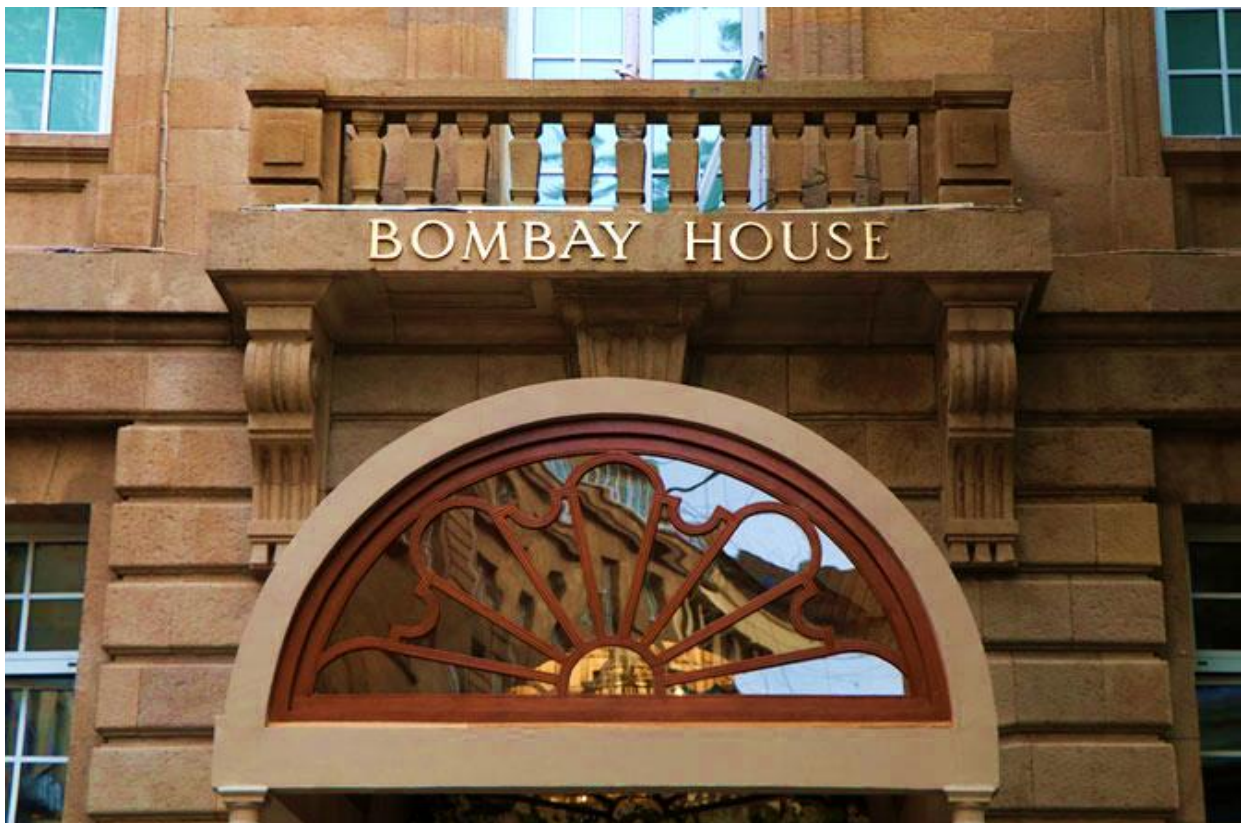


# A new era for the Tata Group

*Providing an exit to the Shapoorji Pallonji Group will compel the Tata Group to reduce its equity holding in TCS, pledge equity of its listed companies against debt, or allow an outside investor in Tata Sons. Any of these options will reduce Tata Sons' financial flexibility, heightening the performance pressures of the group. With the SP Group's exit, the Tata group will no longer resemble its past.*



The Shapoorji Pallonji Group's (SP Group) poignant decision yesterday to sever its relationship with the Tata Group will likely bring an end to the on-going battle between the two groups. The SP Group's need to sell its stake to raise capital does not come as a surprise – the Sterling and Wilson Solar Limited episode, the recent default on debt, and the attempt to pledge Tata Sons' shares are telling signs of the SP Group's despair. Importantly, for stakeholders at both ends, it marks the end of an era.

The Tata Group is uniquely structured: it is essentially a philanthropy that runs a commercial business. Tata Trusts exert control over Tata Sons, which exerts control over operating companies, several of which are listed and subject to

scrutiny by external shareholders and accountable to a wider set of stakeholders. Tata Sons plays the intermediary role of pushing for performance from the operating companies and supporting the Tata Trusts' goals.

This structure worked beautifully for several decades with the support of the SP Group that own 18.37% of Tata Sons. Because the residual equity in Tata Sons was held by charitable trusts, these were not allowed to vote their equity shares until 2000, resulting in the SP Group effectively becoming caretakers of the group. The SP Group had more power than it asserted and the foundation of how Tata Sons and the group operated was built on the ancestral relationship between the Tatas and the Mistrys. Because the structure worked, it was rarely questioned – until the defenestration of Cyrus Mistry. The subsequent battle between him and the Tata group has embroiled Tata Sons and the rest of the listed companies with it, leading to this announcement.

With the SP Group severing relationship with the Tatas, Tata Sons needs to buy out the SP Group's 18.37%, which is conservatively valued at USD 20 bn. There are two possible scenarios that may play-out.

First, for Tata Sons to buy out the SP Group it will need to sell about 16% of TCS, at the current market valuations, bringing down its shareholding to 56% from the current 72%. This will mean that the Tata Group will continue to control TCS, but its cash flows from the company will be lower than before. For the past several years, and even now, Tata Sons ability to infuse equity and provide liquidity support to its businesses has been driven by TCS' dividends and buyback. The sale of 16% of TCS will restrict Tata Sons' financial flexibility and somewhat weaken its ability to hold the group together.

Alternatively, Tata Sons can sell its non-core assets and pledge the equity of its listed companies to raise debt. Traditionally, the Tata group has pledged shares of listed companies with the financial services businesses of the Tata group. While the debt was raised, there has rarely been a concern over potential loss of control. But the amount to be raised is significantly large in this case, and one that will need external (non-group) financiers. In doing so, the group will reverse its past 24-month effort to reduce debt, shore up shareholding in listed companies, and untangle the crossholdings across the group. The group will get saddled with more debt, thus increasing its vulnerability.

The second possible outcome is strategic partners or outside investors (private equity, sovereign wealth funds) enter Tata Sons. This will come with conditions

attached. For one, outside investors in Tata Sons will want the company to go back to being a public company from its current private limited state. The group's structural constraints will likely come to the fore.

In all these scenarios, there will be increased performance pressures on the operating companies of the Tata group. The group will no longer be able to stay hinged on TCS' performance – other companies of the group will have to perform, or in some instances, perish. The group's patience thresholds on performance are likely to contract.

The performance pressures will likely drive cultural change: one that is tougher, more commercial and focussed on a single bottom-line rather than the triple bottom line that the group finds its genesis in. To change the group's ethos will be an extraordinary leadership challenge. Even as the Tata group evolved, began entering newer business lines and had global aspirations, it remained rooted in its culture. A change in corporate culture may likely bring about a change in the corporate governance practices – and importantly, structure of the group. Will the Tata brand then continue to carry as much gravitas as it does now, will remain to be seen.

What the Tata group may have been pushing towards has indeed come true. The SP Group has decided to sever ties – but there are several uncertainties on how this will play out. There is no immediate impact on the operating companies, including the listed ones: these will play out not next month or next year, but several years into the future. Even so, the end of a 70-year relationship between two families – one that built both business houses (the Tatas and the SP Group) – is not to be brushed aside. It will bring an unprecedented change to the Tata Group, India's oldest business house whose fundamental premise, over a century ago, was to bring societal good.

This is a historic yet sombre moment for corporate India. And it brings with it a new era for the Tata group.

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