Chapter 4
Ownership Control and Board Governance of Indian Business Groups: Continuity or Change?

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Abstract This chapter analyzes how the ownership, control, and board governance of Indian business groups have evolved over time against the backdrop of evolving laws and regulations in India. The analysis is based on a panel data of group affiliated and unaffiliated firms for the period 2005–2018 during which the governance reforms that were initiated in the earlier years took root, and several new ones were introduced through revisions of existing regulations and laws. The chapter seeks to answer mainly two questions. First, have the nature of the agency problems pertinent to business groups as manifested in their ownership and control structures fundamentally changed in response to dynamic changes in their institutional environment? Second, have reforms introduced to change the ways in which groups are governed by the board of directors made any impact on the way these groups are actually governed? Contrary to the expectations drawn from the institutionalist perspective that the relevance of business groups that fill institutional voids will wane as markets develop, the analysis in this chapter points to the continued predominance and persistence of Indian business groups within the corporate sector. Several of the groups, such as the Tatas and Birlas, which were established in the pre-independence era, have continued to remain in leadership positions with a handful of large business groups continuing to dominate the sector, irrespective of the changes in the institutional environment. Big groups have become even bigger in terms of their asset base, and changes in the relative positions of groups at the top end of the distribution have been sticky at best even after more than hundred years of their existence and continued entry of new groups from time to time. Within groups, ownership structures have become more concentrated over time, with promoters of almost all groups now having majority control in all the listed firms of the groups. The pervasiveness, persistence, and dominance of promoters in Indian business imply that there is little scope for monitoring internal management by other large block holders.

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4.1 Introduction

Business groups in India have continued to remain a dominant organizational form despite structural shifts in the policy and institutional environment over different time periods. In the post-independence era, one of the most critical shifts in this respect has been the change in the corporate governance framework of firms introduced through far reaching governance regulations since the early nineties, and through the enactment of a revised legislative framework under the Companies Act, 2013. The objectives of corporate governance reforms in India, as in many emerging economies with business group dominance, have been to reduce agency costs manifested in minority shareholder expropriation by controlling shareholders, and to improve firm performance. Thus, reforms have focused on bringing about greater transparency in the ownership and control structure of firms, reducing insider control of the board of directors by increasing board independence, and improving disclosure requirements pertaining to related party transactions and financial statements. Much of such reforms have automatically brought under its purview firms affiliated to business groups by virtue of their complex ownership and control structure as manifested in equity pyramids, cross-holdings and opacity in equity linkages, family dominance of board of directors, prevalence of related party transactions, and presence of internal capital markets. As the existing body of empirical research has shown, such characteristics have had implications for incentives of controlling insiders of business groups to expropriate outside minority shareholders with consequent impact on the value of group affiliated firms.

In view of the above, the objective of this chapter is two-fold. First, it seeks to examine the evolution of the governance structure of firms affiliated to business groups with respect to two key characteristics of business groups, namely, ownership and control, and composition of the board of directors. Second, keeping the objectives of governance reforms in the background, and using a panel of group affiliated firms in India for the period 2005–2018 as well as of the top Indian business groups, the chapter offers a big picture of how the governance of group affiliated firms has evolved over time in relation to its intended objectives. In doing so, the paper evaluates whether *de jure* corporate governance reforms largely intended for business groups have translated to *de facto* changes in their governance structure or whether there has been overall persistence in these two key characteristics despite such reforms.

The empirical analysis in this chapter is based on two types of samples, each of which covers the financial years from 2005 (April 1, 2004 to March 31, 2005) to 2018 (April 1, 2017 to March 31, 2018). The first sample consists of all firms, listed and unlisted, those are reported in the Prowess database. We use this sample to put into perspective the relative dominance of business groups in the Indian corporate sector. Using data for the year 2018, we identify 569 business groups in this sample each of which satisfies two criteria namely that the group has at least two firms, listed or unlisted, and has non-missing values for total assets. The second sample consists of only listed firms belonging to these 569 business groups. We use this sample to trace the evolution of ownership structures and board composition since

the slew of corporate governance reforms in the last three decades, as well as the discussion in the literature, are directed mostly to listed firms. This sample consists of an unbalanced panel of 3,065 firm-year observations, with the number of firms varying from 388 in the year 2005 to 581 in the year 2018.

The rest of the chapter is organized as follows. With Sect. 4.1 being the introduction, Sect. 4.2 examines the origins and early development of business groups in India and discusses their fundamental organizational elements. The incidence, characteristics, and dynamics of the evolution of business groups against the backdrop of institutional changes are analyzed in Sect. 4.3. Section 4.4 examines in detail the ownership and control structures of business groups, how these have evolved over time, and the implications of such structures for corporate governance. Section 4.5 examines the role of the board of directors in mitigating governance problems in Indian business groups in light of the various changes in the regulatory and legislative framework during the period of the study. Concluding comments are made in Sect. 4.6.

4.2 Business Group as an Organizational Form

A business group, as defined in the Indian context, can be considered as an agglomeration of both privately held and publicly traded firms operating in different lines of businesses, each incorporated as a legal entity, but where all the firms are bound together usually under the common ownership and control of a family.[1] This definition largely draws from the characterization of Hazari (1966: 4) who defines a group as "consisting of units which are subject to the decision-making power of a common authority" and functions as a single organization although each of the corporate units under its control has a separate legal entity. The definition is also at par with how Indian groups were defined under the Monopolies and Restrictive Trade Practices (MRTP) Act of 1969 that dealt with the concentration of economic power among Indian business groups, whereby a group was considered to constitute of (i) "two or more individuals, association of individuals firms, trusts, trustees or bodies corporate (excluding financial institutions), or any combination thereof, which exercises or is established to be in a position to exercise, control, directly or indirectly, over any body corporate, firm or trust, and (ii) associated persons" (MRTP 1969: 6).[2] In all these definitions, the key element is the *control* exercised on firms by an apex body (i.e., the family) through equity channels (equity ownership) as well as non-equity channels (administrative control through board of directors, inter-locking directorships, related party transactions).

[1] This definition broadly conforms to the one used by Khanna and Palepu (2000) but brings into its ambit privately owned and controlled firms under a group's control.

[2] https://www.mca.gov.in/Ministry/actsbills/pdf/The_Monopolies_and_Restrictive_Trade_Practices_Act_1969.pdf.

On the basis of several well-cited historical accounts on Indian business,[3] one can trace the beginnings of family-owned business groups in industrial activity to the second half of the nineteenth century. Prior to this period, industrial activity was monopolized by European business houses, and the participation of Indians in business activities was confined essentially to trading and money lending enterprises delineated by family, caste, and ethnicity. The beginnings of the first business group in India in the pre-independence era, the Tata Group, can be traced back to the setting up of the Bombay Spinning and Weaving Company in July 1854 by Cowasji Nanabhai Davar that was followed by the entry of a large number of textile mills promoted by other entrepreneurs. Few years later, the foundations of other major business groups such as the Khataus, Birlas, and the Mafatlals were laid.

The motivation of Indian business leaders to float new ventures, to expand and diversify, coupled with the need for capital to fund such diversification owing to an underdeveloped stock market and banking system led to the evolution of the business group structure over time. Most industrial ventures during this time were floated and financed by families engaged in trade and commerce, with the first round of industrial projects setting off a chain reaction where surplus funds generated in these projects were re-invested to promote other industrial and finance activities. This led to the incorporation of many of the business ventures as joint stock companies, where family members and acquaintances were issued shares to retain family control. It also set off a process of vertical and horizontal integration that bypassed the hazards of market transactions, generated scale, and scope economies, and led to the formation of business group as an institution in India (Mehta 1955). Finally, a business group typically had a managing agency which enabled the group to cope with a deficient managerial market in the early years of industrialization, as also ensured family control over group affiliates. As Tripathi (2004) notes, during 1918–39, the share of Indian business groups in capital employed more than doubled from 13 to 34%. Further, three of the top four business groups were controlled by Indians (Hazari 1966).

Post-independence, two structural breaks in the institutional environment impacted the evolution of groups. First, the post-independence years up to 1991 of extensive regulation of business groups by the government, and second, the post-1991 period of liberalization and globalization of the Indian economy when structural reforms were initiated in 1991. Despite the curbs on the scale and scope of private sector activity placed by the industrial licensing policy till the mid-eighties, and the restrictions placed on the expansion of asset base of big businesses through the MRTP Act of 1969, business groups continued to find their footing well into the 1960s and 1970s. The structural reforms since the early nineties saw the abolition of licensing and the withdrawal of the MRTP Act, and as a consequence, large business houses

[3] For comprehensive historical accounts of Indian business groups, see among others, Tripathi (2004), Piramal and Herdeck (1986), Mehta (1955), Dutta (1997) cited in Sarkar (2010). The account on the evolution of Indian business groups in this section draws significantly from Sarkar (2010).

were free to invest, expand and diversify consistent with their capabilities. Concomitantly, financial sector reforms led to the deregulation of the equity markets as well as that of the banking sector to ease the bottlenecks in external finance and allow for a greater play of market forces in determining the availability and allocation of finance for corporate sector investment. Thus, while prior to the financial sector liberalization, on account of the dormant and underdeveloped capital market, internal financing was dominant as the source of finance for Indian corporates, post liberalization, the importance of external finance in the form of bank borrowings and raising capital from the equity markets have on an average been higher (Sarkar and Sarkar 2012; Rajakumar 2014). Finally, the corporate governance reforms that were initiated since the late nineties changed the institutional environment in which business groups, and corporates at large have functioned. While economic liberalization ensured that business decisions are market based rather than taken by government fiat, and relaxed the constraints on external finance for firms, corporate governance reforms were initiated in the late nineties to put mechanisms in place to enable effective monitoring of firms by the suppliers of finance. Comprehensive reforms in this area sought to strengthen effective protection of shareholders through promoting higher standards of information disclosure and enforcement, and company board structure and procedures were reformed to make the board of directors and management more accountable to the shareholders.

How have Indian business groups as an organizational form responded to the structural changes in their institutional environment? The dynamics of the evolution of business groups in India in the context of an evolving institutional environment can be understood from an institutionalist perspective which sees a business group as a diversified hybrid organizational structure that typically comes up in response to missing markets and weak institutions, combining the functions of both firms and markets (Khanna and Yafei 2007; Leff 1976). In developing economies like India, weak financial markets with imperfect information, imperfections in the managerial markets, weak investor protection, and inadequate rule of law have been cited as some of the shortcomings of the institutional environment, which may have given rise to business groups that can produce these public goods for the benefit of their affiliates (Khanna and Yafei 2007). As a corollary of this hypothesis, as markets emerge and institutions are strengthened, the comparative advantage of the group structure as quasi-market institutions can be expected to diminish vis-à-vis unaffiliated firms.

While the institutionalist perspective predicts the diminishing role of business groups as markets develop and institutions strengthen, alternative perspectives point to the continued dominance of the group structure notwithstanding institutional development. For instance, as Sarkar (2010) notes, the sociological perspective views business groups as social networks of firms bound by formal and informal ties, with the “axes of solidarity” among group affiliates identifiable along geographical, political, ethnic, kinship and religious lines (Granovetter 1995). Given that Indian business groups are deeply rooted in the joint family structure and are not merely economic structures but a source of “social identity” bound by relational contracts and interlocked directorships within the community with high degrees of trust and reciprocity (Dutta 1997; Encarnation 1990), it is unlikely that business groups, once

acquiring a predominance as an organizational form, will lose its comparative advantage as markets develop. There could be non-diversification related benefits too that stem independent of market imperfections. For example, Ramaswamy et al. (2012), using longitudinal data on group affiliated firms, find that affiliation to groups has brought in performance benefits to firms even when markets have developed, thereby concluding that a group structure can generate non-diversification related benefits contrary to what is hypothesized under the institutionalist perspective. On the other hand, Kali and Sarkar (2011), using a case study of Indian firms, find that group affiliate firms are often engaged in activities away from the business of the core firm of the group, which they think are suggestive of the fact that these firms act as destination points for tunneling resources from the top to the bottom of the ownership pyramid for benefitting the family at the expense of the minority shareholders.

4.3 Characteristics of Indian Business Groups

This section presents an evaluation of the importance of Indian business groups in corporate sector activity as of 2018, as well as examines some dynamics of the evolution of major business groups at different time points since 1980 and up to 2018. The data used for these exercises have been sourced partly from previously published accounts of Indian business groups and partly from the Prowess database, a computerized database containing detailed time series information (from 1990 onwards) published in annual reports, along with stock market data, ownership information, and corporate governance characteristics on many companies.

4.3.1 Incidence of Business Groups

Annexure 4.1 at the end of this chapter presents key aspects of the Prowess database from which the data on Indian business groups and firms affiliated to business groups have been culled. An understanding of this data as presented in Table A.1 is important to get an estimate of the importance of business groups in India, and the extent to which information is available in the public domain on these groups. Depending on the analysis at hand, different samples are drawn from the set of groups reported in the Prowess database as of November 2018. As can be seen from Table A.1, 734 distinct Indian business groups are identified and reported in the Prowess database. By distinct, one means that each group is identified by a unique name, and distinct firms are listed under each group reported. With regard to these 734 groups, as of 2018, the total number of firms, those that are listed on either the National Stock Exchange or the Bombay Stock Exchange or both, and also those that are unlisted is 11802. Several of the 734 groups have only one firm reported per group. Given that a group makes sense only if has at least 2 firms, using this filter brings down the number of groups reported to 702 comprising 11,771 listed and unlisted firms.

However, this filter also includes groups with no total assets on account of the fact that Prowess does not report any asset figures for any of the group affiliated firms. Thus, the final filter that is used to generate the groups with non-zero total assets yields 569 groups. A comparable estimate of the number of groups in 2006 was 560 (Sarkar 2010).

Similar to Panel A in Table A.1, Panels B, C, D, and E provide information on business groups with at least one listed firm, with at least one unlisted firm, groups with only listed firms, and groups with only unlisted firms, respectively. Judging from the estimates provided under all the panels, one can conclude that a large majority of Indian business groups have a combination of both listed and unlisted firms. Table 4.1 presents the summary statistics of some basic characteristics of the 569 Indian groups with non-zero assets, namely the average asset size of groups, the average asset size of groups after considering the assets of only listed firms in any group, percentage share of assets of listed firms to total assets of a group averaged across all groups and the percentage share of listed firms in total firms in a group, averaged across all groups. As is evident from the estimates presented in the Table, while, on an average, around 51% of group firms are listed, these firms account for around 72% of group assets, and in some cases around 100% of group assets (in case of groups in Panel D of Table A.1).

4.3.2 Dominance of Business Groups

A large number of business groups in India have persistently dominated private corporate sector activity despite structural changes in its institutional and governance environment from time to time. Figure 4.1 presents the share of group affiliated firms in total corporate sector assets held by privately owned Indian firms which comprise group affiliated firms and non-affiliated or standalone firms. The estimates are presented for the share of group affiliated firms among the top 50 firms, top 100 firms, top 500 firms, and for all firms taken together, at three points in time, 1991, 2001, and 2018. As can be seen from the figure, the presence of group affiliated firms among the top 50 private sector firms has been more than 80% at all the three time points, and 27 years apart, between 1991 and 2018.[4] Estimates published for years in-between (2001 and 2006) also corroborate this finding. What is striking is that the share of group affiliated firms in the top 50 firms in 2018 is the highest, at around 91%. The picture is very similar for the top 100 and top 500 firms wherein the share of group affiliates is not only consistently higher than 80%, but also registers an increase for 2018. However, the share of group affiliates in all firms is lower at around 73% in 2018 and has steadily gone down across the three years suggesting that the presence of standalones among the smaller sized firms has increased over time.

[4] Comparable estimates for 1996 and 2006 are presented in Sarkar (2010).

Table 4.1 Characteristics of group affiliated and standalone firms: 2018

	Group affiliates	Standalones	All firms
A. Listed + Unlisted			
Total assets (Rs. Million)	127,285,657.40	4,61,77,261.90	17,34,62,919.30
Total number of firms	5086	11,232	16,318
Share in total assets	73.38	26.62	100
Share in total number of firms	31.17	68.83	100
Mean asset size (Rs. Million)	25,026.67	4,111.22	10,630.16
Median asset size (Rs. Million)	1033.85	424.45	532.40
B. Listed firms			
Total assets (Rs. million)	9,15,61,979.50	2,22,28,604.70	112,690,584.20
Total number of firms	1268	3311	4579
Share in total assets	81.25	19.75	100
Share in total number of firms	27.69	72.31	100
Mean asset size (Rs. Million)	72,209.76	6381.34	24,610.30
Median asset size (Rs. Million)	4982.35	397.20	670.00
C. Unlisted firms			
Total assets (Rs. Million)	3,57,23,677.9	25,048,657.2	60,772,335.10
Total number of firms	3818	7921	11,739
Share in total assets	58.79	41.21	100
Share in total number of firms	32.52	67.48	100
Mean asset size (Rs. Million)	9356.65	3162.31	5176.96
Median asset size (Rs. Million)	528.05	441.70	472.60

Source Author's computation based on the Prowess database

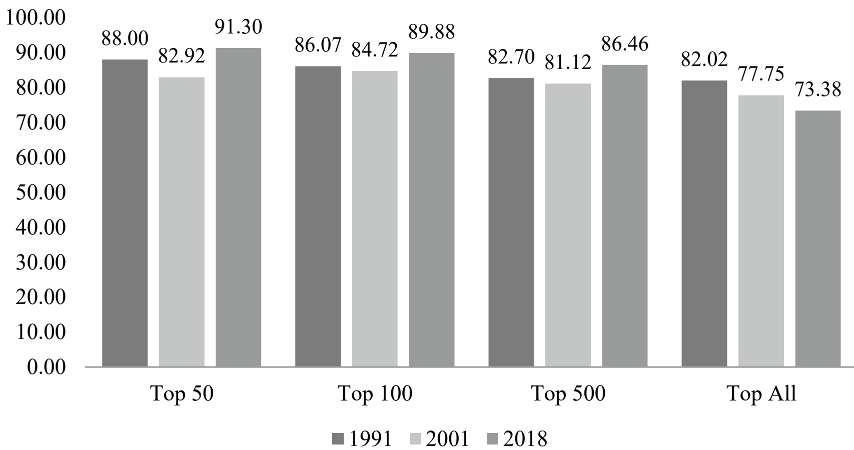


Fig. 4.1 Share of group affiliated firms in total assets: 1991–2018. *Source* Author's computation from the Prowess database

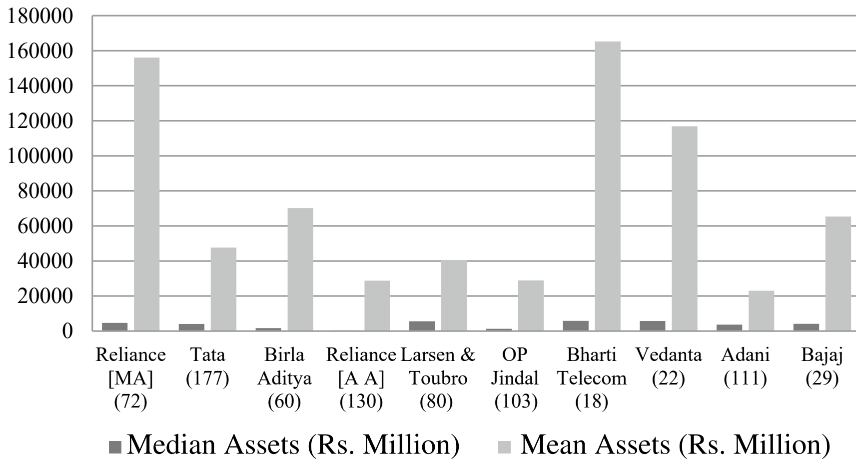


Fig. 4.2 Mean and median assets: Top 10 Business Groups
Notes 1. Figures in brackets are the number of firms in each group with positive assets. 2. Reliance [MA] is Reliance Mukesh Ambani 3. Reliance [AA] is Reliance Anil Ambani. *Source* Author's computation from Prowess database

The dominance in group affiliates in the private sector can be clearly understood from estimates of mean and median asset size of group affiliated and standalone firms. These estimates and related statistics are presented in Table 4.1. First, consistent with Fig. 4.1, the share of group affiliates in total assets across such affiliates and standalones is around 73%, and as can be seen from the Table, group affiliates account for only 31% of the total firms. In contrast, a disproportionate percentage of standalone firms, 68.8, account for about a quarter of total assets (26.6). This picture is even more skewed for listed firms (Panel B of Table 4.1). Second, estimates of average asset size of group affiliates and standalones, both for all firms and for listed firms show that the asset base of group affiliates is higher than that of standalones by several multiples; six times larger when all firms are taken together and 11 times larger when considering listed firms. The difference is relatively less in the case of unlisted firms, although in this category, affiliates are still three times larger than that of standalones. Third, it is important to see the stark difference between the mean and median estimates of size especially for group affiliate firms; in Panel A, estimates show that while the average asset size of group affiliates is about ₹25,026 million, the median asset size is ₹1033 million, which suggests that there are a few disproportionately large firms among the group affiliates which have driven up the average size (Fig. 4.2).

Table 4.2 lists the top ten business groups in India as of 2018, along with the year of foundation, total assets, and major lines of business.[5] As one can see from the Table, each group is well diversified. Further, except for the Adani Group, listed firms account for more than 50% of total group assets. Finally, except for one of the

[5] See Sarkar (2010) for a comparable list for the year 2006.

groups (Larsen and Toubro), all other groups among the top 10 are family-controlled business groups.

A key feature of business group presence in India is that since independence, while the number of distinct groups at any point of time has run into the hundreds, with 569 such groups identified as of 2018, only a few of these groups have accounted for a disproportionate proportion of total business group assets. In other words, much of the business group activity in India is driven by a few large groups, as is the case especially in many emerging economies where such groups dominate, be it Brazil, South Korea, Mexico, or Chile, but the uniqueness of India lies in the fact that there is a long string of much smaller business groups leading to striking level of inter-group inequality. Figure 4.3 presents the Lorenz curve for business group assets, capturing the relationship between the cumulative percentage of the number of groups with the cumulative percentage of the value of assets held by groups. What is striking from the Figure, is that in the year 2018, the top 10% of business groups collectively held almost 80% of the total assets of all business groups put together, while the bottom 10 groups accounted for mere 10% of the total. If we go by concentration ratios as the measure of dominance of business groups in India, estimates as of 2018 reveal that the 3-group concentration ratio among the top twenty business groups was about 41%. That group concentration has persisted over time and across institutional environments is evident from comparable estimates for earlier years (Sarkar 2010).

4.3.3 Persistence of Business Groups

Two observations can be made from the analyses in Sects. 4.3.1 and 4.3.2. First, is the persistent dominance of business groups in terms of the share of total private corporate sector assets, and second, the predominance of a few large business groups among all groups. An additional aspect of the persistence with respect to the evolution of groups can be found in terms of whether there has been churning in ranking among the business groups, especially at the top end. As Sarkar (2010) and Khanna and Palepu (2005) argue, a persistence of the ranking among the top groups over extended periods of time in an emerging economy will signify a kind of path dependence in the evolution of groups; groups that were at an advantage in the early years of their incorporation, and filled up institutional voids when markets and institutions were weak, continue to adapt and thrive even when markets come up to fill up these voids. On the other hand, if there is a churning in the ranks across the groups with institutional change, that would imply differences across business groups in terms of their entrepreneurial responses and abilities to exploit/adjust to emerging market opportunities. Analysis by Khanna and Palepu (2005), tracking changes in relative ranking of the top fifty business groups over two thirty-year periods, 1939–69 and 1969–99, find that while there has been significant persistence of concentrated family ownership, the identities of the top business groups over time exhibited noticeable changes. Using narrower windows of ten years to coincide with structural shifts in the policy environments, Sarkar (2010) finds that between 1969 and 2006, while

Table 4.2 Top ten business groups in India—2018

Rank	Group name	Founding year	Number of firms[1]	Total assets (Rs. Million)	Ownership	Number of distinct 2-digit level NIC codes; Major Business Lines
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1	Reliance Group [Mukesh Ambani]	1966	72 (6)	11,235,210.90 (55.90)	Mukesh Ambani Family	20; Exploration and production of oil and gas, petroleum refining and marketing, petrochemicals, textiles and retail
2	Tata Group	1875	177 (31)	8,436,188.50 (54.50)	Ratan Tata Family	33; Information systems and communications, engineering, materials, services, energy, consumer products and chemicals
3	Aditya Birla Group	1918	60 (8)	4,214,454.00 (76.50)	Kumaramangalam Birla Family	20; Aluminum and copper production, carbon black, cement, viscose staple fiber, insulators
4	Anil Dhirubhai Ambani (ADA) Group	1966	130 (9)	3,743,489.00 (54.80)	Anil Ambani Family	27; Communications, financial services, generation, transmission and distribution of power, infrastructure and entertainment
5	Larsen and Toubro Group	1946	80 (4)	3,228,669.90 (42.10)	Non-family	20; Engineering and construction projects, heavy engineering and electrical and electronics, information technology
6	Om Prakash Jindal Group	1952	103 (11)	2,982,927.30 (74.42)	Om Prakash Jindal Family	25; Hot rolled coils and other flat rolled products; power generation
7	Bharti Telecom Group	1986	18 (4)	2,975,089.70 (85.04)	Sunil B. Mittal Family	8; Telecom, agri business, insurance, and retail

(continued)

Table 4.2 (continued)

Rank	Group name	Founding year	Number of firms[1]	Total assets (Rs. Million)	Ownership	Number of distinct 2-digit level NIC codes; Major Business Lines
8	Vedanta Resources Group	1975	22 (5)	2,570,391.00 (82.50)	Anil Agarwal Family	11; Metals and mining
9	Adani Group	1993	111 (6)	2,550,869.20 (38.50)	Gautam Adani Family	18; Ports, Coal-based thermal electricity, Fund based financial services, Wholesale trade in coal,lignite and peat, Wholesale trade in vegetable oils
10	Bajaj Group	1934	29 (12)	1,895,540.50 (81.33)	Bajaj Family	13; Asset financing services, Motorcycles, Coal-based thermal electricity, Sugar, Securities investment services, Securities investment services, Finished Steel (Non-Alloy Steel)

Notes 1. [1]: Number of listed and unlisted firms under a given business group for which assets are reported in Prowess. 2. Figures in brackets in column 4 are number of listed firms in the group. 3. Figures in brackets in column 5 are the percentage of assets of listed firms in total assets of a business group
Source Author's computation based on the Prowess database

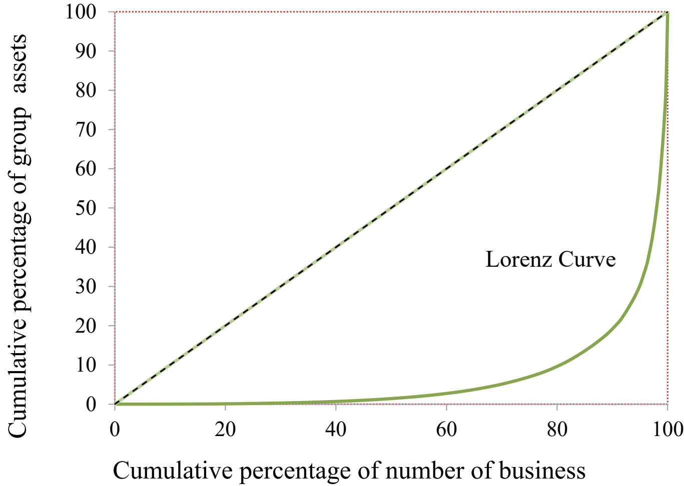


Fig. 4.3 Lorenz curve of business group assets: 2018. *Source* Author's computation from the Prowess database

there have been some changes in relative ranking, some groups going up the ranks, while some others going down, there have seldom been dramatic changes in relative positions, of moving more than five places up or down.

To find out the relative rankings of groups in a period when substantive governance reforms were brought about in the form of more regulatory oversight on business groups that could impact their growth prospects, a period which also includes the continuing strengthening of markets, the analysis of Sarkar (2010) is extended from its last time point, 2006 to twelve years later, to 2018. The results of the analysis are presented in Table 4.3. Focusing on the period between 2006 and 2018, during those twelve years, eight new groups entered the top 20 whereas 12 groups continued to be in the list. Of these 20 groups, 5 groups had no change in ranks, and of all the rank changes that happened, either up or down, except for one group (Essar Ruia), none of the changes were more than five places. Of those business groups which were in the top 20 list in 1980, five continued to be in the list almost thirty years later, and there has been little churning in the top four spots of the ranking since 1990.

The persistence of business groups in terms of their share in total corporate sector assets, the continued dominance of a few business groups over time both in terms of their share in total business group assets and the stickiness in terms of their relative ranking, along with the existence of 500 odd groups, implies that the group structure continues to be an optimal choice for organizing business in India. This could be a purely sociological phenomenon, given that groups have emerged historically as essentially family-based structures, or could also reflect expropriation motives, or, as Masulis et al. (2011) suggest, because of the extensive financing advantages of internal capital markets that provide a competitive edge to group firms vis-à-vis

Table 4.3 Evolution of top twenty business groups: 1980–2018

Rank	1980		1990		2000		2006		2018	
	Group	Assets (in Rs.Mn)	Group	Assets (in Rs Mn)	Group	Assets (in Rs Mn)	Group	Assets (in Rs Mn)	Group	Assets (in Rs Mn)
1	Tata	1538.97	Tata	7546	Reliance	65,914.12	Reliance (Mukesh)	108,510.95	Reliance [Mukesh]	11,235,210.90
2	Birla	1431.99	Birla	7235	Tata	58,987.05	Tata	97,969.39	Tata	8,436,188.50
3	Mafatlal	427.54	Reliance	3241	Essar Ruia	23,384.37	Reliance (Anil)	46,666.86	Birla Aditya	4,214,454.00
4	J K Singhania	412.00	J K Singhania	1829	Birla (Aditya)	19,409.55	Birla (Aditya)	45,513.94	Reliance [Anil]	3,743,489.00
5	Thapar	348.06	Thapar	1763	Larsen and Toubro$	19,395.65	Essar Ruia	35,538.01	Larsen and Toubro	3,228,669.90
6	ICI	343.01	Mafatlal	1297	Om Prakash Jindal	17,102.82	Om Prakash Jindal	26,040.34	Om Prakash Jindal	2,982,927.30
7	Sarabhai	317.94	Bajaj	1228	RPG Enterprises	12,906.22	Bharti Telecom	21,334.34	Bharti Telecom	2,975,089.70
8	ACC	274.51	Modi	1192	Bajaj	10,947.07	Sterlite Industries[4]	19,239.43	Vedanta Resources	2,570,391.00
9	Bangur	264.33	M A Chidambaram	1032	Thapar	7635.50	Larsen and Toubro$	17,891.05	Adani	2,550,869.20
10	Shriram	241.00	TVS	909	Mahindra and Mahindra	7222.19	Mahindra and Mahindra	14,998.47	Bajaj	1,895,540.50
11	Kirloskar	220.37	Shriram	800	Sterlite Industries	7055.17	Bajaj	14,805.32	IndiaBulls	1,819,991.50
12	Hindustan Lever$	219.30	UB	716	Jaiprakash	6649.65	TVS	13,737.13	Mahindra and Mahindra	1,794,006.10
13	Larsen and Toubro$	216.03	Bangur	674	Birla K. K	6606.15	Krishna	12,849.59	Essar (Ruia)	1,781,507.00

(continued)

Table 4.3 (continued)

Rank	1980		1990		2000		2006		2018	
	Group	Assets (in Rs.Mn)	Group	Assets (in Rs Mn)	Group	Assets (in Rs Mn)	Group	Assets (in Rs Mn)	Group	Assets (in Rs Mn)
14	Modi	198.82	Kirloskar	633	TVS	6588.20	Jaiprakash	12,067.57	Shriram Transport	1,521,350.10
15	TVS	188.64	Walchand	626	M. A. Chidambaram	6409.52	RPG Enterprises	10,707.58	IDFC	1,483,575.20
16	Mahindra and Mahindra	186.03	Mahindra and Mahindra	620	Krishna	6173.44	Videocon	10,293.36	I L and F S	1,473,085.90
17	Bajaj	179.26	Goenka	570	Birla B. K	5281.42	Wipro	9120.87	G M R	1,176,292.50
18	Reliance	166.33	Nanda (Escorts)	537	Lalbhai	4804.35	I L and F S Group	9040.50	Wadhawan (Rajesh K)	1,166,944.10
19	ITC$	156.29	Lalbhai	479	Zee Telefilms	4256.86	Birla K. K	8934.86	DLF Group	1,134,319.90
	Walchand	150.36	Essar Ruia	437	Murgappa Chettiar	4220.50	Thapar	7901.48	Jaypee Group	1,091,126.40
			Number of New		Number of New		Number of New		Number of New	
			Entrants[1]	6	Entrants[1]	11	Entrants[1]	4	Entrants[1]	8
			Number Continuing in		Number Continuing in		Number Continuing in		Number Continuing in	
			Top 20 (1980–1990)	14	Top 20 (1990–2000)	9	Top 20 (2000–2006)	16	Top 20 (2006–2018)	12
			No Rank change	5	No Rank change	0	No Rank change	5	No Rank change	5

(continued)

Table 4.3 (continued)

Rank	1980		1990		2000		2006		2018	
	Group	Assets (in Rs.Mn)	Group	Assets (in Rs Mn)	Group	Assets (in Rs Mn)	Group	Assets (in Rs Mn)	Group	Assets (in Rs Mn)
			Number: Rank Up	5	Number: Rank Up	4	Number: Rank Up	4	Number: Rank Up	4
			Number: Rank Down	4	Number: Rank Down	5	Number: Rank Down	6	Number: Rank Down	3
			No. Rank Up[2]: 5–10	2	No. Rank Up[2]: 5–10	1	No. Rank Up[2]: 5–10	1	No. Rank Up[2]: 5–10	0
			No. Rank Up[3]: > 10	1	No. Rank Up[3]: > 10	1	No. Rank Up[3]: > 10	0	No. Rank Up[3]: > 10	0
			No. Rank Down 5–10	1	No. Rank Down 5–10	1	No. Rank Down 5–10	1	No. Rank Down 5–10	1
			No. Rank Down: > 10	0	No. Rank Down: > 10	0	No. Rank Down: > 10	1	No. Rank Down: > 10	0

Notes [1] refers to the number of groups that entered the Top 20 list in a given time/window and have not appeared in the previous windows. [2]refers to the number of groups whose respective ranks have moved up by five to ten places. [3] refers to the number of groups whose respective ranks have increased by more than ten places. Rank down is analogously defined. [4] Sterlite Industries was renamed Vedanta Resources in 2015

Sources Data for 1980 and 1990 sourced from Piramal (2003); data for 2000, 2006 and 2018 sourced from the Prowess database

other firms that must rely predominantly on external sources of capital for their investments.

4.4 The Nature of the Governance Problem of Indian Business Groups

A survey of the academic and policy literature on corporate governance reveals multiple definitions of the concept of governance of corporates. These range from the agency perspective of minimizing the cost in aligning managers and shareholder's incentives to mitigate self-interested managerial behavior (Jensen and Meckling 1976), to the corporate finance perspective of designing economic and legal mechanisms that ensure that suppliers of finance get a return on their investment (Shleifer and Vishny 1997), to the all-encompassing definition of corporate governance dealing with conducting the affairs of a company that is fair to all stakeholders, and to ensure ethical conduct, openness, integrity and accountability of business (SEBI 2003).

4.4.1 Agency Problems in Business Groups

Notwithstanding a plethora of definitions and theoretical perspective on corporate governance, the dominant theoretical paradigm in economics and finance is the agency and corporate finance perspective that focuses on agency costs between outside shareholders and inside management whereby on account of asymmetric information between shareholders and managers, or unobservable efforts of the managers (moral hazard), managers are able to take self-serving actions that are against the interests of the shareholders. As has been widely discussed in the governance literature, the type of agency costs can vary depending on the ownership and control structure of a corporation, whether ownership and control are dispersed or concentrated.

For corporations with diffuse share ownership, where the day-to-day functioning of a corporation is entrusted by the shareholders (the principal) to managers (the agent), so that there is separation of ownership and control, the agency problem is dubbed Type I or vertical agency problems. Such corporations, termed as widely held, are typically present in the United States and the United Kingdom. In contrast, for corporations characterized by concentrated share ownership and control, agency problems arise between two categories of shareholders or principals, namely the inside shareholders with substantial equity stakes and management control, and dispersed minority shareholders, the agency problem is dubbed as Type II or horizontal agency problems (Roe 2004).

Under Type II problems, as Morck and Yeung (2004) argue, controlling shareholders have incentives to opportunistically extract and optimize private benefits for

themselves at the expense of the outside minority shareholders. Although minority shareholders are entitled to the cash flow rights corresponding to their share of equity ownership, they face the uncertainty that an entrenched controlling owner may opportunistically deprive them of their rights through various means (Claessens and Fan 2002). Corporations with Type II agency problems are the rule rather than an exception in Asian economies including India, Latin America, and Continental Europe. Further, by virtue of the inherent structural characteristics of family-based business groups, Type II agency problems are particularly endemic in groups as opposed to independent firms with concentrated ownership and control. For the latter, concentrated ownership can bring about greater goal congruence between the controlling insider shareholders and the minority outside shareholders, but as have been discussed extensively in the literature, a business group with a network of independently incorporated firms, and interconnected through a web of shareholdings, can enable the manifestation of Type II agency problems (Morck and Yeung 2004; Masulis et al. 2011; Gilson 2006).

In business groups, Type II agency costs through opportunistic behavior of controlling shareholders can manifest in several forms depending on the type of controlling owners (Cronqvist and Nilsson 2003), and the type of controlling devices, namely, either through substantial equity investments or through structural devices like dual class shares and stock pyramids (Gilson 2006). In family-owned business groups, as Bautista (2002) observes, owing to the dominance of family members in management and non-transparency in functioning, minority shareholders are "often kept in the dark" regarding the actual performance of the corporation. Expropriation of minority shareholders in family-owned business groups can also happen through structural mechanisms like stock pyramids where a family firm A, having a majority ownership in a publicly traded firm B, can control a publicly traded firm C in which A has no direct ownership but in which B has a majority ownership. A linking of equity ownership between firms through pyramids can therefore drive a wedge between control rights and cash flow rights and gives the shareholder of A, a vehicle for the expropriation of minority shareholders of D to transfer assets and profits from firms with lower cash flow rights (i.e., from D) to firms with higher cash flow rights (i.e., to A) (La Porta et al. 1999). Such a phenomenon, referred to the literature as tunneling, essentially involves self-dealing transactions that remain undetected by minority shareholders and regulators alike, such as outright theft or fraud, under- or over-invoicing of asset, goods, or services sales, obtaining loans on preferential terms, transfer assets from listed companies to unlisted companies and through preferential pricing of fresh equity (Johnson et al. 2000).

There is ample evidence in the extant literature that business groups are typically organized as pyramids and that there are divergences between control rights and cash flow rights of controlling shareholders (Claessens and Fan 2002; Faccio and Lang 2002; Masulis et al. 2011)). For instance, Masulis et al. 2011), in analyzing the control and financing structure of family business groups in 45 countries around the world, find that two thirds of these groups are set up as pyramids with listed firms used to a different extent to separate group members from the ultimate owner. Evidence on tunneling in pyramidal structures are however relatively limited. Given

that tunneling by design is clandestine, researchers have tried to empirically ferret out such activities through various proxies (see for example, Bertrand et al. 2002 for India; Claessens and Fan 2002 for East Asia; Cheung et al. 2006 for Hong Kong).

Finally, while pyramidal structures contribute to ownership complexity in business groups and manifest in Type II agency problems, an additional and related source of such complexity that can potentially facilitate the expropriation of minority shareholders is the *opacity* of insider control (Sarkar and Sarkar 2012). The term opacity seeks to capture incomplete information on the ownership control webs that link firms either through pyramids or through cross-holdings (firms mutually having equity stakes in each other), to the extent that outside investors of listed firms or regulators are unable to decipher from publicly disclosed information on shareholding patterns, the complete chain of control among group affiliates and the benefits that flow to the ultimate owner(s) of a group and its constituent firms. Lack of information on such control webs can be an important source of agency costs as it can help conceal the diversion and flow of expropriated funds.

Several types of ownership opacity can be relevant for business groups depending on the regulatory disclosure requirements on equity holdings. One could be the incomplete disclosure of the identity of insider owner(s) (Type I opacity), two, the fragmentation of insider ownership across a large number of owners (Type II opacity), and three, the extent to which inside ownership and control are in the hands of private unlisted entities for which disclosure requirements are limited (Type III opacity). With regard to Type I, if disclosure rules require the reporting of only those stock holdings that cross a particular threshold, ownership structure can be strategically engineered by controlling shareholders through the fragmentation of shareholding whereby individual ownership by insiders could be deliberately kept at less than one percent to avoid mandatory disclosures. The larger the percentage of shareholding in the less than one percent cut-off and outside the public domain, the more opaque could one consider the ownership structure to be from the point of view of an outsider. Type II stems from the extent to which insider shareholding could be "fragmented" among its constituents; distributing a given shareholding among a large number of insiders again could potentially be an obstacle to efficient monitoring and raise transaction costs. Finally, related to Type II opacity, Type III opacity accounts for the class of promoter shareholding, namely individuals, listed companies, and unlisted companies and trusts. The more the weight of such shareholding is toward unlisted companies and trusts, the more unlikely would it be for an outside minority shareholder, to decipher chains of control as well as any related party transactions. The ownership network can become all the more complex if cross-holdings by such private companies in group affiliates.

Given the discussion on the nature of the governance problem in business groups, Sects. 4.4.2 and 4.4.3 presents some key analyzes on ownership and control structures in Indian business groups. The analysis is based on the panel data on Indian group affiliates and standalones for the period 2005 to 2018, as referred to in the introduction.

4.4.2 Concentrated Ownership and Control in Indian Business Groups

Historical accounts testify that from the very early years of business group formation in India, such groups, along with their affiliates were characterized by concentrated ownership and family control together with pyramidal ownership structures as well as cross-holdings (See for example, Hazari 1966). Further, governance issues in these groups could be clearly understood from an agency-theoretic/corporate finance perspective as outlined in the previous section.

The ownership and control structure in the formative years of Indian business groups was a natural consequence of how companies under Indian ownership were financed at a time when stock markets were thin, and the banking system was weak. The growth of companies during that period was largely financed from retained earnings and from non-institutional sources, i.e., funds borrowed from family members, close business associates, social contacts, and money lenders (Tripathi 2004). With a major source of finance originating within the family, formal ownership and control of the companies were often accomplished through the setting up of joint stock companies legally, where family members and acquaintances were issued shares to retain family control. A family member could therefore control a group of companies, either through direct equity control (the "inner circle") or through indirect control through companies that were under its direct control (the "outer circle") (Hazari 1966). This was the beginning of concentrated ownership and control of family-owned business groups in India.

Individuals who were instrumental in floating and developing the various ventures, which were eventually incorporated as joint stock companies, came to be known as "promoters." As Lokanathan (1934) observes, Indian promoters were not typically the professional promoters who focused mainly on starting a business but not necessarily developing it further. Instead, promoters in Indiahad substantial financial interests in the concerns that they floated, and organized themselves as managing agents, taking it upon themselves the entire gamut of functions ranging from pioneering, to promoting, to financing to managing the concerns while retaining control over them (Lokanathan 1934).

The presence of minority outside shareholders too can be traced back to the early years of group formation. When external finance was raised by companies by managing agencies through initial public offerings, these were invariably oversubscribed (Lokanathan 1934; Hazari 1966; Goswami 2000) so that the shares at the time of allotment were split into small lots to the extent that no single shareholder, other than the managing agency, would have enough stakes to exercise control over the company in terms of their presence on the board of directors. *De facto* control of the company by managing agents with stock ownership could be achieved with as little as 10% (Goswami 1989).

With ownership by outside shareholders fragmented and dispersed, investments by promoters were made, not based on efficiency considerations, but to serve the purposes of controlling interests. This was reportedly undertaken via the setting up

of companies that could facilitate in the purchase of their own shares indirectly as also enable them to transfer profits and losses among group companies (Hazari 1966). Apart from direct equity control, indirect control of firms was acquired through interconnected equity holdings among affiliates through a combination of pyramiding and cross-shareholdings/circular chains of investments (Hazari 1966; Mehta 1955). Equity control in turn ensured management control, allowing managing agents to sit on company boards. Such integration of control and ownership structures was characteristic of both European corporate groups as well as Indian business groups (Mehta 1955). For Indian concerns, the practice of appointing family members at higher levels of the management hierarchy irrespective of their capabilities adversely affected efficiency and led to "glaring abuses" of minority investors (Hazari 1966).[6] Explicit concern for minority investors is also found in several narratives documented in a review in the late fifties of the working of the managing agency system (NCAER 1959).[7]

The preceding account clearly affirms that business groups in India in their early years were characterized by Type II agency problems, between the controlling insiders and minority shareholders. As with the persistence of business group dominance in private corporate sector activity (Sect. 4.4.3), the ownership and control structure of business groups and their affiliates have also been path-dependent even to the extent that the nomenclature of promoters to refer to inside owners have persisted till the present, in regulatory and legal parlance such as in securities market regulations and company law. With regard to the company law, for instance, both the terms "promoter" and "control," have been defined under the Companies Act 2013. Under Section 2(69), a promoter shall be any of the following persons (a) whose name appears as a promoter in the prospectus or annual return or (b) who, directly or indirectly has the control over affairs of the company either as a shareholder, director or otherwise or (c) A person in accordance with whose advice, directions, or instruction the board of directors of the company is accustomed to act. However, any person who is acting merely in a professional capacity cannot be considered as a promoter under (c).[8] Section 2(69) must be read with Section 2(27) which defines "control" under the

[6] For instance, Mehta (1955) estimates that as of the early fifties, nine leading families of India held 600 directorships or partnerships in Indian industries, about 100 persons held as many as 1700 directorships, and finally, the top 10 industrialists held together around 400 directorships. Such high estimates have been argued to be a fallout of the dearth of managerial talent in India in the early years of industrialization and also a result of the high level of concentration of ownership and control exercised through the managing agency system.

[7] For example, as part of parliamentary debates in 1951–52, a parliamentarian, Shri Tyagi remarked that "…the primary object in acquiring control over management has not been the progressive expansion or development of those undertakings but the furtherance of the personal advantage of certain people, to the detriment of investors and the interests of the companies themselves" (NCAER 1959; pp. 8–9).

[8] It may be noted that while the earlier company law, Companies Act 1956 included the term promoter, it did not formally define it, the term was explained under clause (a) of sub-section (6) of the section 62 Companies Act, 1956 stated that "the expression "promoter" means a promoter who was a party to the preparation of the prospectus or of the portion thereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity for

Act. Under the latter provision, "control shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner."

As with the Companies Act 2013, the terms promoters and control have also been defined by the SEBI for listed companies as under Regulation 2 (1) (za) of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. Likewise, AS-21 of the Accounting Standards has also defined "control" for the purpose of consolidation of financial statements. A careful reading of the various definitions of the terms promoter and control will reveal that while some of the wordings may differ, the basic essence of the definitions is the same. Finally, it is important to note that neither of the terms have been defined in the specific context of a business group or group affiliates and are applicable to all companies irrespective of their ownership status.

Turning to an analysis of the structure of ownership and control in business groups and group affiliated firms, Table 4.4 presents the ownership structure of Indian private sector listed firms, those that are affiliated to business groups and those that are standalones for the year 2018, as disclosed under Regulation 31 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 under which listed entities are required to disclose their shareholding pattern under a prescribed format. As is evident from the Table, promoters in group affiliates on an average held majority stakes, 54.63% of total shareholding, whereas those for standalones was a little short of majority of 49%. Thus, irrespective of whether a firm is affiliated to a group or not, ownership is concentrated in the hands of promoters or insiders. However, if one compares the composition of promoter ownership in terms of the types of promoters, we find a noticeable difference between group affiliates and standalone; for the former, the share of promoters as corporate bodies is on an average nearly 40% as compared to around 24% for standalones. Further analysis can reveal whether the greater presence of corporates within the promoter group for group affiliates is on account of other affiliates within the group holding equity positions in an affiliate.

Considering outside shareholders as listed under non-Promoters, one finds that there is not much difference in the composition between group affiliates and standalones. It is to be noted that, going by the standard cut-off of 20% ownership that is applied to define control in the literature, barring non-institutional individuals, who are essentially dispersed outside shareholders, and cannot be considered as a controlling block, none of the other constituents under the non-promoters, be these mutual funds, banks, or financial institutions, have controlling stakes on an average.

To examine whether the structure of ownership is substantially different for the affiliates of the top ten groups (Table 4.2) as compared to the average ownership structure across all group affiliates, comparative estimates are presented in Column (5) of Table 4.4. As is evident from the Table, while average promoter share in the top

persons engaged in procuring the formation of the company." https://www.icsi.edu/media/portals/86/Geeta Saar 38 Promoter and Control Part-1.pdf.

Table 4.4 Composition of share ownership of Indian companies: 2018

	Group affiliates	Stand alone	All	Group affiliates (Top 10 groups)
(1)	(2)	(3)	(4)	(5)
A. Promoter and Promoter Group	54.63	49.33	52.07	54.47
Individuals/HUF	12.31	29.35	20.79	2.37
Bodies corporate	39.66	24.12	33.44	45.04
Government	0.26	0.06	0.17	1.35
4. Financial Institutions and Banks	0.08	0.11	0.09	0
5. Indian Promoters Others	2.28	2.29	2.28	2.49
6. Foreign Promoters	4.33	3.43	3.90	4.71
B. Non-Promoters	45.64	51.01	48.24	46.37
Mutual Funds	3.97	3.01	3.58	4.45
Banks and Financial Institutions	1.59	2	1.78	1.43
Government	0.21	0.05	0.13	0.54
Non-Institutional Corporate Bodies	7.76	9.68	8.67	5.08
Non-Institutional Individuals	21.29	28.25	24.65	15.68
Non-Institutional Others	3.17	4.28	3.71	3.37

Source Author's computation based on the Prowess database

10 affiliates is comparable to the overall mean for group affiliates, the composition of promoter share is noticeably different; the share of individuals/Hindu Undivided Family (HUF) is strikingly less, at 2.37 as compared to 12.31% for all affiliates, whereas corporate bodies have higher holdings in the former as compared to the latter. Thus, much of the promoters in affiliates of large groups are corporate entities rather than individuals.

While understanding the structure of ownership of group affiliates and standalones in terms of average equity holdings of the key shareholding group provides some overall picture of the incidence of insider control, it is important to delve further into the distributional characteristics of promoter ownership in both group affiliates and standalones. Given that the level of ownership of any shareholder or a block of shareholder is associated with voting rights and control, and with promoters being the single largest block in group affiliates, it is important to find out the distribution of group affiliates by different blocks of promoter ownership. Drawing on the relevant literature on ownership and governance on how voting rights can change

with ownership, we break-up the promoter ownership of Indian affiliates into the following blocks, namely holdings of greater than zero and less than 5% (Block 1), between 5 and 10% (Block 2), between 10 and 20% (Block 3), between 20 and 26% (Block 4), between 26 and 51% (Block 5), between 51 and 75% (Block 6) and greater than 75% (Block 7). In the Indian context, shareholders with a minimum of 10% paid-up voting capital can call an extraordinary general meeting. A cut-off of 20% is typically the minimum level of equity ownership that is necessary to control a corporation (La Porta et al. 1999) and if corporations are relatively large in size, it is likely to have a larger base of dispersed shareholders and hence insiders can gain effective control with even lower levels equity. A stake of 26% or more under the Indian company law entitles a shareholder to block special resolutions and have a say in the management of a company. A 51% shareholding gives a majority stake and allows wide control over the management of the firm but is subject to a blocking minority, and a stake of more than 75% is not subject to a blocking minority and important corporate decisions, such as proposed mergers, altering memorandum and articles of association requires 75% in favor.

The distribution of firms across the different blocks of promoter share is presented in Fig. 4.4. The estimates in the Figure are striking in terms of the overwhelmingly large number of companies, both standalones and group affiliates with majority control by promoters; almost 62% of group affiliates and 55% of standalones have promoters with equity ownership in Block 5, i.e., between 51 and 75%. This is followed by Block 4, where close to 30% of group affiliates and standalones have equity ownership between 26 and 51%. If 20% is taken as equity ownership with effective control, then as of 2018, strikingly in almost 96% of group affiliates and 90% of standalone promoters or insiders have effective control. This is much higher than comparable estimates for insider control in other countries using the 20% cut-off—50% documented in La Porta et al. (1998) and Claessens and Fan (2002).

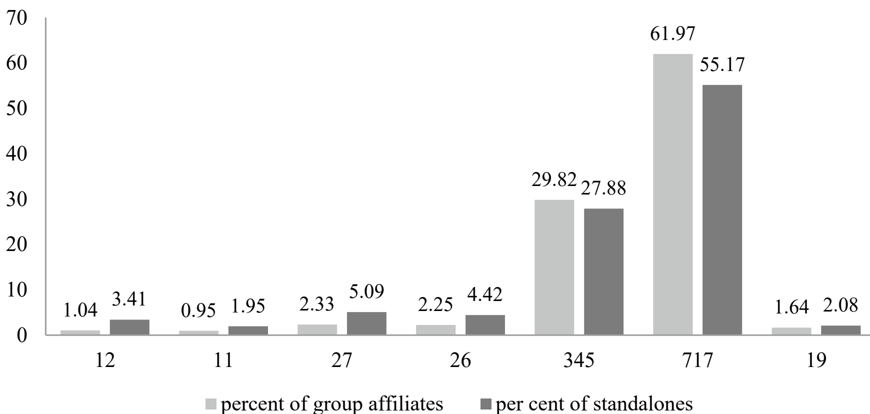


Fig. 4.4 Distribution of firms by promoter share: 2018. *Source* Author's computation from the Prowess database

4.4.3 The Persistence of Concentrated Ownership and Control

With a dynamic institutional and economic environment since the late nineties well into the 2000s, one needs to examine whether there have been any major changes in the shareholding structure of group affiliates over time, or whether there is persistence too in this regard. During the period under study, 2005–18, several major legislative and regulatory changes have been instituted including a new company law, Companies Act 2013 repealing Companies Act, 1956, the Substantial Acquisition of Shares and Takeovers Regulations, 2011, repealing the earlier 1997 regulations, continuous strengthening of disclosure standards for listed companies by the SEBI, as well as changes in the entry of foreign institutional investors, could have led to re-optimization of equity portfolios of the different types of shareholders. To this end, the analysis in this section will, one, examine the trends in the components of the aggregate ownership for listed group affiliates for the period 2006–2018, and two, examine trends during the same period in promoter shares for different groups as measured by their size.

Figure 4.5 presents trends in the ownership structure of group affiliates between 2006 and 2018. As can be seen from the Table, promoter ownership since 2006 up until 2013, increasing steadily from 49% and crossing the majority mark in 2009. Thereafter, promoter holdings have stabilized around 54% all the way up to 2018. No clear trend is discernible for the other owners except for banks and financial institutions steadily decreasing their already limited holdings from around 4% in 2006 to being consistently below 3% after 2015. The overall impression that one gets from Fig. 4.5 is that the predominance of promoter control in group firms has persisted over a span of 12 years irrespective of structural changes from time to time in the institutional environment. If one takes an even longer time frame, back to 2001, this pattern seems to have been the same of a steady consolidation of promoter ownership while other blockholders showing marginal changes at best (Sarkar and Sarkar 2012).

While Fig. 4.5 provides a broad-brush picture of the trends in equity ownership over more than a decade, by major types of owners, Fig. 4.6 takes a close look at whether the consolidation that one finds in insider control on an average across all group affiliates has also happened across groups of different sizes. The analysis of group characteristics in Sect. 4.2 reveals that there is substantial heterogeneity among groups in terms of their asset size and that is there are few large groups at one end of the spectrum and a large tail of small groups at the other end. Has there been consolidation of promoter ownership in the larger groups with a larger network of affiliates where the scope of Type II agency costs can be expected to be higher, or is it the smaller groups with a fewer number of firms and activities where such consolidation has taken place? From an agency perspective, greater consolidation of insider ownership on an average in a group is not necessarily harmful for outside investors; it brings about greater convergence of interests between the insiders and outsiders, and hence would mitigate Type I agency costs. However, at the same time,

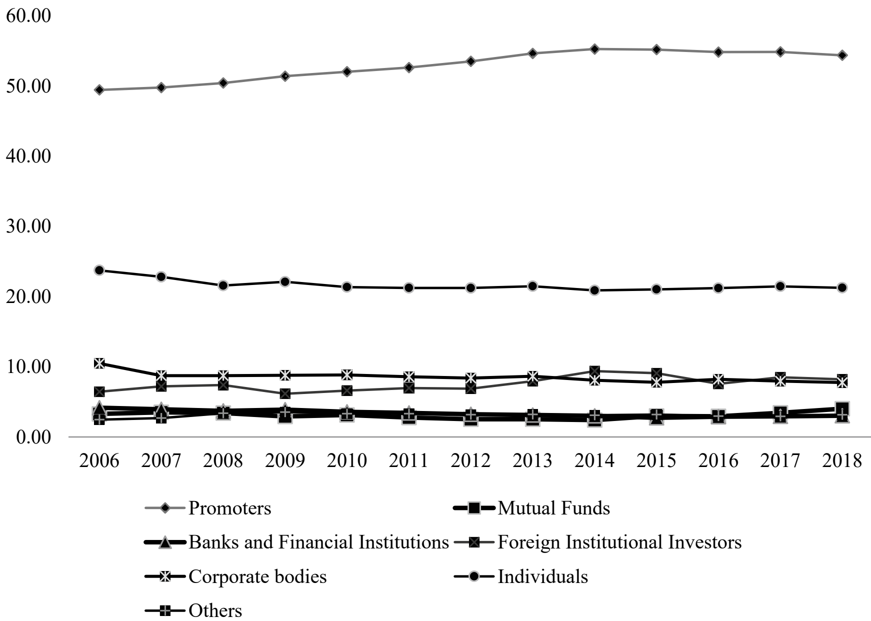


Fig. 4.5 Trends in shareholdings in group affiliates by major types of owners: 2006–2018. *Source* Author's computation from the Prowess database

higher insider holdings can aggravate Type II agency costs through the entrenchment of insiders who by virtue of higher control, can successfully insulate themselves from outside disciplining forces such as that from the takeover market or managerial labor market (Demsetz 1983; Fama and Jensen 1983) and can exercise greater control through pyramids and other mechanisms to expropriate minority investors. It is not therefore a priori clear whether greater consolidation aggravates or mitigates agency costs.

Turning to the analysis in Fig. 4.6, based on the distribution of group size, seven size classes of business groups are considered by percentile values (denoted by P) as shown in the graph, with P < 25 are groups lower than the first quartile of the distribution, P25-P50 being groups falling between the first quartile and median, and so on. Several observations can be made from the figure. First, as with the case of all affiliates, average promoter shares across all groups irrespective of size have risen by 4 to 6%age points during 2006–2018, with much of the percentage increase happening by 2012, post which promoter holdings of all groups on the average have exceeded the majority mark of 51%. Second, if one compares the average promoter holdings by size classes, by and large there is an inverse relationship between group size and average promoter holdings of a group. The promoter's share of smaller groups is greater than that of the larger groups: this is along the expected lines as larger groups with larger firms on the average typically have a higher proportion of outside shareholders. But from the perspective of control, such differences in

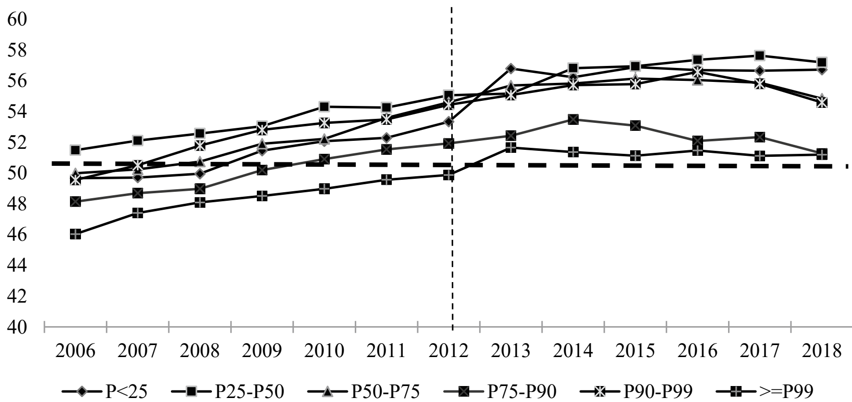


Fig. 4.6 Trends in promoter ownership by group size: 2006–2018. *Source* Author's computation based on the Prowess database

the case of Indian business groups do not seem to matter as groups, across all size classes, post 2012 have majority insider ownership. Third, trend estimates across groups show that between two end points of the period of analysis, 2006 and 2018, promoter consolidation has been the highest for the smallest two groups.

4.4.4 Ownership Complexity

As discussed in Sect. 4.1, agency costs in business groups are manifested not only in terms of concentrated ownership and control by insiders, but on account of complexities in group structure arising from stock pyramids, cross-holdings, and opacity of ownership. This section presents some measures of ownership complexity in Indian business groups and how these can vary across groups in terms of examining for the year 2018, the intra-group distribution of promoter ownership for the top ten groups, mapping out the group structures of the top two groups, the Tata Group, the Reliance Group (Mukesh Ambani), and the Adani Group to identify the existence of pyramidal structures and cross-holdings if any, and to present some measures of ownership opacity based on firm level data of major promoters reported in the Prowess database.

Table 4.5 presents the distribution of promoter ownership for the top ten groups as of 2018. The estimates are presented at different percentiles (denoted by P), starting with the minimum, followed by the 5th, 10th, 25th, 50th, 75th, 90th, and 95th percentile and the maximum shareholding in a group. As can be seen from the estimates, promoter share differs considerably across firms within a group, the range between the lowest and the highest being substantially different for several of the groups. For 80% of these groups, the median shareholding is more than 51%.

Further, the variations in promoter ownership within each group imply that theoretically tunneling incentives exist if the firms are structured as pyramids, with firms where promoters have the highest cash flows located at the top of the pyramid. All that is necessary for pyramidal structure to generate tunneling incentives is that the firm at the top of the pyramid has controlling rights on the firm below it, and the second firm has controlling rights on the firm below it and so on. With a typical cut-off 20% for a controlling stake, one can see from the estimates in Table 4.5 that promoters have controlling stakes even where their shareholder is at the minimum across all group firms. While one cannot for certain conclude from the dispersion in promoter share that groups are necessarily organized as pyramids, Masulis et al. (2010) have estimated that the percentage of Indian group affiliates that are controlled through pyramids is around 10%, the average pyramidal layer being 0.36 and the percentage of market of capitalization held by pyramid-controlled firms is 4.10.

The complexity of ownership and control structures and its variation across business groups can be illustrated from an analysis of the Tata Group, the oldest of all business groups, the Reliance Group (Mukesh Ambani) which emerged in the eighties, and the Adani Group, which emerged in the nineties, and which entered the ranks of the top ten business groups in recent years. These are presented in Fig. 4.7a–c. All the structures mapped are based on only the listed companies in a group for which shareholding information is present in the public domain; including the holdings of all unlisted companies in each group would increase the complexity of shareholding manifold.

Focusing on the Tata Group, it is evident from Fig. 4.7a that Tata Sons is the main holding company of the Tata Group which is privately held and has controlling direct stakes in all major group listed companies including that in the group's flagship

Table 4.5 Distribution of promoter ownership of top ten groups: 2018

	Promoter Share								
	Min	P5	P10	P25	P50	P75	P90	P95	Max
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Reliance (M A)	36.45	45.43	45.43	45.43	46.44	47.45	47.45	47.45	75
Tata	30.3	30.80	32.61	34.12	50.09	71.92	74.96	74.99	75
Aditya Birla	34.68	34.68	34.68	40.10	47.07	61.98	74.03	74.03	74.03
Reliance (A A)	49.54	49.54	49.54	50.89	52.66	64.05	75.00	75.00	85.76
Larsen and Toubro	64.01	64.01	64.01	64.01	64.01	64.01	64.01	64.01	88.81
O. P. Jindal	41.75	41.75	41.75	53.59	58.66	62.32	74.99	74.99	74.99
Bharti	53.51	53.51	53.51	53.51	60.33	67.14	67.14	67.14	67.14
Vedanta	50.13	50.13	50.13	50.13	54.03	64.92	64.92	64.92	64.92
Adani	66.27	66.27	66.27	66.27	73.07	74.92	74.92	74.92	74.92
Bajaj	15.43	15.43	44.32	49.30	55.14	66.86	69.61	73.12	73.12

Notes P denotes percentile
Source Author's computation based on the Prowess database

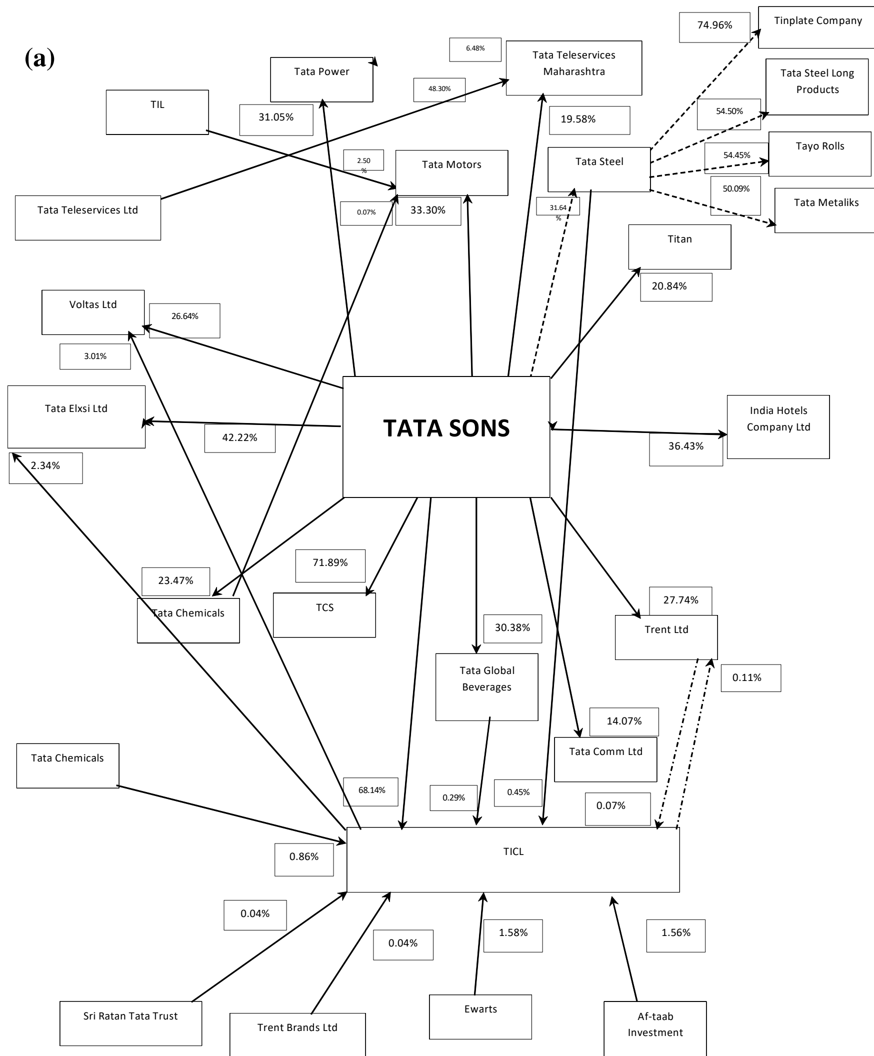
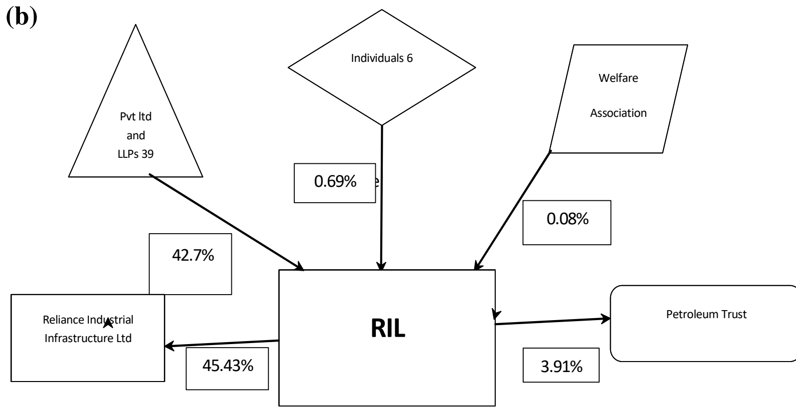


Fig. 4.7 **a** Ownership Structure of the Tata Group: 2018. **b** Ownership Structure of the Reliance Group (Mukesh Ambani): March 2018. **c** Ownership Structure of the Adani Group: March 2018. *Source* Author's compilation based on shareholding pattern for quarter ending March 2018, as reported in the Prowess database

company Tata Steel. The Figure also illustrates a single layered pyramid flowing from Tata Sons to Tata Steel to four other listed companies. Cross holdings can also be identified in the group structure between TICL and Trent Limited. Moving on to the structure of the Reliance Group (Mukesh Ambani), (Fig. 4.7b), the structure is fundamentally different from the Tata Group. By virtue of having much lesser number of listed companies, the structure looks less complex than that of the Tata

(b)



(c)

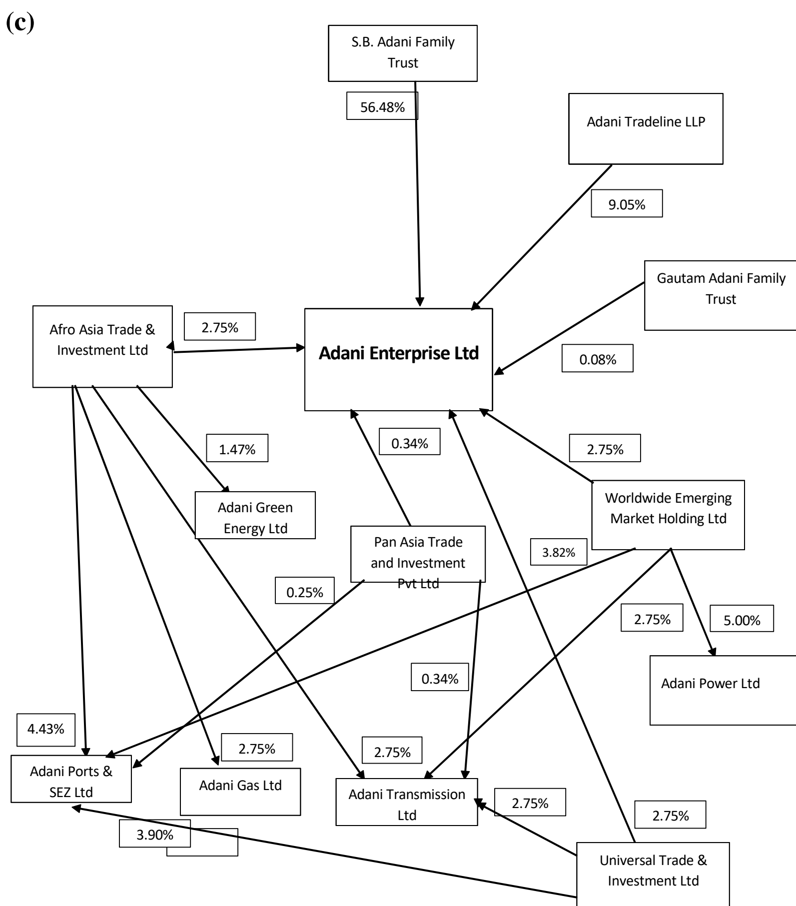


Fig. 4.7 (continued)

Group. However, unlike that of the Tata Group, there is a preponderance of private limited companies on which information is scarce in the public domain, and a greater fragmentation in promoter holdings, contributing to ownership opacity. Finally, the ownership structure of the Adani Group (Fig. 4.7c) is dominated by a large number of private limited companies as is the case with the Reliance Group. What is different however from the Reliance group is the controlling holdings of family trusts in the flagship listed company Adani Enterprises. Both in the case of the Reliance Group and Adani Group, unlike the Tata Group, the ownership of the major listed companies is all in the private domain, as also the fact that there is no information on how these private companies and the trusts are interconnected.

Examining the different types of opacity for Indian listed companies, Type I opacity has almost been eliminated due to a change in disclosure regulations since April 2006, which required the identity of all constituents of promoters and promoter group along with their respective shareholdings to be disclosed to the stock exchanges under SEBI regulations. Prior to this period, the presence of such opacity was documented by Sarkar and Sarkar (2009).

With regard to Type II and Type III opacity, Table 4.6 presents a detailed picture of such opacity for the flagship companies of the top three business groups as of 2018, namely Reliance Industries Limited of the Reliance Group, Tata Steel of the Tata Group, and Hindalco Industries of the Aditya Birla Group. As can be clearly seen from the Table, the different manifestations of Type II and Type III opacity are in-built in the ownership structure of these companies, but to different extents. In case of Type II opacity, Reliance Industries had as many as 47 entities listed under promoters and promoter group with a total equity share of 47.45%, which came to be an average share of only 1.01% per promoter. The corresponding estimates for Tata Steel and Hindalco Industries were around 2.76 and 2.03%, respectively, all three lower than the average of 4% obtained for the total sample of group affiliates for the year 2018. Further, what is of interest to note is that except for Tata Steel, more than 50% of promoters belong to unlisted companies, trusts, and individuals, the highest being for Reliance Industries, at around 85%. With regard to percentage of equity holdings by the three types of promoters, as Panel B shows, unlisted companies and trusts overwhelmingly account for promoter equity in the case of Reliance Industries (98%), and Hindalco Industries (85%) and Tata Steel (95%).

4.5 Insider Control and Board Governance

The pervasiveness and persistence of promoter ownership and control in Indian business groups evident from the detailed analysis in the previous section underscores the important role that board of directors can play in the mitigation of Type II agency costs in such groups. One of the governance mechanisms that is proposed in the literature as a prescription for reducing agency costs focuses on the positive role that outside blockholders with relatively large equity positions can play in disciplining inside management. Dubbed as the “efficient monitoring hypothesis,” (Berle and

Table 4.6 Promoter ownership characteristics in selected companies: March 2018

	Reliance Industries	Tata steel	Hindalco industries
A. Number of promoters by type			
All	47	12	17
– Individuals	6	0	5
– Listed Companies	1	10	3
– Unlisted Companies and Trusts	40	1	9
% B. of holdings by promoter type			
All	47.45	33.21	34.67
– Individuals	0.69	0.00	0.11
– Listed Companies	0.01	1.57	5.25
– Unlisted Companies and Trusts	46.75	31.64	29.31
C. Average Promoter Holdings by			
Promoter Type (B/A)			
All	1.01	2.76	2.03
– Individuals	0.11	–	0.02
– Listed Companies	0.01	0.16	1.75
– Unlisted Companies and Trusts	1.17	31.64	3.26

Notes "A" lists the number of promoters constituting Promoters and Promoter Group as well as the number of each type of promoter (individuals, listed companies and unlisted companies and trusts). "B" lists the total percentage shareholding by promoter type, i.e., the percentage equity holding by promoters who are individuals etc. "C" is the average holding by type of promoter
Source Authors' computation based on the Prowess database and www.corpfiling.co.in

Means 1932; Pound 1988), the basic premise of the hypothesis is that large outside shareholders, unlike small, dispersed shareholders, are likely to exercise optimal oversight on the insiders as they have substantial investments at stake as well as the voting power to ensure that the investments are not lost (Fama and Jensen 1983; Shleifer and Vishny 1997).

In this regard, the literature highlights specifically the role of institutional investors in bringing about collective action against the management should it stand in the way of shareholder value maximization (Dodd and Warner 1983). However, as the estimates of shareholding by outside shareholders in Indian companies, as under non-promoters, reveal, the holdings by outside institutional blockholders, namely, mutual funds, banks, and financial institutions, fall far short of the controlling shareholding even if all institutional holders act as a block together. On the other hand, promoters, the inside blockholders, have majority holding in more than 90% of groups/group affiliates. Empirical evidence on the effect of outside blockholders on firm performance in the case of Indian firms, including group affiliates have yielded mixed results, with some studies find no evidence of efficient monitoring of promoters (Khanna and Palepu 2000; Douma 2006), whereas Sarkar and Sarkar (2000) and Kumar (2008) find a positive effect of banks and financial institutions once their

equity positions cross a particular threshold. The likelihood of outside blockholders not being efficient monitors of insiders, owing to non-controlling stakes, coupled with the fact that other external governance channels like the market for corporate control is likely to be weak in the face of consolidated promoter equity positions, puts the burden of monitoring on another disciplinary mechanism, that of the board of directors.

4.5.1 Monitoring by the Board

As laid down in the Cadbury Report on corporate governance (Cadbury 1992), directors on a company board are fiduciaries of shareholders and other stakeholders and should therefore act in their interest. Directors on boards have both a strategic role and a monitoring role; under the former, the responsibility is to define a company's purpose and to draw up plans to achieve that purpose, and under the latter, to monitor and assess the performance of the management and execute, if necessary, the power to replace the chief executive and/or internal management team.

The monitoring and disciplining responsibilities of the board of directors depend on the nature of the agency problem, Type I or Type II, which is slated to mediate (Roe 2014). While the board acts as an intermediary in both cases, the nature of the agency problem it mediates and associated problems of monitoring and disciplining that it addresses are different. Under Type I agency problems, with complete separation of management and control and given the inability of diffused shareholders to monitor, the board's responsibilities are that of "vertical governance" that entails working on behalf of the shareholders to minimize managerial opportunism and maximize shareholder wealth. On the other hand, a board is engaged in of "horizontal governance", of mediating between the dominant shareholders who in all likelihood also have management control, and the outside minority shareholders and shield the latter from being expropriated by the former. Thus, in this case, the focus of board functions would be more on preventing self-dealing transactions by the management than on shirking by managers as is the case under Type I problems (Roe 2004).

The governance by the board of directors of firms with concentrated ownership and control is further compounded by the presence of promoters in management positions, including occupying the positions of a CEO or Chairperson or both. CEOs from the founding family are found to be more influential in decision-making (Finkelstein 1992). Such CEOs can have a say in the composition of the board on the one hand and are more likely to be in management control on the other, so that much greater potential exists for "board capture," "CEO hegemony" or the creation of an "inner circle." Non-executive directors on boards of such firm may therefore require different strategies and skill sets as well as incentives to impart their fiduciary duties

of monitoring and advising management (Anderson and Reeb 2004; DeMott 2007).[9] For them, the problem of governance in family firms is to balance the conflicting interests of the two major blocks of shareholders, controlling insiders and minority outsiders rather than aligning the interests of the manager and shareholders to maximize shareholder value as is the case with non-family firms. Thus in family firms, in order to protect firm value, independent directors would have to be extra vigilant to guard against the expropriation of assets by a controlling shareholder (DeMott 2007; Claessens and Fan 2002; Maury 2006).

A critical aspect of the quality of board governance of any firm, irrespective of its ownership status is the "busyness" of its directors, both inside directors and outside directors. A director is construed as being busy if she/he holds directorial appointments in other firms to the extent that such multiple directorships can make directors over-committed and thereby compromise on their ability to monitor company management effectively on behalf of the shareholders (Ferris et al. 2003). On the other hand, busy directors can be potentially beneficial as the number of multiple directorships can proxy for high director quality (Fama 1980; Fama and Jensen 1983). Further, from a resource dependency perspective, directors with multiple appointments, by virtue of being more networked, can generate benefits by helping to bring in needed resources, suppliers, and customers to a company (Pfeffer 1972; Booth and Deli 1996).

Being firms affiliated to a business group can have implications for the costs and benefits associated with busyness. As Sarkar and Sarkar (2009) contending the context of group affiliated firms in India, multiple directorships could be on account of multiple positions in companies belonging to a single group. In particular, inside directors belonging to founding families, i.e., promoter directors are likely to sit on the boards of other group affiliates with the purpose of collective coordination, overall supervision, and control. Likewise, independent directors may have their directorships concentrated within a particular group and form an "inner circle" of the group's management team. Thus, boards of group affiliates could end up with a set of closely related core leaders with duplicating positions in affiliates and vested with major responsibilities. While group-centric multiple directorships can be associated with benefits too, stemming from goal congruence and group synergy (Ouchi 1980), it can also create additional scope for promoters to engage in nepotism or kinship and to fill up member firms with friendly faces, thereby leading to promoter hegemony. Evidence of group centric multiple directorships is found for a sample of 1704 listed Indian firms for the year 2018[10]; directors on an average have around 72% of their directorships in group affiliates with 42% of directors having all their directorships in only group companies. With regard to inside directors including promoters on

[9] A case in point is that independent directors in family firms are required to be one of the "primary lines of defense" for minority shareholders to guard against expropriation by controlling shareholders (Anderson and Reeb 2004).

[10] Author's estimates based on the Prowess database. Earlier estimates of group centric directorships pertaining to the year 2003 are found in Sarkar and Sarkar (2009).

board, an overwhelming majority of around 80% of their directorial positions are in group affiliates. Of these positions held by inside directors in group affiliates, 81% are found to be within the same group where the director acts as an insider director of one of its affiliates. In contrast, relatively few inside directors of non-affiliates or standalones occupy a directorial position as an outside director in group affiliates. What is further telling is that a similar picture of group-centric positions holds for independent directors.

4.5.2 Board of Directors: The Evolving Corporate Governance Framework in India

In India, the rules and regulations that determine the composition and functioning of corporate boards to enable directors to exercise their fiduciary duties to the shareholders have historically been laid down in company law. Prior to the initiation of corporate governance reforms in India in the late nineties, other than the relevant provisions in company law, there was little by the way of a comprehensive and consistent set of laws and regulations that would come under the ambit of corporate governance. However, historical accounts of the evolution of the corporate form and that of business groups (see Khanna 2005; Tripathi, Mehta 1955; Goswami 2007) do mention the existence of a governance framework in terms of the institution of the managing agency system, the existence the centralization of management with delegation of powers, the appointments of professional managers, and powers and fiduciary responsibilities of the board of directors. As Goswami (2007) states, as the corporate sector grew in the colonial era, corporate law was put in place early on through the Companies Act 1913, which formed the foundation of the later Companies Act 1956 and Companies Act 2013.

Issues of corporate governance and the need for reforms came to the forefront in the second half of the nineties following the adoption of structural adjustment and globalization program, which in turn coincided with the East Asian crisis and a series of corporate failures even in countries which were blamed on failures in governance systems. The impetus to reforming extant governance systems both in developed and developing countries came from the Cadbury Committee Report of 1992 which brought into focus the rule that corporate boards played in corporate governance.

Governance initiatives in India since their formal initiation have come from the government via government legislations involving several amendments of the then Companies Act, 1956, which subsequently was replaced by the Companies Act, 2013, from the SEBI in the form of statutory regulations, and through other institutions such as the Institute of Chartered Accountants of India. The first round of reforms was initiated through the setting up of the Kumar Mangalam Birla Committee in 1999 by the SEBI, following the recommendations of which the SEBI introduced a separate section in the Listing Agreement of Stock Exchanges, namely, Clause

49. The objectives of the Committee and the underlying purpose of the issuance of Clause 49 was the agency-theoretic view of corporate governance being deemed necessary for investor protection and raised standards of governance would enable the development of the domestic capital market, and through adopting globally accepted practices of governance, will ensure that investors in India are informed and protected as any investor in the best-developed capital markets of the world.

Subsequent to the introduction and implementation of Clause 49, several more committees were set up to tighten up its different provisions in light of the experience on the ground, and also to clear up any ambiguity that crept into the provisions. The major committees that dealt with governance rules for listed companies were the Naresh Chandra Committee Report on Corporate Audit and Governance set up in 2002 by the Department of Company Affairs, Government of India, the Narayana Murthy Committee in 2003 constituted by the SEBI, the Companies Act 2013, replacing the Companies Act 1956, and the Uday Kotak Committee on Corporate Governance, 2017. Based on the recommendations of these various committees, corporate governance rules including those pertaining to the board of directors have been periodically revised in an attempt to be in step with market dynamics and other changes in the institutional environment.

The bedrock of the Kumar Mangalam Committee recommendations and their implementation via Clause 49 was the regulations pertaining to the board of directors and were applicable to all listed private and public sector companies and had to be complied with in a phase-wise manner. While matters such as minimum board size, appointment and rotation of directors, limits on directorships, board procedures and responsibilities of board members have been laid down under the Companies Act 1956, regulations regarding board independence, board procedures, and financial disclosures, along with disclosures related to the composition and functioning of the directors were introduced for listed companies under the purview of the SEBI. In September 2015, SEBI issued the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR) with the aim to consolidate and streamline the provisions of existing listing agreements, and the provisions of Clause 49 were incorporated within the ambit of LODR 2015. Finally, in May 2018, SEBI issued the LODR (Amendment) Regulations which have sought to implement the key recommendations of the Uday Kotak Committee. Box 4.1 presents the timeline of corporate governance reforms in India since 1999.

Box 4.1: Key Developments in Corporate Governance Reforms in India: 2000–2018

Date	Motivation/Rationale
1. **Kumar Mangalam Birla Committee Report on Corporate Governance [2000] set up by** to design a mandatory cum-recommendatory code for listed companies	– Corporate governance is considered an important instrument of investor protection particularly in light of the financial crisis in the Asian markets.
	– "Raising standards of corporate governance is "extremely relevant" to attract global capital. …would ensure that the Indian investors are in no way less informed and protected as compared to their counterparts in the best-developed capital markets and economies of the world."
	– Provided a set of mandatory and non-mandatory requirements on board of directors, disclosure, investor protection and other aspects of company governance. Compliance by listed companies in three tranches (based on listing status and company size) spread over three consecutive years.
2. **Institution of Clause 49 of the Listing Agreement [February 2000]** by SEBI following the Birla Committee Report	– "With the opening up of the economy and to be in tune with the WTO requirements, if Indian companies have to survive and succeed amidst increasing competition from transnationals and foreign companies and it can only be through achieving 'Excellence' in their working."
3. **Department of Company Affairs (DCA)[2001–02]: Task Force on Corporate Excellence through Governance.** Modified Companies Act, 1956 to incorporate provisions regarding Independent Directors and Audit Committees	– Triggered possibly by the Enron debacle and the Sarbanes Oxley Act of 2002 in the US, the Naresh Chandra Committee was entrusted *to analyse and recommend changes*, to the issues related to the statutory auditor-company relationship, certification of accounts and financial statements by the management and directors; and role of independent directors.
4. **Naresh Chandra Committee Report on Corporate Audit and Governance [2002] appointed by DCA**	– "Belief "of SEBI that "efforts to improve corporate governance standards in India must continue. This is because these standards themselves were evolving in keeping with market dynamics. Committee set up to evaluate the adequacy of existing corporate governance practices (Clause 49) and further improve these practices."

(continued)

(continued)

Date	Motivation/Rationale
5. **Narayana Murthy Committee Report [2003]: Committee on Corporate Governance constituted by SEBI**	– Important changes in Clause 49 related to the definition of independent directors, detailed outline of the role, responsibilities, and the powers of the audit committee, enhanced disclosure on accounting treatments, related party transactions and risk management as well as requirement of CEO/CFO certification of the accounts.
6. **Revision of Clause 49 [October 2004] in light of the recommendations of the Narayana Murthy Committee Report**	– More stringent requirements for board independence for companies with promoters (or persons related to promoters) as non-executive chairman.
7. **Revision of Clause 49 [April 2008] as clarification and revision of Clause 49 (2004)**	– Explanation of the expression "related to any promoter."
8. **Companies Act, 2013—Came into effect from August 30, 2013**	– significant additions include the requirement of having at least one-woman director on board, expansion in the duties and responsibilities of directors, restrictions on number of multiple directorships, tenure and cooling period for independent directors, formation of audit committee for all registered companies, rotation, maximum tenure and cooling period of auditors, and mandated CSR spending for listed companies above a certain size.
9. **Listing Obligations and Disclosure Requirements (LODR) Regulations—SEBI, September 2, 2015**	– The LODR regulations put into effect all the provisions of the Companies Act, 2013 with respect to corporate governance. The Clause 49 requirements were subsumed into the much more expansive LODR regulations as listed above.
10. **Uday Committee Report on Corporate Governance, October 5, 2017**	– Recommendation to further tighten corporate governance standards related to size and board composition, CEO duality, women independent directors and host of other recommendations.

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Date	Motivation/Rationale
11. **Listing Obligations and Disclosure Requirements (LODR) (Amendments) Regulations—SEBI, May 9, 2018**	– Implementation by SEBI of many of the Uday Kotak Committee recommendations including the requirement to have at least one-woman independent director, separation of the position of CEO and Chairman, minimum board size of six, reduction in total number of directorships from eight to seven, higher quorum for board meetings. Implementation came into effect from April 1, 2019, for the top (500/1000) listed companies and scheduled to effective from April 1, 2020, for the top (1000/2000) listed companies.

Source Author's compilation from various publicly available official documents

The corporate governance regulations issued from time to time by the SEBI starting from the Clause 49 regulations in 2000, have sought to cover the entire gamut of issues that one comes across in the literature regarding the board of directors. In particular, the regulations have contained provisions relating to (a) Composition of the Board, (b) Non-Executive Directors' Compensation and Disclosures, (c) Other Provisions as to Board and Committees, which specify the frequency of meeting of the BOD and the number of multiple directorships that board members can hold in other companies, and (d) Code of Conduct for the Board members.

A reading of the different committee reports and the provisions of the various corporate governance laws and regulations reveal that the provisions apply uniformly to all listed Indian companies, irrespective of whether these are group affiliates or not. The issue of minority shareholder expropriation in promoter-controlled firms was flagged for the first time in the Naresh Chandra Committee Report in 2002 whereby the committee stated that the controlling promoter of an Indian company can through several actions such as fixing the election of board members, packing boards with crony directors, to deprive minority shareholders of their *de jure* ownership rights without negatively affecting pre- or post-tax profits. The Uday Kotak Committee Report was even more scathing in its reference to promoter-controlled companies, whereby the report alludes to the "Raja" (Monarch) model of running an Indian company where promoter self-interest rules over the interests of the minority shareholders and other stakeholders.

4.5.3 Promoter Presence and Board Governance

In view of the discussion in the preceding sub-section on regulations pertaining to the board of directors, this Section presents some key statistics on board characteristics of group affiliates. These board statistics relate to the composition of company boards

in terms of the presence of independent directors, the presence of promoters in leadership positions signifying their control on the board, and finally the presence of women directors.

For the purpose of analysis, since board variables are likely to be slow moving and change only marginally from year to year, for the sake of brevity of discussion, three time points are chosen. In particular, we select the year 2005 when the revised Clause 49 strengthening the definition of independent directors came into effect (Box 4.2), the year 2013 marking the enactment of the new Companies Act, 2013, and the year 2018, the end date of the study period and five years post the new Act. The time points chosen can provide some insight into how keyboard characteristics that are relevant for evaluating the governance by company boards have evolved in response to the various changes in board regulations. For these three time points, the results of the analysis of board characteristics are presented in Table 4.7 which is organized in terms of four panels, Panel A to Panel D.

Box 4.2: Changes in Board Composition and Independence: 2000–2014

Board composition	Board Composition	Board Composition	Board Composition
February 2000 “Optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors. The number of independent directors would depend on whether the Chairmanisexecutiveornon-executive. In case of a non-executive chairman, at least one-third of board shouldcompriseofindependent directors and in case of an executive chairman, at least half of board should comprise of independent directors	*October 2004* *Similar as February, 2000*	*April 2008* *Additional qualification for boards with non-executive chairman* If the non-executive Chairman is a promoter or is related to promoters or persons occupying management positions at the board level or at one level below the board, at least one-half of the board of the company should consist of independent directors	*October 2014* *Additional qualification*: (a) The Board of Directors of the company shal lhave an optimum combination of executive and non-executive directors with at least one-woman director (b) Companies Act, 013 Section 149(1) requires at least one women director for not only for listed companies but also, for such non listed companies as prescribed

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Board composition	Board Composition	Board Composition	Board Composition
Determination of Independence “Independent directors” means directors who apart from receiving director’s remuneration, do not have any other material pecuniary relationship or transactions with the company, its promoters,itsmanagementorits subsidiaries, which in judgment of the boardmay affect independence of judgment of the director	**Determination of Independence** *Revised* “Independent directors” shall mean a non- executive director of the company who a. apart from receiving director’s remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management, or its holding company,its subsidiaries and associates which may affect independence of the director; b. is not related to promoters or persons occupying management positions at the board level or at one level below the board; c. has not been an executive of the company in the immediately preceding three financial years; d. is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following: (i) the statutory audit firm or the internal audit firm that is (ii) associated with the company, and (iii) the legal firm(s) and consulting firm(s) that have a material association with the company e. is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director; and f. is not a substantial shareholder of the company, i.e., owning two percent or more of the block of voting shares	**Determination of Independence** *Similar as October 2004*	**Determination of Independence** *Similar as October 2004*

Source Author’s compilation from various publicly available official documents

Table 4.7 Board Characteristics of Indian Group Affiliates: 2005–2018

	2005	2013	2018
A. Board Size	10.02	9.54	8.42
B. Promoter Control of Board (proportion of affiliates)			
1.Promoter present on board	0.66	0.84	0.50
2. No control (promoter not CEO or Chairperson)	0.38	0.22	0.54
3.Operational Control (promoter CEO but not Chairperson)	0.06	0.07	0.04
4.Strategic Control (promoter not CEO but Chairperson)	0.14	0.24	0.15
5.Full control (CEO duality—promoter both CEO and Chairperson)	0.42	0.46	0.26
C. Board Independence			
Percentage of independent directors	46.51	52.53	53.46
Percentage of independent directors with executive chairperson	52.49	53.69	53.81
Percentage of independent directors with non-executive chairperson	42.68	51.77	52.53
Percentage of independent directors with non-executive chairperson who is promoter	41.68	51.76	52.39
Percentage of Independent Directors under no control	43.60	51.31	53.65
Percentage of Independent Directors under operational control	41.26	49.83	52.59
Percentage of Independent Directors under strategic control	45.20	53.16	52.72
Percentage of Independent Directors under full control	50.38	53.22	53.66
D. Female director presence on Board (proportion of companies in which at least one female director is present)			
Female director present on board	34.54	35.92	61.96
Female executive director present on board	8.75	10.96	6.37
Female independent director present on board	10.57	16.19	39.07
Female grey director present on board	15.22	9.77	16.52
Total number of companies in sample	388	593	581

Source Author's computation based on Prowess Database

As can be seen from Panel A which presents estimates of average board size across group affiliates, average board size of group affiliates has declined from around 10.02 directors per board in 2005 to 8.42 directors per board in 2018. Estimates from an earlier period, between 2003 and 2008, point to a declining trend in board size. The estimates for the later period presented in Table 4.7 seem to be consistent with the trend found for the earlier years since Clause 49 came into effect. The decline in board size could reflect the efforts on the part of companies to meet the gradually tightening up of the board independence requirement through reducing the board size rather than by increasing the number of independent directors.

Panel B of Table 4.7 presents estimates of promoter control of board as captured by the proportion of group affiliates in each of the three years under different types of promoter control. As different estimates of promoter ownership in Sect. 4.4 show,

promoters of group affiliated firms have persistently held controlling voting blocks in group affiliates, having on an average a majority share in group affiliates. From these estimates, although it is presumed that voting control would give promoters management control, the incidence of this cannot be deduced from the equity shareholding. Using board level data, such estimates have been derived in Table 4.7. To capture the range of promoter control in management, following Luo and Chung (2013), the sample of group affiliates is classified by patterns of family control as follows (1) no promoter control, where neither the chairperson nor the CEO is a promoter, so the firm is under professional management (2) operational control, where the chairperson is a non-promoter but the CEO is a promoter (3) strategic control, where the chairperson is a promoter but the CEO is a non-promoter, and finally (4) full control or CEO duality where the promoter is both the chairperson and CEO.

As is evident from the Table, notwithstanding the pervasiveness of controlling stakes of promoter ownership in group affiliates (Sect. 4.4), not all such firms have promoters on their boards; in 2005, the proportion of firms with at least one promoter present on board was 66%. However, what is interesting is to see that while promoter consolidation in terms of voting share has taken place over time, professionalization of group affiliated companies seems to have happened; the proportion of companies with no promoters on board in leadership positions has seen an increase with more than half of the sample firms having promoters as either a CEO or as a chairperson. This is also consistent with the decline seen between the two time points 2005 and 2018 in the proportion of companies in which a promoter was present. The other interesting point to note from the estimates in Panel B is that of firms where promoters were present on board, instances of a promoter being a CEO but not a chairperson are relatively rare; only 6% of companies in 2005, 7% in 2013 and 4% in 2018 of firms had operational control by the promoter. Affiliates with promoters as chairperson but not as a CEO implies that promoters in such companies are entrusted more with providing a strategic vision for the company, whereas the day-to-day management is professionalized. As of 2018, 15% of companies are in this category, a category that has been mandated to have at least 50% independent directors as per the rules introduced in 2008. Finally, it is evident from the estimates of CEO duality that the incidence of promoters in dual positions in group affiliates, although substantial has shown a noticeable decline in 2018 over earlier levels and this decline is consistent with the overall trend toward professionalization of boards apparent in group companies.

4.5.4 Board Independence

A typical board of modern corporations consists of inside or executive directors who are full time employees of the company and are involved in its day-to-day operations and non-executive or outside directors who do not have any executive responsibilities and play mostly an advisory role. The outside directors can be further classified

as "affiliated directors" (or grey directors) and "non-affiliated directors." Affiliated directors are former company officers, relatives of the company officers, or those who have existing business relationships with the company such as investment bankers and lawyers. Non-affiliated directors are outside directors with no such affiliation. It is the non-affiliated outside directors, commonly referred to as "non-executive independent directors" or simply as "independent directors" who are envisaged to perform the monitoring role and are widely regarded as the fiduciaries of shareholder interests.

From an agency-theoretic premise, one of the important focuses of corporate governance regulations across countries is to institute an optimal presence of independent directors on the board in order to increase the efficacy of board monitoring. It is argued that if boards exist to monitor shirking or self-dealing by inside management, then outside directors in general, and independent directors, in particular, should be more effective monitors than insiders whose interests may not be aligned with that of outside shareholders (Weisbach 1988). Independent directors, keen to protect their reputational capital and to avoid being sued by shareholders, have incentives to promote the interests of shareholders and be effective monitors (Bhagat et al. 1987; Fama 1980). Further, from a resource dependency perspective, outside busy directors, through their interlocks with other companies, can generate benefits by helping to bring in needed resources, suppliers, and customers to a company (Pfeffer 1972).

Board independence worldwide has typically been defined objectively based on objective criteria requiring either the presence of a minimum number or a minimum proportion of independent directors. However, this is only part of the exercise of constituting an independent board as it is necessary to first identify directors who are "independent" of inside management so that there is no conflict of interest in monitoring the management. The usual way of defining "independent" directors in most regulations is to first state that an independent director is one for whom any material relation with the company is absent, and then identify conditions that prima facie suggest that material relations could be present. Any person who does not fall under these conditions is then deemed to be independent. The law in various countries differs according to (i) the list of the presumptive conditions that lead to a material relation and hence lack of independence and (ii) the authority which makes this determination.

In India, both the composition of the board as well as the definition of independence have been revised from time to time based both on committee recommendations and experience on the ground. Changes have been made with the singular objective of strengthening board independence in line with existing best practices. Further, attempts have been made to bring about greater congruence between the legislations/regulations issued by different administrative authorities, in terms of what constitutes an independent board, and who constitutes and independent director. Box 4.2 presents the evolution of policies with respect to board composition and independence since 2000.

As is evident from the different regulations on board composition and the definition of director independence, there has been a concerted attempt at strengthening board independence. At the same time, there is a clear recognition that board dynamics depend on whether the chairman of the board is a non-executive director, in which case, the board independence requirement is lower than when the chairman is an executive director. Further, over time, there has been an increasing recognition that given the pervasiveness of promoter control and the potential agency costs associated with it, the "concession" that was built in the initial regulation of the requirement of independence of a board where the chairman is a non-executive is likely to be disturbed when the non-executive is a promoter of the company. By requiring that at least half of the board should comprise independent directors when the chairman is an executive or when the chairman is a promoter, the regulation is recognizing that a promoter in a leadership position without being an executive, can exert excessive control in the operation of the company.

As with the strengthening of regulations with regard to board independence, Box 4.2 also reveals the move toward achieving greater objectivity in the definition of director independence. The original definition of what construes as independence of a director was kept broad perhaps for the sake of pragmatism and flexibility, but as the Naresh Chandra Committee recognized, such a definition is circular and tautological. Further, with promoter control of companies so pervasive, the application of such a definition by any promoter in a leadership position to select independent directors, could lead to the constitution of friendly boards rendering monitoring by independent directors weak. The revised definition of independence since October 2004 seeks to incorporate a set of bright line tests for independent directors that are in line with international best practices.

Turning toward an evaluation of board independence in group affiliated firms, items 1–4 of Panel C of Table 4.7 present estimates of board independence according to the regulations presented in Box 4.2, and items 5–8 of Panel C present comparative estimates for different types of promoter control as specified under items 2–5 of Panel B. Several observations can be made from these estimates, especially with regard to compliance of affiliates to changes in regulations pertaining to board independence. As can be seen from the timeline of changes in the regulations pertaining to board composition and independence, requirement of a minimum percentage of independent directors to be appointed to the board of a listed company has been conditional on whether the chairperson is an executive or a non-executive director. The regulation that existed between 2004–2008, did not consider the possibility that a chairperson who is designated as an non-executive can *de facto* act as an executive director if the person is a promoter of the firm, in which case the management should require the same extent of independent oversight had the chairperson been an executive director. This lacuna was removed in the revised provisions in 2008 which specified that the presence of independent directors for companies with a promoter chairperson should be the same as for companies with an executive chairperson. Panel C of Table 4.7 presents estimates pertaining to board independence of firms with different extents of promoter control when promoters are in leadership positions. Here too, there is little

variation in board composition in 2013 and 2018, the level remaining almost the same since 2011 (not reported). This seems to coincide with the time when average equity holdings of promoters crossed the majority mark and could be indicative of the fact that there is no discriminating power left in using the extent of board independence as a marker for inferring about firm governance.

As is evident item 1 of Panel C, the percentage of independent directors in group affiliates in 2005 was 46.51%. This estimate is arrived at by pooling all affiliates, those for which the mandatory requirement is one-third (chairperson is a non-executive) and those with executive chairperson for which the requirement of independence is at least 50%. By 2013 (earlier estimates not reported), the percentage of independent directors irrespective of whether the director is executive/non-executive or promoter, has crossed 50% on an average, and was 53.46% in 2018, suggesting that at least some firms, including perhaps those with a non-executive, non-promoter chairperson, over complying. Item 2 of Panel C captures the percentage of independent directors for affiliates with executive chairperson, for which the minimum requirement of such directors on board is 50%. It is clear from the estimates that on average such companies are complying with the regulation. Turning to item 3 of Panel C, the estimates pertain to that class of group affiliates with non-executive chairperson, the minimum requirement for which was one-third of the board. This category is relevant for the period 2005–08, and 2005 estimates again suggest over compliance with the regulatory requirement on an average. While it appears from the estimate of year 2005 that the extent of over compliance remained below 50%—the level that is required for companies with executive chairperson -, estimates for later years, 2013 and 2018, indicate that even for these group of companies, the percentage of independent directors crossed the 50% cut-off. Thus, tying independence requirements to the specific position of the chairperson has not made a difference on the ground. Finally, the estimates of board independence under item 3 of Panel C capture compliance with the revised regulation in 2008 of requiring boards with non-executive chairperson who is a promoter, to constitute boards with at least 50% directors. The percentage of group affiliates that fall under this category in the sample as of 2005 was 25.1% for which the independence requirement would be 50%. Estimates for 2013 and 2018 suggest that these set of firms have complied with the higher independence requirement.

4.5.5 Women Directors on Board

As in most countries, women are under-represented on the board of directors of companies.[11] India has been no exception in this regard, with women, on an average, accounting for less than 5% of board seats in listed Indian non-financial companies between 2005 and 2014 (Sarkar and Selarka 2021). Since 2003, beginning with the

[11] A survey of 8,600 companies in 49 countries found that women held only 16.9% of all global board seats as of 2018. Catalyst, *Quick Take: Women on Corporate Boards* (March 13, 2020).https://www.catalyst.org/research/women-on-corporate-boards/ accessed on July 17, 2020.

institution of gender quotas in Norway, there has been a push toward greater gender diversity on corporate boards over the years has been primarily driven by the business case for having more women on company boards.[12] In India, in order to increase the presence of woman directors on company boards, legislation was enacted in 2013 with to institute gender quotas on company boards under section 149(1) of the Companies Act, 2013 (MCA, 2013), which required every company or classes of companies, as may be prescribed, to appoint at least one-woman director.[13] Initially, similar to other countries, the law in India did not specify the type of woman director, namely, grey or independent, to be appointed under the quota requirement. However, a more stringent gender quota was introduced by the SEBI under the Listing Obligations and Disclosure Requirements (LODR) (Amendment) Regulations 2018 which required the top 1000 listed companies in India to have at least one independent woman director by April 1, 2020.[14]

Panel D of Table 4.7 presents estimates of the proportion of group affiliates with at least one-woman director, and corresponding estimates for women executive, independent, and grey directors for three time points 2005, 2013, and 2018. Additionally, Fig. 4.8 plots trends in the presence of women director on company boards in terms of the percentage of affiliates with at least, one-woman director (*dfdir*), one independent director (*dfind*), one grey director (*dfgrey*) and one executive director (*dfed*). Till the year 2018, both the Indian law and correspondingly the SEBI regulations did not specify the type of woman director, namely, grey, or independent, to be appointed to meet the quota requirement. However, one of the channels through which family control is exerted on the board of family firms, a large majority of which are group affiliates is through the presence of grey directors, directors who are non-executive, but who, unlike the independent directors, are often founding family members or are their relatives. Thus, compliance of the gender quota for group firms could be a channel through which family control of the board can simultaneously be increased.

As is evident from the estimates provided in Fig. 4.8 and Table 4.7, there is a clear structural break in the percentage of companies with at least one-woman director, and a steep increase in the percentage of *dfdir* shows increasing compliance with the relevant law. Significantly, there does not seem to have been any jump

[12] More inclusive and diverse boards, it is argued, are likely to be better at decision making and monitoring as directors drawn from different demographics are in a better position to understand customers and stakeholders, bring in fresh perspectives, new ideas, different problem solving, advisory and monitoring attributes, and have a wide range of experiences that helps them deal with issues in a more holistic way, all of which are likely to have a positive effect on a company's bottom line (Davies Report; Ferreira, 2011; Anderson et al., 2011).

[13] The rules with respect to the implementation of this Sub-section 149(1) were notified on March 31, 2014 and required that all listed companies, as well as all unlisted registered companies with a paid-up share capital of Rs. 100 crore or more, or turnover of Rs. 300 crore or more, have to appoint at least one woman on their board within six months of the notification.

[14] The timeline for the implementation of the new regulation would be as follows: the top 500 listed entities shall have at least one independent woman director by April 1, 2019, and the Board of directors of the top 1000 listed entities shall have at least one independent woman director by April 1, 2020.

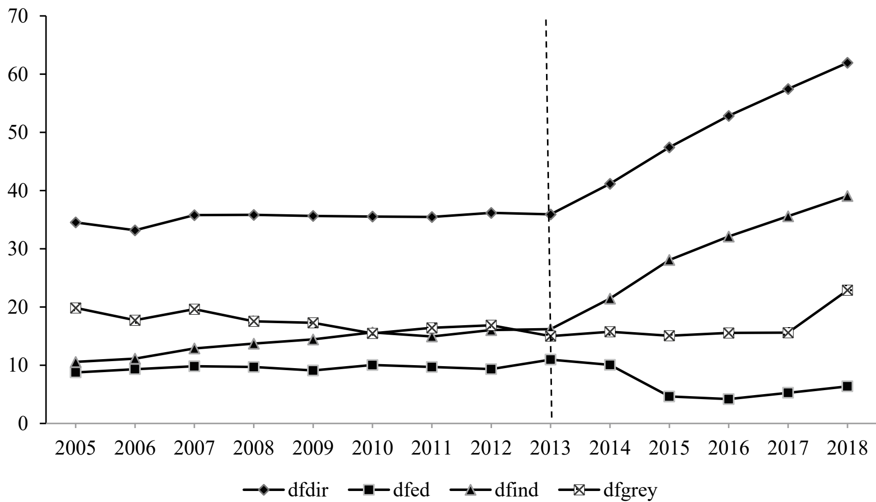

Fig. 4.8 Group affiliates with at least one woman director (%): 2005–18. *Source* Author's computation from Prowess database

as of 2018 in the appointment of grey women directors in group affiliates since the enactment of the quota, and instead the compliance is being driven by the appointment of women independent directors. This trend could be further strengthened given the revised provision for independent boards for listed companies under the LODR (Amendments) Regulations of SEBI, as mentioned above.

4.6 Concluding Comments

This chapter analyzes the ownership and governance of Indian business groups in the backdrop of evolving laws and regulations in India. The analysis is conducted using a panel data of group affiliated and unaffiliated firms for the period 2005–2018 during which the governance reforms that were initiated in the earlier years took root, and several new ones were introduced through revisions of existing regulations and laws. The twin objectives of the analysis have been to examine (i) whether the nature of the agency problems pertinent to business groups as manifested in their ownership and control structures have fundamentally changed in response to dynamic changes in their institutional environment, and (ii) whether reforms introduced to change the ways in which groups are governed by the board of directors have made any impact on the way these groups are actually governed. The analytical approach has been to understand the changes, if any, through the lens of history, to find out whether there is path dependence in the present functioning of the groups, and whether *de jure*

changes in governance mechanisms that have been introduced progressively through board reforms has *de facto* altered the governance structure of business groups in line with the intended objectives.

Contrary to expectations drawn from the institutionalist perspective that the relevance of business groups that fill institutional voids will wane as markets develop, the analysis in this chapter points to the continued predominance and persistence of Indian business groups in corporate sector activity. Several of the groups, like Tata and Birla, which were established in the pre-independence era, have continued to remain in leadership position with only a handful of large business groups continuing to dominate corporate sector activity irrespective of the changes in the institutional environment. Big groups have become even bigger in terms of their asset base, and changes in the relative positions of groups at the top end of the distribution have been sticky at best even after more than a hundred years of their existence and the entry of new groups from time to time. Within groups, ownership structures have become more concentrated over time, with promoters of almost of all groups now having majority control in all the listed firms of the groups.

The pervasiveness, persistence, and dominance of promoters in Indian business imply that there is little scope of monitoring internal management by other large blockholders. Hence a disproportionate burden of governance has to fall on the board of directors of group companies. This is perhaps why the major governance reforms in India since their initiation in early 2000s have focused on good board governance. Thus, regulations have emphasized board independence of listed companies as reflected in the requirement of the percentage of independent directors and the definition of independence. Presumably, while agency problems of business groups have stayed the same or even aggravated, board regulations have exhibited the dynamism to address the potential agency costs. Data on observed board characteristics do suggest that these regulations are influencing board structure of affiliated firms in directions intended by the regulations. In some cases, the data suggests that there has been over compliance. Thus, with regard to the main question of whether *de jure* reforms with regard to board governance have translated to intended *de facto* changes in observable "good" governance parameters, the answer is in the affirmative. However, whether this is on account of simply tick box compliance or whether there are fundamental ways in which governance of groups is changing and resulting in lower agency costs, remains to be seen.

Annexure

See Table A.1.

Table A.1 Data on Indian business groups: an analysis of the prowess database 2018

A. *Business Groups with both listed and unlisted firms*		Number of firms
Total Number of Distinct Business Groups Reported in the Database	734	11,802
Total Number of Distinct Business Groups Reported in the Database with number of firms per group reported > = 2	703	11,771
Total Number of Distinct Business Groups Identified in the Database with number of firms per group reported > = 2 AND with firm level data on total assets	569	5086
B. *Groups with at least one listed firm*		
Total Number of Distinct Business Groups Reported in the Database with at least one listed firm	659	2094
Total Number of Distinct Business Groups Reported in the Database with at least one listed firm AND firm level data on total assets	534	1277
C. *Groups with at least one unlisted firm*		
Total Number of Distinct Business Groups Reported in the Database with at least one unlisted firm	663	9708
Total Number of Distinct Business Groups Reported in the Database with at least one unlisted firm AND firm level data on total assets	417	3823
D. *Groups with only listed firms*		
Total Number of Distinct Business Groups Reported in the Database with only listed firms AND firm level data on total assets	157	245
E. *Groups with only unlisted firms*		
Total Number of Distinct Business Groups Reported in the Database with only listed firms AND firm level data on total assets	44	191

Source Author's computation based on Prowess Database

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