

# **Business Groups in India**

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## **Abstract**

The business group as an organizational form is one of the many unique business structures that exist in the global economy. Literature aimed at understanding whether group-affiliated firms function differently from standalone firms, more so with respect to basic corporate finance decisions like investing, financing and reporting has remained scarce. It is in this context that we, through three empirical essays based on India, aim to understand and provide answers to some unresolved questions related to how group-affiliated firms differ from standalone firms when making corporate finance decisions.

Business groups are a dominant economic force in India particularly and have been so historically. About 31 percent of firms in India belong to business groups but this 31 percent accounts for almost 59 percent of total assets held by all firms in India. This highlights the economic significance of business groups in the Indian context and makes it imperative to understand how especially since Goldman Sachs identified India as one of the four most important economic powers among the emerging countries in 2001, Indian capital markets have become increasingly important to the international investor. According to estimates by a PricewaterhouseCoopers (PwC) report, India is slated to become the third largest economy in the world by 2030, from its 2013 rank of ten. This makes India an important market to study.

Thus, within the Indian context, the first chapter explores corporate reporting decisions at business groups. The Satyam fraud in 2008

involved not just large scale manipulations of reported figures but also elaborate and complex

Maytas. This sparked an interest in examining earnings manipulation within business groups where internal capital markets remain a necessary evil. It is in this context that we examine if and why group-affiliated firms decide to use more real earnings management to inflate reported figures in the first essay. Our analysis reveals that group-affiliated firms engage in significantly higher real earnings management than standalone firms. We then examine accruals-based

group firms is found to be inefficient, compared to standalone firms where the real earnings management is generally found to be more efficient.

Since the first two essays in this thesis help identify costs at business groups, the third essay explores whether external stakeholders can see through some of the wrongdoings and segregate the good group-affiliated firms from the bad firms. Within this context, we explore the impact of additional disclosure requirements, i.e., ownership and governance-capital constraints as measured by its investment-cash flow sensitivity. We further examine whether this sensitivity is affected by variation in agency costs, due to group affiliation and insider ownership. Investment-cash flow sensitivity is found to decrease after mandatory disclosures increase, in particular for those firms that had limited access to external capital earlier. Group-affiliated firms are found to have lower investment-cash flow sensitivity (i.e., enjoyed better access to external capital) before regulation, which increases after regulation when compared to standalone firms. On further analysis of only group-affiliated firms, this increase in sensitivity is found restricted to only firms with high insider ownership that perform poorly in the future.

Overall, this thesis helps understand further how corporate decision making varies at business groups from that at standalone firms. It identifies why business group firms manage earnings by manipulating real activities and also provides evidence on how accounting policies that are meant to be cautious can be misused. The thesis also shows how regulations in low enforcement regions like India and other emerging countries can be useful in separating out the efficient firms from the opportunistic ones thus, reducing business costs.