taking over,

> *"I think we were in many more areas than we should have been in and we were not concerned about our market position in each of those businesses. I think the needs today are that we define our businesses much more articulately and that we remain focused rather than diffused, and that we become more aggressive than we used to be."*

The objectives for restructuring were defined clearly. These included: (a) Returns must be greater than cost of capital; (b) Each company must be the industry leader occupying one of the top three positions; and (c) The business identified must have potential for high growth and should be globally competitive. Having decided on these objectives, there were clear strategies for exits and entries. There was a break from the earlier sentimental approach to businesses that have been built over decades. Ratan Tata decided to exit the businesses of soaps and toiletries, cosmetics, consumer electronics, pharmaceuticals, computer and telecom hardware, branded white goods, paints, oil exploration services, cement, textiles ... equally fervent was his expansion/entry into businesses identified as having high growth potential. These included passenger cars, auto

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[12] Fee schedule: right to use the Tata name in both company banner and products, 0.25%; right to use the Tata name in either the company banner or products, 0.15%; right to be perceived as a Tata company, 0.10%.

[13] Inclusion under the Tata Brand Equity Scheme was subject to two qualifiers wherein the company must be a signatory to the group's code of conduct and comply with the Tata Business Excellence Model (TBEM). Group firms would reportedly be evaluated on the seven critical criteria that comprise the TBEM - leadership, strategic planning, customer and market focus, information and analysis, process management, human resource focus and business results. Participating companies would be eligible for recognition with the JRD Quality Value award modeled after the Malcolm Baldrige National Quality award in the USA.

components, retailing, telecom, power and insurance. Appendix 1 gives a list of businesses the group entered and quit.

❖ Injecting Capital in Tata Sons

Through its primary holding company i.e., Tata Sons, the Tatas held minority shares in group companies ranging from 0.01% to 15%. In order to increase its stake in its affiliates, Tata Sons[14] determined that they would need to raise a total of Rs. 7 billion in 1995-96, to realize a 1 percent increase in stake in each of the major Tata companies. To raise the necessary funds Tata Sons invited subscriptions to a Rs. 3 billion rights issue on September 1995. The shares were made available to Tata group affiliates (at a premium) through the renunciation of shares by various charitable trusts (having the rights).[15] The additional money would be raised by internal generation, debt, and other strategies.

While it was legal for Tata group companies to purchase Tata Sons shares and vice versa, collusion between the companies to exchange shares would be a violation of law. The media queried Ratan's plans; concerns stemmed partly from debate that the selling price of Tata Sons shares had been overvalued. From an analyst's point of view, the deal seemed to lack any benefit for the investing companies. It was estimated that the interest cost on the Rs 3 billion investment would be Rs. 450 million, whereas even a 100% dividend declaration by Tata Sons would yield only Rs. 30 million. Ratan argued that the shares would appreciate immensely if Tata Sons were to go public, and no shareholders had yet officially complained of the illiquid nature of the Tata Sons investment. But one foreign investor admonished the participation of the Tata companies in the Tata Sons rights issue thus, *"…This (diversion of capital) won't do the Tatas any good"*. There was a lot of criticism from various media writers (such as Sucheta Dalal).

4. Findings and Discussion

❖ Tata Sons and Group Companies Cross Holdings

We now look at the Tata group holding company i.e., Tata Sons and some of their big affiliate's corporate characteristics especially with respect to their changing cross holding ownership pattern.

Table 1: Ownership Structure of Tata Sons

Stakeholder	Stake FY 94[16]	Stake FY 05
Tata Trusts	78.0%	65.9%
Tata Group Affiliates	Not Available (but much less than 1%)	12.8%
P. S. Mistry	17.5%	18.4%
Tata Family	3.5%	2.9%

[14] Pallonji Shapoorji Mistry owned 18.4% stake in Tata Sons.
[15] A few years earlier the Government had adopted a regulation forbidding public charitable trusts from investing in the private corporate sector.
[16] Estimates based on a *Business World* Article and other references. Business World is a reputed Magazine

Table 2: Increase in Cross Holdings after the Tata Sons Rights Issue in FY96 (Rs in million)							
Tata Sons Financial Numbers			**Major group companies**	**Value of Tata Sons shares bought by companies**	**Tata Sons stake in group companies[17]**		
Parameter	**FY 96**	**FY 05**		**FY 96**	**FY 95**	**FY 96**	**FY 05**
Book value	8,990	80,350	Tata Iron & 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 Chemicals	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%

Note: (a) All amounts in Rs millions; (b) Year ending is 31st March

As seen in table 1, the ownership structure of Tata Sons has changed after the rights issue. Although information about exactly how many companies invested in Tata Sons and to what extent was difficult to get, but we have enough data to conclude that the major companies did subscribe to the rights issue as can also be seen from the tables 1 and 2 above. The route followed by Tata Sons to increase their shareholding was the creeping acquisition route from the market.

The rights issue was a crucial step in the overall strategy to increase the cross holdings between Tata Sons and group companies. It does provide Tatas a lot of comfort by increasing their management control and also in avoiding hostile takeover battles. But, if we combine information of Table 1 with the information of Table 2, we observe that there is a need for scrutiny. *It was using the independent company shareholders money (herein, Tata Group affiliates) to increase Tata Sons stake in the company itself. Consequently, Tata Sons used this money to increase their stake in these Tata Group affiliates.*[18]

[17] In March 1991 the shareholding pattern was lesser. The Tatas combined shareholding in March 1991 in Tata Steel was 7.5%, Tata Motors was 15.3%, and Tata Power (erstwhile Tata Electric Companies) was 1.7%.

[18] One way to argue in favor of cross holdings is to state that this benefit will give access to the affiliate company shareholders by giving them access to the upside of high growth Tata affiliate concerns such as Tata Consultancy Services. This they would receive by way of dividends declared by Tata Sons in future (after the rights issue). But, the counter argument would remain that portfolio diversification of assets and investment management can be done by an individual/institutional investor on their own (or by investing in the mutual funds).

❖ Group Companies Increasing Investment Activities

Now we go through related financial numbers of major Tata group affiliates over the past fifteen years.

Table 3: 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 Tata Finance)	0	1,909	2,874	19,422
Sales	25,508	56,403	87,309	202,765
PBDIT (Profit before Depreciation, Interest, and Tax)	3,704	7,527	9,243	23,369
Assets	16,975	41,369	90,028	139,946
Net Worth	5,831	14,203	37,541	41,113
Receivables from group companies as a percent of Sales	0.1%	1.3%	4.3%	2.7%
Investment in group companies as a percent of Assets	0.0%	4.6%	3.2%	13.9%
Investment in group companies as a percent of Shareholders Funds	0.0%	13.4%	7.7%	47.2%

As per table 3, Tata Motors has performed well in sales growth over the years. Its investments in group companies has risen phenomenally over the period which points to increasing stakes in other group associates.

Table 4: 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 Construction & Projects)	405	2,057	6,077	13,897
Sales	21,922	45,487	74,988	167,270
PBDIT (Profit before Depreciation, Interest, and Tax)	4,861	7,909	12,919	61,659
Assets	33,854	77,845	121,198	166,959
Net Worth	14,241	26,880	53,449	70,599
Receivables from group companies as a percent of Sales	0.5%	0.1%	0.4%	4.1%
Investment in group companies as a percent of Assets	1.2%	2.6%	5.0%	8.3%
Investment in group companies as a percent of Shareholders Funds	2.8%	7.7%	11.4%	19.7%

Tata Steel is the most important company in the group apart from Tata Motors. As seen from table 4, sales and profits have grown consistently over the period. Tata Steel has generated substantial amount of funds from internal sources to fuel its expansion plans. External funds are miniscule compared to internal funds. Receivables from group companies have risen consistently over the period, which may be seen as leeway to group companies. Investment in group companies has also gone up substantially over the period which reflects the groups strategy of increasing the cross holding between the group companies to thwart hostile takeover bids.

Table 5: Group Dealings of Tata Power (Rs. in millions)				
	1991	**1995**	**2000**	**2005**
Receivables from group companies	0	54	2,058	1,087
Investment in group companies (mainly VSNL & Tata Teleservices)	0	1,922	3,690	20,206
Sales	4,740	10,599	14,046	39,565
PBDIT (Profit before Depreciation, Interest, and Tax)	791	3,082	5,435	12,335
Assets	6,510	21,539	36,806	93,862
Net Worth	2,309	10,445	18,565	51,364
Receivables from group companies as a percent of Sales	0.0%	0.5%	14.7%	2.7%
Investment in group companies as a percent of Assets	0.0%	8.9%	10.0%	21.5%
Investment in group companies as a percent of Shareholders Funds	0.0%	18.4%	19.9%	39.3%

Tata Power has shown a huge jump in sales and profits in the last five years due to the merger of the three power companies and this is also the reason for a substantial jump in its total assets, net worth and gross fixed assets over the last five years. Merger has led to decrease in its group receivables. We also observe from table 5 its ten fold increase in its investment activities (in group associates) in the last one decade.

Table 6: Group Dealings of Tata Chemicals (Rs. in millions)				
	1991	**1995**	**2000**	**2005**
Receivables from group companies	83	73	0	0
Investment in group companies (mainly Indian Hotels & Titan)	2	996	1,981	3,876
Sales	2,994	4,983	15,194	30,979
PBDIT (Profit before Depreciation, Interest, and Tax)	1,316	3,655	4,924	6,728
Assets	10,417	23,296	34,575	45,919
Net Worth	3,345	8,249	16,931	19,978
Receivables from group companies as a percent of Sales	2.8%	1.5%	0.0%	0.0%
Investment in group companies as a percent of Assets	0.0%	4.3%	5.7%	8.4%
Investment in group companies as a percent of Shareholders Funds	0.0%	12.1%	11.7%	19.4%

Table 6 also depicts a similar story of good sales and profits growth in Tata Chemicals. Investments in other Tata affiliates again are very much in line with our overall hypothesis of increasing cross holdings.

Table 7: Group Dealings of Tata Tea (Rs. in millions)				
	1991	**1995**	**2000**	**2005**
Receivables from group companies	138	120	6	358
Investment in group companies (mainly Tata Chemicals, Tata Investment Corp , Titan & Tata Coffee)	226	1,207	5,990	7,804
Sales	2,943	3,991	9,133	8,930
PBDIT (Profit before Depreciation, Interest, and Tax)	1,061	1,085	2,201	2,057
Assets	3,593	5,467	13,526	15,402
Net Worth	1,628	2,888	8,521	10,489
Receivables from group companies as a percent of Sales	4.7%	3.0%	0.1%	4.0%
Investment in group companies as a percent of Assets	6.3%	22.1%	44.3%	50.7%
Investment in group companies as a percent of Shareholders Funds	13.9%	41.8%	70.3%	74.4%

Tata Tea has increased its sales and profits over the period (see table 7). As seen in FY2005, the investment in group companies is more than three times its PBDIT which possibly indicate that the company is not getting much benefit from such an investment and this move is actually hurting shareholder interests. This can be considered as something which is not in line with good corporate governance practices.

Table 8: Group Dealings of Indian Hotels (Rs. in millions)				
	1991	**1995**	**2000**	**2005**
Receivables from group companies	34	20	2,043	6,435
Investment in group companies	30	303	3,364	5,617
Sales	1,563	2,983	6,186	8,880
PBDIT (Profit before Depreciation, Interest, and Tax)	367	981	2,043	2,538
Assets	2,325	3,606	15,644	26,102
Net Worth	716	1,856	9,590	11,282
Receivables from group companies as a percent of Sales	2.2%	0.7%	33.0%	72.5%
Investment in group companies as a percent of Assets	1.3%	8.4%	21.5%	21.5%
Investment in group companies as a percent of Shareholders Funds	4.2%	16.3%	35.1%	49.8%

Table 8 gives the numbers for Indian Hotels. The picture depicts that the company has the highest group dealings. The receivables from group companies and also the investment in group companies have increased to a huge extent over the last ten years. Receivables from group companies stand at almost 70% of the sales of the company. One needs to probe these numbers to make further conclusions on Governance related aspects.

Appendix 2 gives similar financial numbers for other smaller Tata group affiliates, namely, Voltas (table 9), Titan (table 10), Rallis (table 11), Tata Metaliks (table 12), Tata Tinplate (table 13), Tata Sponge Iron (table 14), and Tata Coffee (table 15). The picture is very similar for companies which are making profits such as Voltas but for companies which are struggling such as Rallis we find that there are no investments in group affiliates. There are extreme cases, for example, Titan's dividend payout ratio has decreased while its intra-group investments have increased. Turnaround companies such as Tata Tinplate, Tata Metaliks, and Tata Sponge Iron (which have just started having good numbers) have also made a modest beginning by investing in group companies. Due to lack of sufficient history, we have not presented the numbers of some a large Tata affiliates such as Tata Consultancy Services, and Trent.

❖ Trends in Dividends of Tata Group Companies

Another way of looking at the whole issue could be from the benefits perspective of a long-term minority shareholder in one of these large Tata group affiliates. Table 16 tracks down the dividend payments of some of these Tata group affiliates:

Table 16: Annual Dividend Per Share Payments of Tata Affiliates (as a % of the Par Value)

Year	Indian Hotels	Tata Steel	Tata Motor	Tata Power	Tata Chem	Tata Tea	Rallis	Nelco	Titan	Voltas	TRF	Tata Metlik
1995	55	35	60	30	65	60	45	10	30	35	27.5	0
1996	75	45	60	35	65	60	45	0	33	25	27.5	0
1997	85	45	80	35	65	65	45	0	33	0	30	0
1998	85	40	55	37	65	101	50	0	25	0	35	0
1999	85	40	30	37	50	110	60	0	26	12	20	0
2000	85	40	25	42	50	101	60	0	26	12	22	0
2001	100	50	0	50	50	90	0	0	26	12	26	12
2002	80	40	0	50	50	70	100	10	15	18	26	23
2003	70	80	40	65	55	70	0	10	10	25	12	25
2004	80	100	80	70	55	85	0	0	10	30	26	35
2005	100	130	125	75	65	100	10	n/a	20	50	30	60

Note: These figures are not adjusted for any bonus issues and stock splits[19].
Source: CMIE-PROWESS and ISI Emerging Markets Database

If we compare these dividend payment trends (see table 16) with the trends in the cross investments of these affiliates (tables 3 to 15), one can observe that the increase in cross holding investments by group companies has risen at a much rapid pace compared to the increase in the dividend payments to shareholders. These differing trends possibly give a hint at the major objective of these organizations.

❖ Capturing the Changes in Cross Holding Structure

We observe that the ownership pattern of various Tata group affiliates gives us the increasing indirect holding of Tatas over these companies. Table 17 summarizes the total equity stake held in companies by Tata Group affiliates. The last column shows the change in the number of group companies holding the stake from 2000 to 2005.

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[19] To our knowledge only Tata Steel has issued bonus shares (recently).

Table 17: Number of Holding Companies for each Group Member and their Total Stake			
Company	Total stake by Tata Group		No. of Holding Companies
	2000	2005	
Tata Sponge	39.7	41.5	1 --> 2
Tata Metaliks	46.7	47.7	1 --> 1
Tata Finance[20]	17.9	87.7	1 --> 5
Tata Construction & Projects	26.5	27.2	1 --> 2
Voltas	25.0	27.6	2 --> 2
Indian Hotels	16.6	30.0	3 --> 5
Tata Advanced Materials[21]	90.7	Amalgamated	
Tata Honeywell	20.8	Sold off stake	
Tata Coffee	50.6	50.7	1 --> 1
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 Elxsi[22]	38.1	38.1	2 --> 1
Tata SSL[23]	87.0	Amalgamated	
Tata Steel	24.5	26.7	2 --> 2
Tata Motors	23.3	34.2	2 --> 3
Tata Infotech[24]	74.8	74.9	1 --> 1

Note: (a) For counting the number of holding companies, we only consider holding companies having more than 1% stake; (b) We have not been able to gather enough about some other affiliates such as Tata Consultancy Services and Tata Industries.
Source: CMIE-PROWESS, and Bombay Stock Exchange Database

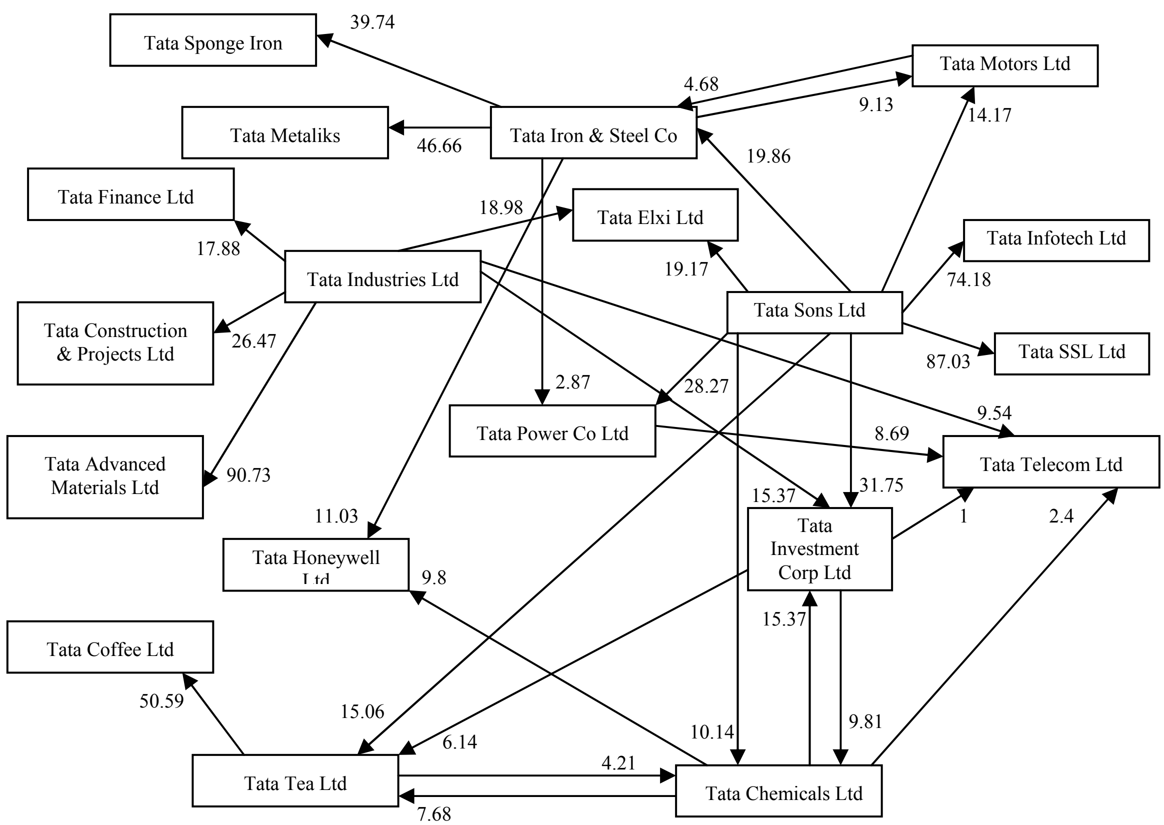
Table 17 gives us some more inputs. We observe that the group has largely increased its indirect holding over these affiliates during the five year period. It is also consolidating firms in similar business into one. Secondly, we also observe that the ownership of these Tata group affiliates is becoming more dispersed i.e., the number of holding companies is increasing. Apart from the primary holding company (Tata Sons), we observe that there are many other Tata group controlled investment firms which are part of this complex holding pattern (say, Tata Industries, Kalimati

[20] During the last five years, the Tata group lent Tata Finance around Rs 300 crore, which was converted into equity. Post conversion, the Tata group's stake jumped to around 85-88 per cent from 65 per cent. Of the Rs 300 crore that was pumped in, Tata Sons invested Rs 160 crore, while Tata Industries chipped in with Rs 140 crore. Recently, Tata Motors amalgamated Tata Finance with itself.
[21] Tata Advanced Materials Ltd was making losses since 1993 and was referred to BIFR in 1999. Tata Industries acquired the stake held by public in the company in 2001.
[22] Tata Sons, the holding company of the group bought out the entire stake held by Tata Industries, the original promoter of Tata Elxsi in 2003. The inter se transfer was part of the group's plans to integrate all IT companies with TCS. As most group IT companies are likely to be merged into TCS.
[23] Tata SSL was amalgamated with Tata Steel in 2003
[24] Tata Infotech was merged into TCS on April 2005, although the BSE website still shows it as a separate company.

Investments, Aftab Investment Corp, Ewart Investments and Sheeba Properties).[25]

Now that we have reasonably documented the major changes in the investment patterns of Tata Group and its affiliates, we now go ahead and depict the probable crossholding pattern of the group in the years 2000 and 2005.

Figure 1: Structure of Tata Groups Listed Firms during financial year 2000 [26]



Note: (a) Shown above is the Equity Ownership Pattern of major Tata affiliates having more than 1% as of FY 2000; (b) Tata Sons is the primary holding company of the group. Most of the firms are held by Tata Sons and Tata Industries. The Tatas control 83.03% in Tata Sons and 74.18% in Tata Industries.

The ownership structure of Tata group shows signs of both "pyramid" and "cross-shareholding" structures in-group firms. A "pyramid" denotes a hierarchical chain by which a family controls a

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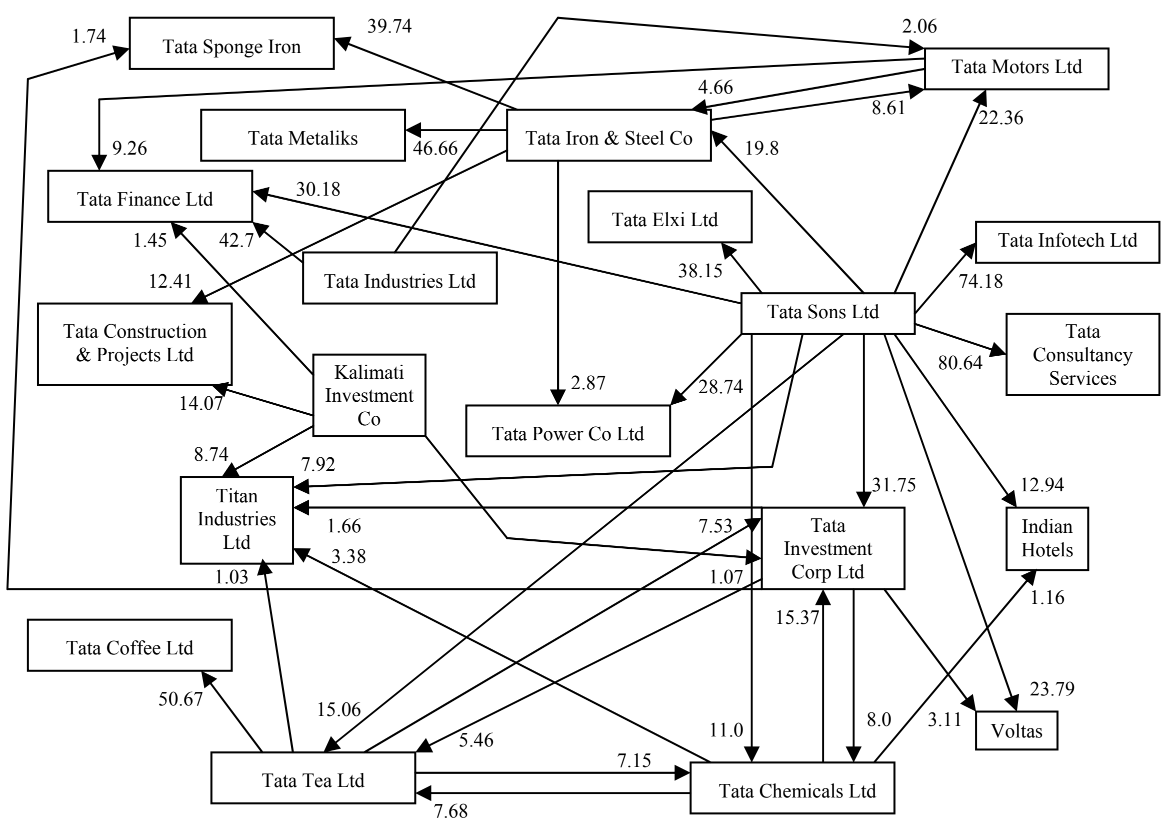
[25] The available information on shareholding pattern of listed affiliates suggests the following investment companies being active – (a) Aftab Investments: Holdings in Nelco 1.24%, Tata Investment 3.01%; (b) Kalimati Investment Company: TRF 1.56%, Titan 8.74%, Tinplate Company 1.24%, Tata Investment 1.07%, Tata Construction and Projects 14.07%, Tata Finance 1.45%; (c) Ewart Investments: Holings in Rallis 1.35%, Tata Investment Corp. 1.58%; (d) Sheeba Properties – Holding in Tata Finance 2.82%. We also find some other entities in the list of persons acting in concert such as Jamsetji Tata Steel, Navajbai Ratan Tata Trust, Sir Dorabji Tata Trust, and Lady Tata Memorial Trust.

[26] Taken from a research paper by Jayesh Kumar titled "Capital Structure and Corporate Governance", XIMB

firm, and cross holding happens when a controlled firm owns any shares in its controlling shareholder or in the firms along that chain of control (including any indirect means). The Tata family owns equity in core affiliates (i.e. Tata Industries Limited and Tata Sons Limited which are not publicly traded firms, majority of the stake in these two firms are held by 66 philanthropy trusts mainly headed by Tata family members).

In India, cross-shareholding between two firms is common. For instance, Tata Investment Corporation Ltd holds 9.8% in Tata Chemicals Ltd, and 6.14% in Tata Tea Ltd, while Tata Chemicals Ltd holds 15.37% in Tata Investment Corporation Ltd directly. Tata Tea holds 4.21% in Tata Chemicals Ltd and Tata Chemicals Ltd holds 7.68% in Tata Tea Ltd. 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.

Figure 2: Structure of Tata Groups Listed Firms during financial year 2005



Note: (a) Shown above is the Equity Ownership Pattern of major Tata affiliates having more than 1% as of Year 2005; (b) Tata Sons is the primary holding company of the group. Most of the firms are held by Tata Sons, Tata Industries, and Kalimati Investment Company. The Tatas control more than 83% in Tata Sons and more than 74% in Tata Industries. Information on the other holding arm, Kalimati Investment Company is not available.

5. Conclusion

One of the enduring themes of the corporate world in the last decade has been the restructuring effort of large corporate houses. The restructuring efforts have been quite high in countries going through the process of liberalization and globalization such as India. Restructuring efforts in India usually involve issues related to managing the ownership structure for having good management control and also it involves building enough defenses to avoid possible hostile takeover battles. We undertook to study the Tata group as probably the best example of a large Indian business group that has gone through a great deal of restructuring and changes in ownership pattern over the past few years. We were primarily interested on looking at the changes in cross holding pattern and its influence on various issues related to management control and corporate governance.

The Tatas used to manage their companies with very small equity stakes.[27] Prior to restructuring, in 1991, the Tata group was a loose confederacy of 300 companies having sales of around Rs 86 billion and controlling an asset base totaling more than Rs 85 billion with minor ownership stakes. As a consequence the chairmen of larger affiliates had grown accustomed to ruling their domains without interference from the Tatas and once in a while competing with each other in a similar line of business. Ratan Tata decided to change the group. The Tata group restructuring involved various steps such as building Tata brand, reviving its managerial recruitment and retaining practices (through, reviving TAS), changing the portfolio of business lines, and most importantly making the group more cohesive, and controllable.

Using various published information, we looked at the changes in their corporate characteristics of various Tata group companies. While the brand name of the Tatas would have ensured that there would be little risk to loss of management control still the group decided on increase its ownership stake in its affiliates. Surely, a stake of at least 26% would have made it morally and legally easier to manage them. An increase in the cross holding structure of group companies combined with pyramid structures provided a mechanism for the Tata group to control firms within the group without necessarily having significant equity investment. We found that the group has indeed achieved higher control.

We also observe that in their quest to increase stakes in group companies, the Tatas can be said to have hurt the investor's interests. In the last ten years, we observe that using crossholdings the Tata Sons, other investment companies and other major affiliates have increased their shareholding in major companies beyond the required 26 per cent. This 26% stake was a limit required to protect against hostile takeover bids. An increased complexity in the cross holdings among group companies is a classic counter takeover defense strategy. There is nothing illegal about it but there are many other ways in which it could have been done with safeguarding the shareholders interests. For example, we observe that most of the well to do Tata group companies have increased their investment in other group companies at a rapid pace compared to the slow rise in their dividend payments.

[27] One of the popular anecdotes in initial 1990s used to be the fact that the Birlas had a higher stake in Tata Steel (TISCO) than the Tatas.

The advantages of having higher crossholdings are: (a) helps in aligning the incentives of the Tata group affiliates; and (b) helps in sharing of information among group affiliates. The disadvantages of having higher crossholdings are: (a) reduction in transparency of the companies; (b) allows companies to take actions in the group management interests ignoring other shareholder interests (i.e., without fear of reprisal from capital markets). Cross holding as observed in Japanese keiretsus can also result in affiliates creating a mutual understanding to not disturb the status quo i.e., creating a quite life equilibrium position (see, Bergloff and Perotti, 1994); and (c) cross holdings forces an individual shareholders portfolio diversification i.e., the shareholders (in any one of the Tata company) begin to hold a much more diversified portfolio of shares.

Literature is laced with a large number of empirical papers providing the negative effects of increasing cross holdings. A divergence in cash flow rights and control rights may exacerbate agency costs as it provides incentives and opportunities for controlling shareholders to expropriate wealth from minority shareholders of firms in which they have low cash flow rights to firms in which they have higher cash flow rights (see, Marisetty, 2005). This can be done by tunneling/ transfer of assets and earnings.

There are many business groups which have adopted crossholdings and intra-group transactions. In Asia Pacific countries it is a common practice. We would like to mention that this study on the Tata Group is part of a larger study on Indian business groups. The work on other business groups is on going. Some of the Indian groups worth mentioning are Reliance, Thapar, and RPG. One has to look at other groups crossholdings to come out with stronger conclusions.

❖ Limitations and Further Scope

Our study has all the limitations which a case-based study normally carries.

To our knowledge, in India, this is one of the few case studies in this direction attempting to link crossholdings, with control and governance. One can take the research further. A deeper analysis would need a higher level of quality and quantity of data. One can isolate and see the effect of increase in shareholding alone. One can also look at the other alternate strategies that could have been adopted by the group.

One can probe the findings by looking at the strategic intent for the long term in mind and for which sometimes short term shareholder interests need to be sacrificed. For example a company might reduce its dividend payments or forgo collections from group companies and invest the funds for expansion only to give shareholder higher returns in the future.

We observe the popular media stating that some of the larger business groups (such as Aditya Birla, and Bajaj) have adopted a different position and they have been untangling their cross holdings. An interesting study would be to compare and see at the process adopted by them, look at the related agency issues (if any) and also compare the style and financial performance vis-à-vis the Tata group.

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Appendix 1: Tata Groups Portfolio: Businesses In and Out

The group has aligned its businesses into seven core sectors namely: Engineering, Materials, Energy, Chemicals, Services, Consumer Products, and Information Systems & Communications. The table below shows the diversification pattern followed by the group, the businesses they exited and the new sectors they entered.

Diversification pattern of the Tata Group		
Year	**Industry entered**	**Industry exited**
1874	Textiles	
1902	Hospitality	
1907	Steel	
1910	Power	
1912	Cement	
1917	Soaps & Cooking Oils	
1931	Paper and Publishing	
1932	Aviation	
1939	Chemicals	
1940	Consumer electronics	
1945	Locomotives & Commercial Vehicles	
1952	Cosmetics	
1953		Aviation
1954	Air-Conditioning	
1958	Pharmaceuticals	
1962	Tea & Coffee	
1968	Software & Information Technology	
1970		Locomotives
1984	Watches	
	Financial Services	
1994	Auto components	Soaps & Cooking Oils
1996	Telecom	
1998	Passenger Cars	Cosmetics
		Pharmaceuticals
1999	Retail	Bearings
2000		Cement
2001	Insurance	Oil Drilling & Textiles
2002		Paints
2006	Biotech & Drug R&D (consideration)	

Appendix 2: Financial Numbers of Other Tata Group Companies

Table 9: Group Dealings of Voltas (Rs. in millions)				
	1991	**1995**	**2000**	**2005**
Receivables from group companies	48	196	117	34
Investment in group companies	20	191	428	505
Sales	6,248	8,108	7,903	14,497
PBDIT (Profit before Depreciation, Interest, and Tax)	482	770	483	755
Assets	4,332	8,658	6,357	10,588
Net Worth	749	1,647	1,538	1,935
Receivables from group companies as a percent of Sales	0.8%	2.4%	1.5%	2.2%
Investment in group companies as a percent of Assets	0.5%	2.2%	6.7%	4.8%
Investment in group companies as a percent of Shareholders Funds	2.7%	11.6%	27.8%	26.1%

Table 10: Group Dealings of Titan (Rs. in millions)				
	1991	**1995**	**2000**	**2005**
Receivables from group companies	0	0	521	1,072
Investment in group companies	0	206	211	487
Sales	1,062	2,803	6,322	11,373
PBDIT (Profit before Depreciation, Interest, and Tax)	274	600	966	932
Assets	1,654	4,019	6,907	8,195
Net Worth	332	1,485	2,008	1,772
Receivables from group companies as a percent of Sales	0.0%	0.0%	8.2%	9.4%
Investment in group companies as a percent of Assets	0.0%	5.1%	3.1%	5.9%
Investment in group companies as a percent of Shareholders Funds	0.0%	13.9%	10.5%	27.5%

Table 11: Group Dealings of Rallis (Rs. in millions)				
	1991	**1995**	**2000**	**2005**
Receivables from group companies	87	4	30	0
Investment in group companies	31	288	273	6
Sales	3,617	6,784	14,528	6,229
PBDIT (Profit before Depreciation, Interest, and Tax)	191	433	1,068	707
Assets	1,922	3,172	8,102	4,642
Net Worth	456	652	1,572	1,461
Receivables from group companies as a percent of Sales	2.4%	0.1%	0.2%	0.0%
Investment in group companies as a percent of Assets	1.6%	9.1%	3.4%	0.1%
Investment in group companies as a percent of Shareholders Funds	6.8%	44.2%	17.4%	0.4%

Table 12: Group Dealings of Tata Metaliks (Rs. in millions)				
	1991	1995	2000	2005
Receivables from group companies	n/a	0	0	0
Investment in group companies	n/a	0	0	4
Sales	n/a	438	937	3,123
PBDIT (Profit before Depreciation, Interest, and Tax)	n/a	48	105	1,061
Assets	n/a	617	676	2,037
Net Worth	n/a	238	287	1,022
Receivables from group companies as a percent of Sales	n/a	0.0%	0.0%	0.0%
Investment in group companies as a percent of Assets	n/a	0.0%	0.0%	0.2%
Investment in group companies as a percent of Shareholders Funds	n/a	0.0%	0.0%	0.4%

Table 13: Group Dealings of Tata Tinplate (Rs. in millions)				
	1991	1995	2000	2005
Receivables from group companies	0	0	0	0
Investment in group companies	0	0	0	2
Sales	1,895	2,383	1,500	2,653
PBDIT (Profit before Depreciation, Interest, and Tax)	115	192	344	683
Assets	933	3,847	3,920	3,805
Net Worth	229	1,202	884	1,275
Receivables from group companies as a percent of Sales	0.0%	0.0%	0.0%	0.0%
Investment in group companies as a percent of Assets	0.0%	0.0%	0.0%	0.1%
Investment in group companies as a percent of Shareholders Funds	0.0%	0.0%	0.0%	0.2%

Table 14: Group Dealings of Tata Sponge Iron (Rs. in millions)				
	1991	1995	2000	2005
Receivables from group companies	0	0	0	0
Investment in group companies	0	0	0	8
Sales	152	538	1,254	2,671
PBDIT (Profit before Depreciation, Interest, and Tax)	73	110	236	1,038
Assets	393	579	1,094	1,979
Net Worth	-73	261	505	1,319
Receivables from group companies as a percent of Sales	0.0%	0.0%	0.0%	0.0%
Investment in group companies as a percent of Assets	0.0%	0.0%	0.0%	0.4%
Investment in group companies as a percent of Shareholders Funds	0.0%	0.0%	0.0%	0.6%

Table 15: Group Dealings of Tata Coffee (Rs. in millions)				
	1991	**1995**	**2000**	**2005**
Receivables from group companies	0.3	12	3	212
Investment in group companies	1.5	2	74	87
Sales	262	768	2,157	1,987
PBDIT (Profit before Depreciation, Interest, and Tax)	75	358	551	436
Assets	358	674	1,885	3,000
Net Worth	192	323	1,218	1,732
Receivables from group companies as a percent of Sales	0.1%	1.6%	0.1%	10.7%
Investment in group companies as a percent of Assets	0.4%	0.3%	3.9%	2.9%
Investment in group companies as a percent of Shareholders Funds	0.8%	0.6%	6.1%	5.0%