After Months of Acrimony, an Outbreak of Brotherly Love at Reliance

Published : July 13, 2005 in Knowledge@Wharton

On Saturday, June 18, 2005, peace returned to Reliance, India's largest business group, after a settlement was hammered out between the two warring brothers at its helm. During seven months of a nasty public feud, the $23 billion group controlled by the Ambani family seemed close to breaking up. The dispute drew out Kokilaben Ambani, the mother of two warring brothers, from her role as homemaker to center stage. "With the blessings of Srinathji (a reference to the Hindu god Krishna), I have today amicably resolved the issues between my two sons, Mukesh and Anil," she said in a brief statement.

Now, the group's two parts seem set to become greater than the whole, unlocking hidden value and unshackling ambitious expansion plans. As Anil Ambani, 46, the younger of the brothers said: "For us, 1 plus 1 now means 111." He now has control of the group's companies in power, telecommunications and financial services, while his brother Mukesh, 48, will retain Reliance's petrochemicals, polyester and refining companies. Within a week of the settlement, Anil announced a slew of projects valued at more than $18 billion. Mukesh already has in his pipeline nearly $10 billion of investments, mostly in expansion projects.

As the saga closes a chapter in Indian business, it offers insights for large, family-owned industrial houses all over the world. Perhaps the most significant lesson is that poor transparency can depress value for companies and their shareholders. The group's flagship Reliance Industries is a cash cow, and it had invested up to $4.3 billion in affiliate companies. Some of those were unlisted entities such as Reliance Infocomm, in which the parent company invested $2.75 billion. After the settlement, the process has begun to convert some of those investments from preferred equity to common equity shares at higher, updated valuations, literally unlocking hidden value.

The Ambani truce also shows why business families need to manage their ownership structure in group enterprises. As the settlement rearranges the family's holdings, its advisors will need to unravel holdings and crossholdings involving an intricate maze of more than 250 investment companies. Corporate governance is another area where practices may change as the Ambani brothers attempt to bury the hatchet. While the dispute raged during the past few months, allegations arose of investments being made without board consultation, and of share allotments at discounted values, among others. India's regulatory authorities haven't yet closed those files, though there is no evidence of foul play or that anyone has launched an investigation. The Ambani dispute and its resolution also demonstrate the need for family-owned businesses to set up effective processes for communication and conflict management.

Despite the bitterness that may linger because of the squabbles, Kokilaben Ambani couldn't have hoped for a better outcome. She picked K. V. Kamath, a family friend and managing director of India's ICICI Bank, to broker the deal, and he was aided by ICICI's deputy managing director Kalpana Morparia and prominent investment banker Nimesh Kampani. Most significantly, she was able to meet her self-imposed deadline for family peace by July 6, the third anniversary of the death of her husband and the group's founder, Dhirubhai Ambani. The Kamath-led team's final session of negotiations lasted 18 marathon hours, ending at 4:00 a.m. on the day the settlement was announced.

Kokilaben used a simple 30:30:40 formula to split the family's 34% ownership in the group's companies.

Mukesh and Anil got 30% each, and the rest went to others in the family - Kokilaben retains 30%, and 10% is split between her daughters Nina Kothari and Dipti Salgaocar. The acrimony between the brothers seems to have vanished overnight; Anil Ambani said he has forgotten what happened in the last 25 years and is looking forward to the next 25.

Sensitive Issues

The Ambani brothers will share in the fortunes of a group that has all the trappings of a global business giant. Annual group revenues in fiscal 2005 exceeded $22.6 billion or 3% of India's GDP, and generated net income of $1.4 billion. The group's shareholders account for one among every four investors in India, and its employees number about 160,000. Its flagship company, Reliance Industries, earns 17% of the total profits of India's private sector and commands 6% of the country's stock market capitalization. It also contributes nearly a tenth of the country's indirect taxes and nearly 8% of its exports.

The settlement addressed several sensitive issues. Mukesh's new empire has annual revenues of about $17 billion with net income of about $190 million. By contrast, Anil's group has revenues of about $2.4 billion and net income of just about $16 million. In an attempt to level the field, Mukesh will write a big check for Anil that company watchers estimate at between $2.3 billion and $3.5 billion. Anil has resigned as vice chairman and managing director of Reliance Industries, where Mukesh is chairman and managing director. The brothers have also signed a 10-year non-compete agreement where Mukesh will not enter power, telecommunications or financial services, and Anil will steer clear of petrochemicals, oil and gas. Both groups will use the Reliance brand and logo, but Anil's companies will carry the tag line, "A Dhirubhai Ambani Enterprise."

Raphael (Raffi) Amit, a Wharton management professor and academic director of the Wharton Global Family Alliance, has seen disputes like the one in the Ambani family but believes they are avoidable. He cites the example of the Jatania business family in London, where four brothers own and manage Lornamead, a $600-million maker and marketer of personal care products in 50 countries. He recalls Lornamead's CEO Mike Jatania talking about how his family has avoided conflicts: "They way they resolved it is to have the mind set of a 'business family' and not that of a 'family business.' You then know what comes first, and egos and feelings get addressed." Amit adds that an unnamed, British business family that is in the 11th generation is now going strong as a prominent financial institution because it has "a constitution and governance structure that everybody has to abide by, and that helps deal with ownership issues across generations."

The absence of such structures aggravated the Ambanis' feud, but their truce was widely welcomed in India. The day the settlement was announced, the Mumbai stock market's index rose to a record high. India's finance minister P. Chidambaram told Knowledge@Wharton, "We are happy about the settlement. The brothers have preserved the interests of millions of shareholders." Three days after the settlement, Moody's Investor Service hinted that an upgrade may be in the cards for Reliance Industries' rating from the current Ba2, which is below investment grade but with a stable outlook. Moody's said it will continue to review the rating, adding, "The resolution of the family ownership issue is a key development, but its potential financial impact is uncertain."

Not everybody sees the settlement impacting anything substantially beyond the Ambani group's fortunes. "It (the settlement) removed a lot of uncertainty over the future of one of India's largest groups; I don't think the market as a whole was affected," says Adi Godrej, chairman of the $1.3 billion Godrej group of companies in Mumbai, a diversified family owned business with personal care products, home appliances, office equipment and machine tools, among others. He also notes it was important to accept the settlement as fair to both parties; he said he personally also felt that way. "Each will now focus on the future growth of his part of the business." Similar sentiments were echoed by Rahul Bajaj, chairman of Bajaj Auto, India's largest maker of two- and three-wheel vehicles. "Let us not overplay it. The Ambanis control the largest private group in the country, so the settlement is important, but it is now behind us," said Bajaj. "We have to get on with our jobs."

Bajaj offers some pointers from a similar situation in his 79-year-old business, which is now close to finalizing an ownership dispute after boiling away for four years. Three years ago, Shishir Bajaj, one of the five brothers who controlled the group, wanted to sell his stake to the other four and go his own way. Negotiations stalled over the price of the assets, but family members for the most part avoided making a public spectacle of their dispute, though reports of some disagreements were reported in the media. Two years after the dispute surfaced in 2001, the Bajaj family worked with a mediator, who in six weeks got everyone concerned to sign a Memorandum of Understanding. Bajaj now hopes that the two dozen agreements for the sharing of property, shares, capital gains and gift taxes will be wrapped up by August.

Going for Growth

At the newly-formed Ambani groups, Anil and Mukesh are losing little time getting on with their agendas. The settlement process, including de-mergers of group investments and tax planning strategies, is well underway and the reorganization is expected to be completed in four or five months. The day after the settlement, Anil announced the formation of Anil Dhirubhai Ambani Enterprises (ADAE), as he christened his new group. He also announced an investment of $685 million from his personal resources into Reliance Energy and Reliance Capital, both of which have floated preferential share issues to fuel expansion plans. At Reliance Energy, Anil put up $230 million along with foreign investors who are said to include Temasek of Singapore and New York Life. Reliance Capital's preferential offer attracted bids of more than $1 billion from foreign investors against a target of $75 million, and Anil committed to invest $450 million.

At Reliance Infocomm, a mobile phone services provider that has about a fifth of India's market, Anil plans an initial public offering of nearly $3.5 billion, which would make it India's biggest so far. ADAE is also bidding for two large power projects with investments totaling $13.5 billion, and for privatization of airports in Mumbai and New Delhi. It has been shortlisted for a mass rapid transit system in Mumbai.

Mukesh is no less resolute in his growth plans. He plans to invest $4 billion in expanding oil and gas exploration and development of gas fields. Reliance has the world's largest greenfield refinery at Jamnagar in western India, which can process 27 million tons of crude a year. The company has had a string of gas discoveries in central India's Krishna-Godavari basin and off the country's eastern coast, besides three oil wells in Yemen. Reliance is also investing $1.5 billion in creating a retail marketing network. Mukesh wants his company to be among the top 10 worldwide in oil and gas exploration, production, distribution and marketing. "It is no coincidence that three of the top five Fortune 500 companies are energy companies," he said at a Reliance shareholders' meeting in June 2004. In petrochemicals, the group plans fresh investments of about $2 billion over the next five years to take its annual production capacity from the current 12.4 million tons to 15 million tons. And in the next two years, recent acquisition and expansion will help Reliance emerge as the world's largest maker of polyester fiber and yarn with capacities of 1.8 million tons, up from the current 1.1 million tons.

While the settlement seems to have unleashed lots of entrepreneurial energy, few observers suspected the rift between Mukesh and Anil before their father Dhirubhai Ambani passed away at age 69 in July 2002. Other than the occasional rumor of disagreements, Mukesh and Anil appeared to be loving brothers working under their father's guidance. The son of a village school teacher in India's western state of Gujarat, Dhirubhai had less than $350 when he started out in 1958 with a trading house, after working at a Shell gas station in Aden, Yemen. By 1966, he had set up his own textiles manufacturing unit, and it went public 11 years later with one of India's biggest IPOs. Reliance followed up with a string of public equity and debt offerings, fostering an enduring and widespread investment culture in the country.

Differences between the Ambani brothers resurfaced after their father's death, but stayed largely within the walls of Sea Wind, the family's 16-story residence in Mumbai. However, a can of worms opened up when Mukesh gave an interview last November to a reporter from Indian television channel CNBC-TV18. In response to questions, he acknowledged that the Ambani family was grappling with ownership issues. That triggered a wave of accusations and leaks from friends and company executives loyal to either brother, who now belonged to so-called camps.

The most serious charges that came from Anil's side were allegations of poor corporate governance at Reliance Industries. In December, he abstained from voting on a company share buyback proposal saying it was an inappropriate time, and later sought details on the financial performance of unlisted group companies. His camp also accused Mukesh of cornering equity in Reliance Infocomm at artificially low valuations. In January 2005, Anil sent a 500-page note listing alleged governance lapses at Reliance to its directors. He also resigned from his directorship at IPCL, saying it was below his dignity to sit on the same board as Mukesh's confidante Anand Jain, whom he accused of trying to divide the family.

Wharton's Amit, whose focus areas include entrepreneurship and family businesses, has dealt extensively with questions of corporate governance in his research projects. In a soon-to-be-published paper titled "How do family ownership, control and management affect firm value," Amit and his co-author Belen Villalonga of Harvard Business School examine governance issues. The study looked at more than 500 companies over seven years and came up with some surprising results. "Our findings about family ownership and control suggest that, despite the costs associated with the family's excess control, the benefits of family ownership make minority shareholders better off than they would have been in a non-family firm," the authors say. Amit offers an explanation for that counter-intuitive finding: "These families go overboard in terms of trying to be better governed simply because they want to alleviate concerns of minority shareholders about [the family members'] appropriation of private benefits." That strategy makes business sense because it relieves the pressure on valuations that minority shareholders could bring.

A day after the truce, Anil -- who has his own web site (www.anildambaniforindia.com) -- wrote a signed column in the country's biggest newspaper, the *Times of India*, where he quoted the Buddha and from the Bhagavad Gita, which the Hindus regard as their Bible. "Have a right to action, never to its fruit," he quoted from the Gita. He also wrote in that column, "It is an error to interpret sacrifice as a sign of weakness. True giving is a mark not of submission but of awakening."