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MAGAZINE | MAR 17, 2012



DIVERSIFICATION

# Jack Of All Trades

Why diversification has been a painful exercise for large Indian conglomerates

KRISHNA GOPALAN

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Circa 2006. On a cold December morning, an ebullient Sunil Mittal announces the national launch of Bharti AXA Life Insurance. “Our in-depth understanding of the Indian market clubbed with the experience of setting up a robust network will be leveraged to build and grow the joint venture,” he says. The fledgling insurance business has “aggressive plans” for India and given the telecom giant’s reach, Bharti AXA’s focus on “mass market growth” seems on target.

Fast forward to June 2011. Bharti Enterprises catches the market off-guard with its surprise announcement — the group plans to exit the financial services joint venture in both life and general insurance, and will sell its 74% holding in both to Reliance Industries. Less than five years after its grand entry into the business, the group now says “the financial services ventures do not fit our long-term plans” and that it intends to focus on businesses where it is making a deeper impact in India and overseas (read: telecom). It isn’t a bad decision: for FY11, Bharti AXA accounted for a measly 3% of the gross premium underwritten by private players in the general insurance space and an even lower 0.92% in the life segment. The “aggressive plans” had gone cold and no new branches were opened for over a year. As it happened, a couple of months later the deal with Reliance fell through and the struggling business is still a millstone around Bharti’s neck. Another financial foray, into mutual funds with AXA as partner, has been equally disappointing. For the October-December 2011 quarter, the mutual funds business had average assets under management (AUM) of just Rs 161 crore compared to a total AUM across the industry of nearly Rs 6.82 lakh crore. Not surprisingly, then, Bharti was keen to exit this line of business as well and in December 2011, sold its entire 25% stake in Bharti AXA Mutual Fund to Bank of India.

But this isn’t about Bharti alone. In the past decade, several Indian conglomerates expanded their portfolios substantially, reaching out to newer and seemingly high-potential businesses. Not all have succeeded and, indeed, many have failed ignominiously. After the initial decade of liberalisation, and the time spent on



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**"It [telecom] is a long-term game and calls for deep pockets. It is important for us to be patient...I would give it at least four years"** Venugopal Dhoot, chairman, Videocon group

cleaning up balance sheets and consolidating core businesses, the focus had turned to growth. New avenues were emerging and Indian companies were quick on the uptake. Among many others, a hair oil company made a foray into the wellness and beauty business, a liquor company set up an airline, a consumer electronics major entered the telecom sector and a petrochemicals giant became a retailer. And as the economy grew at breakneck speed and companies' cash flows swelled, their ambitions only grew and the size of bets increased. Even relatively new entrepreneurs couldn't escape the expansion craze: bitten by the diversification bug, a big-box retailer ventured into financial services, a realtor into asset management and a housing finance company into retail. "One possible reason for over-diversification among large Indian groups has to do with overconfidence about their capabilities and resources. This can help explain the desire to get into everything," says Pankaj Ghemawat, professor of global strategy at IESE Business School, Barcelona.

The results are uninspiring, to put it mildly. At worst, the new ventures have eroded value in the core business, making the entire group vulnerable — consider the impact of Kingfisher Airlines on the United Breweries (UB) Group — and at best, the diversifications are hopeful of breaking even, after an enormous opportunity cost to the owners. A quick glance at the financial statements of leading business groups show that most new ventures started in the past decade are yet to generate positive returns. Consider this: of the 16 major diversification moves by the top 10 business groups over the past decade, 12 are still reeling under losses. Of the four new ventures started in 1995-2000, one is still in the red; three of the five ventures started between 2000 and 2005 are yet to breakeven; and all 13 businesses launched in 2005-2010 are bleeding.

Hardly any value has been created for shareholders. If you exclude the de-merger of Reliance, which created some Rs 36,450 crore value for shareholders through the listing of

**A possible reason for over-diversification among large Indian groups has to do with overconfidence about their capabilities and resources**

Reliance Communications, among other subsidiaries, only AV Birla group's Idea Cellular created significant shareholder value — it was listed in March 2007 with a market-cap of over Rs 22,000 crore and the holding company raked in Rs 2,125 crore by offering its shares for sale. Future Capital Holdings' public offer in February 2008 was done with much fanfare, but the stock has languished because of its strained business. There is significant value embedded in the life insurance subsidiaries of ICICI Bank (Rs 16,560 crore), HDFC (Rs 11,680 crore) and Bajaj FinServe (Rs 10,500 crore), according to some research estimates, but in most other cases, even if there is value in the loss-making subsidiary, the stock markets are more sceptical than understanding about the cash drain caused by new ventures. CESC's Spencer and Unitech's Uninor, for instance, have caused much grief to shareholders. Here it is only fair to revisit the extreme example of Kingfisher Airlines. As the company is on the verge of bankruptcy, its mounting debt and losses have caused much damage to promoter Vijay Mallya's flagship companies. Shares of UB and United Spirits have taken a beating as they have given guarantees to lenders of Kingfisher Airlines. Mallya has also pledged shares in most of these listed entities — estimated to be around Rs 4,000 crore. It's not as if all diversifications have been complete failures. A few conglomerates have achieved varying degrees of success in their new ventures. More on that later, but first, just what's gone wrong with India Inc's diversification strategy?

### Headlong rush

In the past decade, the government's decision to ease regulations, prompted the private sector to invest in emerging business that were buoyed by consumer spending. Nothing wrong with the logic. "In the Indian scenario (read: emerging market), there will always be opportunities to participate in nascent sectors that have potential to become huge. It wouldn't be unwise to evaluate such opportunities and invest in them," agrees Naimish Dave, director, OC&C Strategy Consultants.

But in many cases, business groups have rushed into new businesses without adequate understanding of the underlying dynamics or without a properly chalked-out road map, and clearly defined goals and benchmarks. "In the old days, when the government regulated entry, companies permitted to enter a sector were guaranteed profits. That scenario has changed since liberalisation, but mindsets have taken longer to adjust," says Ghemawat. The result: financial disaster.

**The groups have rushed into new businesses without adequate understanding of the dynamics or without a proper road map**

When Mukesh Ambani rose to address Reliance Industries' shareholders at the 2006 AGM, the biggest round of applause came when the chairman announced a venture into organised retail. The group would invest Rs 25,000 crore in this new business through a new company — Reliance Retail. It would have a presence across verticals like food and grocery, apparel and footwear, consumer durables and health and wellness. The entire exercise would provide employment to at least half a million people. This was a big challenge, even for RIL. The consumer space was new territory for the group but shareholders didn't seem worried. "Reliance will change everything in retail," said one, as others nodded fervently. As it turned out, Reliance's retail foray

continued on the same path the parent company trod — emphasising scale. Multiple formats were launched and multiple stores were opened in quick succession, but the focus on



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Butter Chicken At Birla, Lemon For Shareholders  
On The Razor's Edge  
The Dairy Explosion  
Standing Still  
The Reticent Investor  
Chennai Express  
Hungry No More?  
The Co-Operative Corporate  
Blockbuster Luxe  
"Make A Great Company And The Money Takes Care Of Itself"

### OUTLOOK TRAVEL MONEY MARIE CLAIRE

Nelson Mandela (1918-2013), R.I.P  
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A Dachau Of Safety  
Let's Frame This Debate, Nail It And Hang It  
The Truth Is Out There  
At The End Of The Grand Line  
In A Negative Frame  
Smoke Rings In Pindi

were launched and multiple stores were opened in quick succession, but the focus on delivering outstanding service and developing customer loyalty was missing. Supply chain inefficiencies, poor backend logistics and trouble from political and farmer groups didn't help. People were brought in from diverse companies and groups like Tata, Hindustan Unilever, American Express and Philips, and that proved to be a problem in its own right. Almost everyone in the top rung — each division had its own CEO — was very adept at managing an

existing, large business. But, recalls a former executive, "This was all about building a new business, which very few had a clue about. People had experience either in retail or branding but not in both." In the past two years, Reliance has been on a recruitment overdrive, bringing in retail experts from Tesco and Walmart, among others. But the damage has been done: the retail business is oozing losses. So far, the group has deployed equity of Rs 5,730 crore in Reliance Retail, its main holding company for more than a dozen retail companies. Two key companies — Reliance Fresh and Reliance Hypermarket — alone had lost Rs 756 crore as of last fiscal, according to RIL's annual report.

Reliance's earlier foray into telecom in December 2002, which now belongs to the younger Ambani, also suffered from its lack of customer-focus: ridiculously low tariffs and connections given without adequate checks led to huge defaults. And although it invested about Rs 25,000 crore, the choice of technology (CDMA versus the more popular GSM), distribution hassles and lack of interconnect agreements across circles meant Reliance Communications (then Reliance Infocomm) came nowhere close to meeting its ambitious target (breakeven in Year One).

### Crowding in

Running herdlike into sunrise sectors like retail and telecom has proved its own punishment for most business groups. Videocon is a case in point. The ever-smiling group chairman Venugopal Dhoot is always willing to speak about the foray into oil exploration, where he claims to be making an annual profit of Rs 500 crore, or the progress in the direct-to-home broadcast business, where he has cornered a 11% share of the total market of 44 million homes. But quiz him on telecom and the smile turns into a frown. Launched with much fanfare two years ago, Videocon Mobile Services was the 13th operator in an already-overcrowded mobile services market. At the time, Dhoot announced plans of becoming a pan-India player in six months and investment of Rs 14,000 crore over three years. Currently, after the recent Supreme Court ruling, all but one of Videocon's 22 licences stand cancelled and are scheduled to come up for fresh auction.

And it's not as if the company had attained any significant heights in its two years of operations: Videocon has barely 5.4 million subscribers, which is just 0.85% of the overall GSM subscriber base in India, although industry observers say the company must have invested at least Rs 5,000 crore over the past two years. "Telecom is a long-term game and calls for deep pockets. It is important for us to be patient," says Dhoot. But just how long can Dhoot wait in this sector where he is up against established players like Airtel and Vodafone? And that too, as a latecomer in a market nearing saturation? "I would give it at least four years," he says.

Indeed, telecom has been a bad play for many newer entrants, including Tata Teleservices (TTSL). The group began to emphasise this business in 2002, although the company was established in 1995. In late 2008, Japan's NTT DoCoMo picked up a 26% stake in the company for \$2.7 billion and, some months later, Tata DoCoMo kicked off a vicious price war in mobile tariffs by offering per second billing. It has cost the company dearly. TTSL is now saddled with debt of Rs 12,263 crore and the accumulated loss of Rs 5,535 crore is reflective of its tumultuous past. The company's already made some tough decisions: last year, in a restructuring exercise, it let go of some 1,700 employees.



**"We realised that the service business is very different from [the] FMCG [one]. There were unexpected challenges...We ended up spending a lot of money"** Harsh Mariwala, chairman, Marico

### Insurance trouble

Telecom wasn't the only flavour of the diversification season: almost every business group wanted a finger in the insurance pie as well. Even for conventional financial services companies and banks, insurance is a difficult business to understand. It has a long gestation business and requires deep pockets — it usually takes seven or eight years to breakeven. In India, despite most companies taking on an experienced foreign partner, breakeven has remained a distant dream. The biggest issue is the high set-up and distribution cost, especially in the first year of operation. Also, business models have had to be changed to accommodate Irda directives, such as cap on fund management costs. Among non-financial groups that have forayed into the business, analysts say Birla Sunlife and Max NewYork Life are robust businesses that are likely to breakeven soon. Yet, even in the case of the AV Birla group, it is arguable whether the long wait (of over a decade) will be worth it or whether that money would have been better deployed in furthering existing businesses or even given back to shareholders. Over the past 10 years, Hindalco had an average return on equity (RoE) of 16% while Grasim had an average RoE of 25% over the same period. The insurance company will have to register a much higher RoE in the future to cover up for the lost opportunity.



One company that has done remarkably well in insurance is Bajaj Allianz, jointly owned by Bajaj FinServ and Allianz; it's been making profits for the past couple of years. Bajaj's winning stroke was inducting professional managers and rightly milking its brand equity. Like telecom, insurance has had players without any prior



**"In the old days, when the government regulated entry, companies permitted to enter a sector were guaranteed profits"** Pankaj Ghemawat, professor, IESE

equity. Like telecom, insurance has had players without any prior experience of the sector. This meant a lot depended on the strategic expertise of the foreign partner — who still cannot hold more than 26% — and acquiring skills as the business grew. The game changer here was identifying insurance as a completely new venture that required a different mindset.

That's been the differentiator, where manufacturing-led business groups have failed in consumer-centric ventures. "To succeed in emerging markets, competencies like access to finance or the ability to work with foreign partners are factors that cannot be ignored. But that observation is not an invitation to industrial groups to get into every sector possible. Success in a sector like manufacturing does not necessarily guarantee success in a business like retail," points out Ghemawat.

### Et tu retail?

Nowhere has this been more apparent than in retail. In the past several years, almost every conglomerate in India has entered the space, albeit not always in the same form. Reliance Retail aside, the Tatas have Trent and Infiniti Retail, Aditya Birla Group has More, Godrej Industries has Nature's Basket gourmet supermarkets, Bharti has the Walmart tie-up and RPG has Spencer's. Trouble is, none of these is doing well. "Some companies have diversified simply because everyone is doing it — keeping up with the Jones' phenomenon. Obviously, it's not prudent," says Dave.

That's because the retail business throws up innumerable challenges: it's very resource-intensive with a long payback period and margins that aren't too great. So why was everyone queuing up to enter the sector? For most new entrants in the retail space, the biggest trigger was the fact that barely 3% of the overall Indian retail market was organised, so the opportunity seemed immense. But that ratio hasn't changed drastically in the past half-decade. Meanwhile, the shortage of quality retail space, soaring rentals, different consumer mindsets, unfriendly policies and the volatile political climate have taken their toll.

**A lack of passion may not have caused these failures, but the presence of a herd mentality is certainly a factor**

For instance, Videocon's electronics retail venture, Next, has been facing the heat for a while now. On revenues of Rs 1,093 crore for FY10, it brought in a net profit of just Rs 2.3 crore. While revenues have grown steadily by at least 25% each year for the last three years, higher expenses on the back of soaring rentals have ensured that net margins have remained unimpressive at less than 1%. The other big electronics retail venture, the five-year-old Croma (run under Infiniti Retail), is in even worse shape. For FY11, on net sales of Rs 1,543 crore, the company recorded a loss of Rs 61.38 crore. Infiniti Retail had wiped out its networth of Rs 302 crore as of FY11. Apart from the slowdown in 2008, high rentals and stores opened in expensive, prime locations has cost it dear.

One of the worst hit in the retail space is Aditya Birla Retail. The group launched its operations under the brand name More in June 2007, after acquiring South India-based retail chain, Trinethra. This brought in over 170 stores across the four states in the region under its fold. The plan was to invest Rs 9,000 crore in setting up 1,000 supermarkets and an undisclosed number of hypermarkets over a five-year period but it didn't quite work out that way. Some 168 stores were closed down out of a total 582 during the slowdown in FY09: the company had got the size of the stores and catchment areas wrong. "Retail is a complex business. The scale of our organisation building should have been more calibrated," says Thomas Varghese, CEO, Aditya Birla Retail. "We acquired Trinethra and also opened our More stores at the same time. In retrospect, we should have first learnt the business from the Trinethra buyout."



**"Retail is a complex business... we should have first learnt the business from the Trinethra [supermarket] buyout"** Thomas Varghese, CEO, Aditya Birla Retail

Today, More has 575 supermarkets and 12 hypermarkets. The plan is to add 10-12 hypermarkets and around 100 supermarkets each year. According to Varghese, Aditya Birla Retail's revenues for FY11 stood at Rs 1,650 crore and will be at Rs 2,250 crore for FY12. On a standalone basis, the company clocked sales of Rs 688 crore, with a loss of Rs 423 crore, and total accumulated losses stood at Rs 1,975 crore. "We expect to be Ebitda (earnings before interest, taxes, depreciation and amortisation) positive by FY13 or FY14," he says optimistically.

Similarly, RPG's Spencer has lost nearly Rs 780 crore so far in the retail business. It incurred a loss of Rs 183 crore on revenues of Rs 1,000 crore last fiscal. The stock price of group company CESC, which funds Spencer, continues to be at the receiving end — despite its strong core business — because of the retail venture's woes. Bharti's retail companies, Bharti Walmart and Easy Day, too, have wiped out Rs 1,112 crore since inception — high roll-out costs and overheads being the prime guzzlers.

These are standard supermarkets, but even forays into niche retail aren't doing well. Mahindra Group's Mom & Me specialty baby products stores were started in 2008. Four years later, they are still to breakeven and it will be another couple of years before they start making money. Godrej Industries' Nature's Basket is in a similar situation. It was launched in 2005 as a neighbourhood fruit and vegetable vendor. The target: 100 stores and Rs 350-500 crore revenue in five years. "The reason we did not get into multi-brand retail is that we did not want to compete with our customers who are already there. Nature's Basket has a unique positioning for gourmet food, which is creating tremendous value



Nature's Basket has a unique positioning for gourmet food, which is creating tremendous value as it expands," says Adi Godrej, chairman, Godrej Group. In 2009, the business model was changed and the stores started selling upmarket speciality and gourmet foods. But Nature's Basket is still not making money: of the current 19 outlets, less than 10 are profitable at the store level and it will take another two years to reach breakeven.

It's not that retail has been a bad business for all. REI's Six Ten Retail, for instance, is in the black with a FY11 sales of Rs 717 crore and net profit of Rs 29 crore. As is retail chain D-Mart, founded by stock market legend Radhakishan Damani. His success formula has been to expand measuredly by not adding too much debt. His three-pronged strategy of having stores in

There's a good reason recent diversifications haven't prospered as well as it did in the past: timing

residential areas with large population but low real estate prices, having a smaller number of high-turnover SKUs, and buying goods in cash and passing on discounts to customers has paid off very well. Last fiscal, on a turnover of Rs 1,595 crore, it made a profit of Rs 41 crore. And despite the huge losses business groups have suffered, retail could turn out to be an affordable mistake. "When one looks at the diversification process in India today, exiting a sector like retail is not that difficult since it is not hugely scale- or capital-intensive. That cannot be said of sectors like power and telecom where a huge upfront investment is a pre-requisite," says Ghemawat. That's spot on. Anil Ambani's struggle with RCom and Reliance Power are certainly bigger worries, given the money deployed into them: RCom alone has made capex of over Rs 40,000 crore in the past four years. But both companies are struggling for survival as they grapple with the triple whammy of huge debt, falling profitability and unfavourable government regulation.

### Bad timing

There's a good reason recent diversifications haven't prospered as well as unrelated expansions in the past: timing. The economic upheaval across the globe in the past few years has roiled companies across most sectors and new ventures are, not surprisingly, more vulnerable than established businesses. The retail rush, for instance, happened at a time when real estate prices were shooting through the roof. There was also a sense of exuberance triggered by the brief period of robust economic growth. With increasing competition, most companies were competing to expand their store count while not having the expertise to handle the supply chain. The slowdown in 2008 was a rude wake-up jolt.



"The reason we did not get into multi-brand retail is that we did not want to compete with our customers who are already there" Adi

Godrej, chairman, Godrej Group

Apart from the retail sector, a prime example of bad timing is aviation. Kingfisher Airlines started off on a good note snatching market-share from Jet Airways, by upping its service standards remarkably. At the launch, Mallya grandly announced that he expected the airline to be profitable in the first year of operations itself, given its "strategic approach to control costs, deployment of technology and outsourcing". He also promised to make Kingfisher the largest private airline in terms of capacity and market share by 2010. But an ill-timed acquisition of Air Deccan, which coincided with the slowdown, saw it getting into a debt trap that now threatens the entire group. For FY11, Kingfisher Airlines' losses were a steep Rs 1,027 crore on a turnover of Rs 6,450 crore. It's total debt of Rs 6,500 crore overwhelms its marketcap of Rs 1,409 crore and the loss for FY12 itself is well over Rs 1,300 crore.

Another case of bad timing is Future Group's financial foray. The logic seemed impeccable. About 150-200 million people walked into the various Future Group retail formats every year; of this, around 40 million were unique visitors. If even a small percentage of these visitors could be converted as customers for financial services, the group would make a killing. "Offering consumer finance at the stores is the logical way forward for any retail business. Big retailers such as Walmart and Carrefour have done it very successfully. All of them have independent consumer finance verticals," said Future Group founder and CEO Kishore Biyani, speaking with *Outlook Business* a few months ago.

Accordingly, in 2005, he set up Future Capital Holdings (FCH) with the idea of capturing every share of the consumer's wallet. Some progress was made when the business managed to launch product offerings like Future Card in association with ICICI Bank. Consolidated revenue for FY08 was Rs 100 crore, which went up to Rs 185 crore the next year. What changed the plot was the 2008 meltdown; FCH stopped lending in August 2008. The company had been listed on the bourses in early February 2008 at an offer price of Rs 765; it currently trades

under Rs 130 and has a market cap of Rs 827 crore. Not surprisingly, rumours of a sell-out refuse to go away, especially after Biyani himself admitted to *Outlook Business* that he was "open to all options".

Would FCH have done well if the meltdown hadn't taken place? Opinions are divided but broadly, industry observers believe Biyani's mindset is too much that of a retailer, which need not necessarily work for a business like financial services. Given the areas he wanted to focus on, a B2B rather than a B2C approach may have worked better. In a B2B setup, the emphasis is on better utilisation of assets, efficient sourcing and conversion, and aligning the channel to the firm's objectives. However in a B2C setup, success is more dependent on getting the customer

A poor track record only reaffirms the point that success is not about having deep pockets

interaction right. "The emphasis shifts from the backend to the front end. So clearly a team that is oriented around B2B businesses will need to learn new skills and unlearn some old ones to succeed in B2C businesses," points out Dave.

Not surprisingly, Biyani doesn't agree. "I don't think our idea of FCH was faulty. Perhaps we were ahead of time," he maintains. But even if the idea had merit, it wasn't executed well. A former FCH official recalls the "trench wars" in the business. "It was crucial for the store people to make the most from the space available. If someone else was willing to rent a small part of the store, the deal was concluded quickly. There was no special treatment for the financial services business," he elaborates.

Execution was the problem at another diversification: that of Marico into the beauty business. The FMCG company launched Kaya Skin Clinic in 2002 and a decade later, the wholly-owned subsidiary is still in the red; on a topline of Rs 239 crore in FY11 it had a net loss of Rs 2 crore. Marico CMD Harsh Mariwala candidly admits that the Kaya experience has been a revelation. "We realised that the service business is very different from FMCG. There were unexpected challenges like high rentals and attrition levels were as high as 40-50%. We ended up spending a lot of money," he says after giving the issue some thought.

Following the FY09 slowdown, Kaya started offering affordable services like facials, which brought it in direct competition with neighbourhood salons. But that wasn't communicated properly, so the premium perception remained and many customers stayed away, fearing expensive rates. There were other errors, too. There was no change in strategy for large and small cities; and the 'Clinic' tag left many potential customers with the impression that these were medical clinics. Roll out of new clinics was slow because Marico had eschewed the franchise route, preferring control of owned-stores — Kaya currently has 82 clinics in India and 23 in regions like West Asia, Bangladesh and Singapore. The 2010 buyout of Derma Rx's aesthetic business in Singapore was a further drain on resources.

## LOSING PROPOSITION

*Big groups are still bleeding in the retail business*

FY11	SALES	NET PROFIT	RESERVES/ ACCUMULATED LOSSES
Pantaloon	12,366	142	2,799
Reliance Fresh*	2,514	-160	-572
Avenue Super Mart (Dmart)	1,595	41	79
Spencers	1,002	-193	-778
Bharti Wal-Mart (Dec-10)	772	-168	-522
Six Ten Retail (REI Agro)	717	29	92
Aditya Birla Retail (More)	688	-423	-1,975
Reliance Retail*	592	-24	-38
Hypercity	571	-69	NA
Trent Hypermarkets	520	-51	-98
Easy Day (Bharti Retail)	470	-267	-590
Foodworld	204	-22	-190
Nature's Basket	55	-10	-25

## Poor management

The poor track of diversification by major business groups only reaffirms the point that success is not only about having deep pockets. In some ways, having too much money can be a bad thing since a cash-rich parent can simply write off any losses from the diversification. RCom, for instance, wrote off over Rs 5,000 crore in accumulated losses in 2005, while TTSL did the same about three years later, for a similar amount. Companies without any major promoter backing often do better than their competitors belonging to big business groups. "Smaller companies have the advantage of faster decision-making and also possess the ability to react to a situation far quicker," says Dave. In a roundabout way, then, resource constraints can actually be an enabler, rather than a disabling factor, since they force companies to run tighter ships.



**"I am very clear about which industry I should not be in. We are uncomfortable with high regulation which is why we are not in infrastructure projects"** Anand Mahindra, vice chairman and MD, Mahindra Group

A classic example is Idea Cellular. The company, which kicked off operations as Birla-AT&T in 1997, went on to merge its operations with Tata Cellular a couple of years later to create a slightly larger

entity — Batata as it was somewhat unflatteringly called. Though it acquired the Escorts-promoted Escotel, it was still not thought of as a serious player in a market where the likes of Bharti, Hutchison (subsequently Vodafone) and Reliance were clearly ahead. By the time the AV Birla Group was slugging it out with the Tatas in court over the ownership of Idea, there were few who gave this company much of a chance. And when the Birlas finally took charge, the feeling that a commodity-led conglomerate could not make it in telecom was worryingly gaining ground. Eventually, Idea did make this diversification story work. In mid-2006, when Idea's ownership moved to the Birlas, it had a subscriber base of 9.1 million; today it has 108 million subscribers and a market cap of over Rs 31,000 crore. "If you stretch [an] organisation and [its] practices across different sectors, you are bound to run into challenges not just of bandwidth, but also of skill-sets and mind-sets. However, a conglomerate can also be a collection of disparate and individually focused business organisations, when there is no inherent contradiction. There are examples of both types in India," says former corporate CEO Sanjeev Aga.

Early mover advantage aside, what helped Idea was the company's professional management and a conservative approach. Even in the initial years, the group did not open its cash tap; instead Idea relied predominantly on its internal accruals and outside funding for its growth. Even its 3G bidding was indicative of its prudent approach: it paid Rs 5,769 crore for 11 circles where as Bharti paid Rs 12,295 crore for 13 circles. Idea, today, has both strategic and private equity investors and for FY11 had a topline of Rs 15,503 crore, which was approximately 10% of group turnover. For the said period, it made a profit of Rs 898.7 crore.

Another conglomerate that hit the telco jackpot was Essar Group, which is estimated to have made at least a three-fold return on its investment when it sold its 33% holding in Vodafone-Essar last year for \$5 billion. For the Ruia brothers, the investment in telecom, first made in the late 1990s, was the best thing that ever happened, given their debt restructuring nightmare with core sectors like steel and oil. In telecom, interestingly enough, it was again pressed for funds and its operations, barring the Delhi metro circle, included smaller and less lucrative operations like Haryana and Rajasthan. By the time, the government raised the FDI cap in telecom to 74%, Essar was well set and also made a bid to acquire partner Hutchison's 52% stake, which eventually was acquired by Vodafone for close to \$11 billion. Like the AV Birla Group, the diversification into telecom for Essar came with a serious commodity mindset. That certainly was a serious handicap. But experts attribute the success of Essar to its early entry, and its strong and committed partner — the Hong Kong-based Hutchinson invested heavily in setting up networks, leading the way by moving into more circles; it also acquired operations in key locations like Kolkata and Gujarat, all of which helped grow the business considerably.

**Most corporate groups that rushed headlong into new economy businesses have burnt their fingers badly**

"The key to success in unrelated ventures is to dedicate the right quality of resources (people and capital) to these businesses. The traditional Indian mindset of centralised control seriously limits management bandwidth and magnifies the danger of applying cookie-cutter solutions to problems across different types of businesses," cautions Dave.

## STRUGGLING FOR LIFE

*Most private insurers, even those that belong to financial services groups, are saddled with accumulated losses*

HALF YEAR-ENDED SEPTEMBER 2011	SALES	NET PROFIT	RESERVES/ ACCUMULATED LOSSES
ICICI Prudential	5,999	689	-2,022
SBI Life	5,030	200	821
HDFC Standard Life	4,144	21	-1,717
Bajaj Allianz	3,045	110	1,149
Max NewYork	2,839	39	-864
Birla Sunlife	2,663	97	-1,481
Reliance Life	2,338	16	-2,787
TATA AIG	1,697	97	-1,461
Kotak Mahindra OM	1,164	15	-54
ING Vysya Life	693	-43	-1,162
Bharti Axa Life	347	-96	-1,655
Future Generali	305	-93	-1,060

All figures in ₹crore; Source: Ace Equity and annual reports

Mahindra & Mahindra is another example of how a carefully crafted diversification strategy can yield good returns. Mahindra's diversification was driven by the fact that there was too much emphasis on manufacturing. Now, the group has a presence in financial services, logistics and energy, and group vice-chairman and managing director Anand Mahindra is bemused when people say the group is not too diversified. "If we have grown from a turnover of \$1 billion in 2002 to \$14.5 billion today, we ought to have had a theory of growth," he laughs. "I remember looking at the Tata group several years ago and their presence in businesses like IT and hotels. I was convinced that being in services was key."

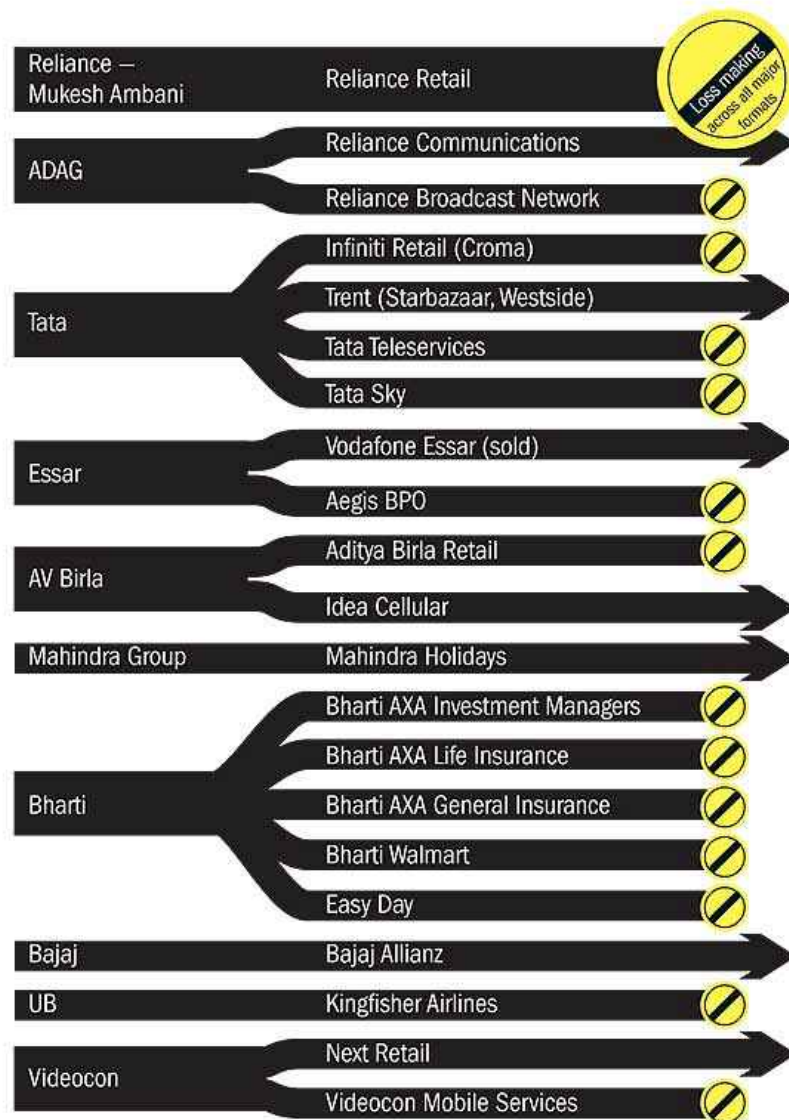
That gap in services has been filled to a large extent by Mahindra Holidays (an earlier hotel venture with Accor didn't work out). Launched in 1996, for FY11 the business brought in a topline of Rs 523 crore and a net profit of Rs 103 crore. The choice of business is rather unusual, but the business seems well poised. "We looked at several businesses — but the risk-reward in certain businesses is inherently unfavourable, and we decided to steer clear of such businesses. Airlines, for example, are not financially viable. Similarly, the hospitals business is risky as one incident can kill your brand," says Mahindra.

The group's investment decisions are driven by Mahindra Partners, the private equity and venture capital arm. As recently as 2010, the group intensively researched the stem cell business, meeting practitioners and academics and then decided not to go ahead. "The space looked interesting but we realised that our understanding was not that great and we would be dependent on scientists," says Zhooben Bhiwandiwalla, managing partner, Mahindra Partners and group executive vice-president (legal). There are also strict rules for new businesses. For instance, the group will not look at industries that are high rent-seeking or where there are high levels of regulation. "I am very clear about which industry I should not be in. We are uncomfortable with high regulation, which explains why we are not in infrastructure projects," says Mahindra.



## Awaiting payback

*India Inc's diversification is yet to bear fruit*



Source: Annual reports

Outnumbered by innumerable diversification ventures that are failing, these exceptions appear to be proving the rule for diversification strategies in India — unrelated expansions do not pay. So, is there no case at all for unrelated diversification? Not exactly. In fact, one of the biggest grouses against diversification is also a point in its favour: cross-subsidisation of businesses. Granted, several large companies are currently suffering for the sins committed by their unrelated subsidiaries, but support and investment from a parent or group company can be invaluable for a fledgling business, which may otherwise struggle for finance in external markets. Of course, it's also critical to ensure support doesn't degenerate into interference — centralised control over subsidiary companies has been a key factor in their not doing well. "It is a rewarding portfolio strategy as long as each business is operated independently with the right team — unburdened by legacy issues of the other businesses of the group," says Dave.

**The downturn has taken a toll on new companies as they are more vulnerable than established businesses**

Being part of a group means access to capital and resources like people and land, as well as informal but critical factors like relationships with government and understanding of regulation. For the parent company, getting into new, unrelated sectors means an opportunity to not only take advantage of a new growth opportunity, but also de-risk the existing structure. Indeed, the logic for unrelated diversifications in the 1990s was driven by the benefits of being a conglomerate — less volatility and susceptibility to business cycles. In recent years, though, it's been more about increasing shareholder value — and that's hardly

worked. A recent McKinsey study on US companies brought out that at an aggregate level, conglomerates have underperformed more focused companies both in real economy (growth and return on capital) and in the stock market. For 2002-2010, for example, the revenues of conglomerates grew by 6.3% a year; those of focused companies grew by 9.2%. Median total return to shareholders were 7.5% for conglomerates and 11.8% for focused companies. A similar study for India can probably not be done considering the lack of transparency in disclosures regarding investments made in subsidiaries (diversification ventures), but undoubtedly the results would be far worse. Most major diversifications in the past decade have made no big money so far.

As the authors of the McKinsey report put it aptly, "Value-destroying failures litter the history of diversification strategies. As managers contemplate moves to diversify, they would do well to remember that in practice, the best performing conglomerates in the US and in other developed markets do well not because they're diversified but because they're the best owners, even of businesses outside their core industries."

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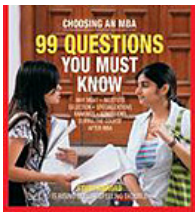
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