As family-businesses make way for family offices

The Indian market and regulations, long accustomed to the presence of a 'promoter', need to prepare for a future without one.

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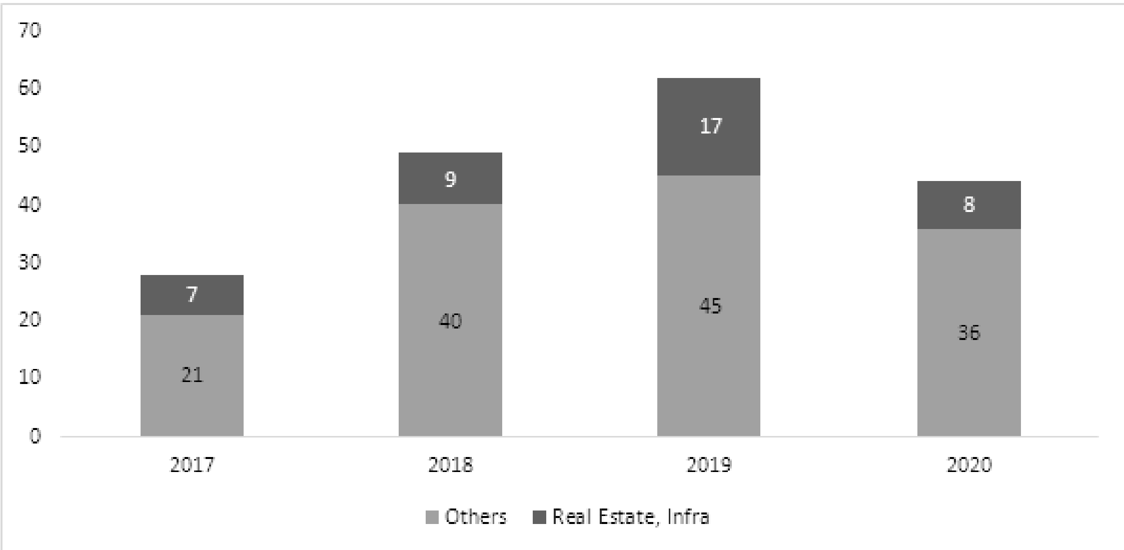
The unicorns and tech start-ups continue to grab the eyeballs, even as the increase in institutionally owned (- defined here as the absence of an Indian promoter) and controlled companies, is taking place virtually unheralded. This development too will transform the corporate landscape in equal measure as the unicorns and deserves attention.

There have been atleast 183 control transaction between January 2017 and December 2020. Remove real estate and infrastructure - primarily roads, this number still adds upto 142. The numbers have steadily gone up, from 28 in 2017, to 49 in 2018 and 62 in 2019. Even in 2020 when economic activity slowed on account of the pandemic, there have been 44 transactions. The current calendar year have already seen 21 transactions up until May.

Control transactions are different from the 'growth transactions' traditionally seen in India market. They are akin to those in the US market: here the investor takes charge of the company while appointing or backing the management. The buck stops at the investor.

Unlike families that have a generational view of business, the PE fund or investor has a horizon that is shorter than the life of the fund. They exit by selling into the market or to a strategic investor (– though based on more recent trends, market exits have an edge).

Exhibit 1: Count of control transactions, excluding start-ups



Source: EY, Multiples, IiAS Research

The above count of 183 includes 20 listed companies that have changed hands after PE firms have injected fresh capital or bought out the existing promoters, to assume control. There have been as many as seven transactions, in 2019 alone. Whether this year has been an aberration, or the pandemic broke the upward momentum, we will know over the course of the next couple of years. Such transactions are set to increase.

A subset in the listed space are the divisions or subsidiaries that have been sold through a control transaction, an example being the animal health division of Zydus Cadila. These businesses may be sold because they are a distraction from the main business, or these divisions need investing in, or the parent company itself needed capital to grow.

Importantly, many of these investors are creating platforms – in healthcare, highways, warehouses etc.. They are using their deep pockets to step in where there is market failure.

In addition to these control transactions, there is slow but perceptible increase of companies without an 'identified promoter' in the listed space. For one, more such companies are listing themselves. This includes the market infrastructure firms - BSE, CDSL, MCX. Adding to this tally are those in the financial sector, Ujjivan Financial Services, UTI, RBL Bank etc.

And then there are the existing institutionally owned and controlled companies (IOCC's) that have spawned listed subsidiaries. Housing Development Finance Company and ICICI Bank both have three listed subsidiaries each. Similarly, Larsen Toubro birthed two IT Companies and acquired one. It may be argued that the newly listed subsidiaries have 'promoters' but there is no mistaking their DNA.

The above excludes start-ups. The most visible no doubt are the unicorns, but the entire funding ecosystem is on a boil and will throw-up high-performance companies. What stands out is the low holding of the founders, and the vice like grip the investors exercise on these businesses. This explains the clamor for shares with superior voting rights, as well as the willingness of the founders to exit (an in Flipkart) or have themselves reclassified as public shareholders (- as in Paytm), but this is the subject of a separate conversation.

As family ownership gives way to 'institutionally owned and controlled companies' there are many questions that need to be asked, including what the implications on investment and growth are? Will businesses become more short-term and less long term in outlook? Will these businesses re-invest in India five or ten years out? Will managements have the same risk appetite? Will they be imbibed with animal spirits in the same measure as the crop of Indian families? Will the institutions prefer to take money out and chase the next growth opportunity outside India? If India suddenly becomes a less attractive investment destination, where will risk capital come from? As business families have a charitable streak, how will philanthropy change? How will changed ownership impact our society and polity and policy making?

Regulations for long have focused on the 'promoter' being present in the room. From the role of the independent director as an arbitrator between the promotors and minority investors, to related party transactions, to majority of minority vote, to promoter guarantee for loans. Regulations assume that family business or the presence of a 'promoter' is the norm with 'institutionally owned and controlled companies' being the exception.

True, today such 'institutionally owned and controlled companies' occupy a small corner of India Inc. But it is not difficult to envisage a future where they tower. This trend will only accelerate as the younger generation exit the family businesses to focus on family offices. Ironically, in the process many will transfer wealth from families to new generations entrepreneurs and professionals. The ownership of Indian corporates is changing and with it, India's corporate landscape will change

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