FAMILY BUSINESSES AND INDIA'S TRANSITION TO A SERVICES LED ECONOMY (1991 – 2018)

WHITE PAPER

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Executive Summary

- India's transition to a services-based economy in the 1990s and the 2000s from its overdependence on the primary sector for contribution to the Gross Domestic Product has been documented among policy makers and development economists alike.
    - Opportunities in the services sector during the period of early reforms in the 1980s and economic liberalization in 1991 saw the contribution of the services sector to the GDP overtake that of the primary sector.
    - Family firms are an integral part of the Indian economy and underwent major changes in terms of the business and sectoral mix of their operations during this period to take advantage of these opportunities.
- Family firms spearheaded the movement into the services sector in the 1990s from an initial inclination towards manufacturing in the pre-liberalization era.
    - Post the advent of the era of digitization and IT in the early 2000s, family firms have asserted their dominance in the modern services sector (such as Telecom and Software) outshining the MNCs and State-Owned Enterprises (SOEs).
    - However, they maintain a strong presence in traditional services too (such as trade and construction) which continue to generate sizeable profits for them.
- Family Business Group Firms (FBGFs) continue to dominate Standalone Family Firms (SFFs) across manufacturing and services in terms of their size and valuation. They are also leveraged much higher than SFFs.
- We find evidence of strong interlinkages between industry affiliation and firm performance (in terms of Returns on Assets) and suggest sector-specific implications must be accounted for by policy makers and business managers alike during decision-making.
- Indian family firms have mirrored the economy in spite of facing tough business conditions. Despite their resilience, a strong industrial policy needs to be formulated in the future that keeps the growth of the services sector on its current path and helps bring the manufacturing sector's productivity and magnitude in line with other nations of India's size.

The Thomas Schmidheiny Centre for Family Enterprise has undertaken a series of studies since 2017 to understand the Family Business scenario in the country and its evolution since 1990. The previous studies by the Centre have touched upon various facets of Family Businesses in India such as the contribution of family businesses to key indicators of economic well-being (GDP and asset creation), impact of the changing promoter shareholding on firm governance and compliance of the corporate social responsibility (CSR) regulations introduced in the Companies Act (2013) by the Government of India. This paper aims to serve as a continuation to the previous white papers and traces the changing portfolio of industries that family businesses in India operate in and their evolution to remain competitive and even dominate in the post liberalized economy.

FAMILY BUSINESSES AND INDIA'S TRANSITION TO A SERVICES LED ECONOMY (1991 – 2018)

1. Introduction

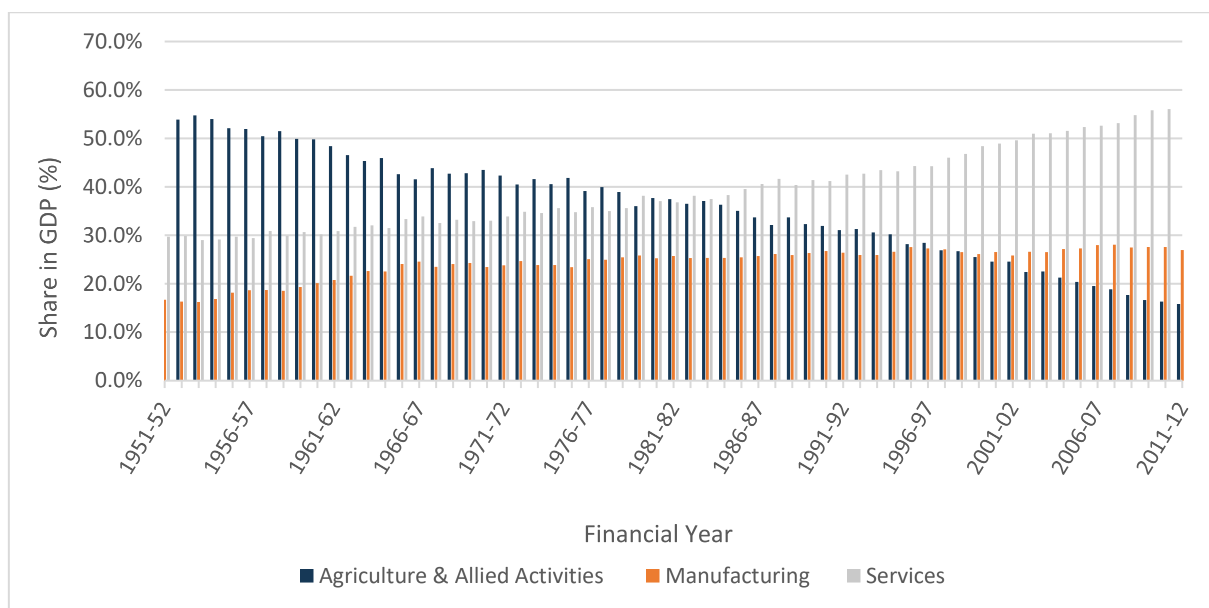
Since 1991, the Indian economy has witnessed several policy reforms aimed at opening it up to the forces of globalization that have resulted in concentrated efforts to improve the institutional mechanisms. The decade prior to liberalization was the period when cautious reforms, or "reforms by stealth" had started in India, following lobbying by the industrialists for removal of restrictions and controls. These reforms in the 1980s included (but were not limited to) provision of increased incentives to export (including tax benefits) for private firms, reducing the monopoly of the government over importing certain capital goods, delicensing several industries, reducing quotas and tariffs and a steady depreciation in the exchange rate. These changes resulted in the industrial growth rate to more than double from 4.5 percent in 1985-86 to 10.5 percent in 1989-90[1].

Due to a severe balance of payments crisis, under pressure from the International Monetary Fund, in 1991, the government further undertook a vast array of policy reforms commonly referred to as "economic liberalization". Regulatory controls such as the Monopolies and Restrictive Trade Practices (MRTP) Act that prevented large companies (with an asset base over a cutoff decided by the government) to diversify and expand to newer sectors were revised to enable such firms and business houses to expand the scope of their businesses. Investment licensing was done away with for most sectors and ended the public sector monopoly in many sectors. Licensing of capital goods was removed which enabled Indian companies to access a wider range of imports. Trade liberalization also enabled Indian companies to export in higher amounts as exchange controls were lifted.

Emerging markets, like India, typically witness a significant change in the contribution of agriculture, manufacturing and services to the GDP as the intensity of economic activity increases. The measures of liberalization described above completely changed how India's industry functioned and enabled it to access the benefits of globalization much like the rest of the world. These reforms also further accelerated the growth of the services sector in India, thereby, increasing the gap between the contribution of the services sector to the GDP and those of the manufacturing and primary sectors (discussed ahead). Exhibit 1 shows the growing dominance of the services sector and it overtaking the primary sector (agriculture and allied activities) to be the largest contributor to the GDP around the early 1980s and the widening gap as the pace and quantum of reforms increased.

[1] For more information, see: https://www.imf.org/external/pubs/ft/wp/2004/wp0443.pdf

Exhibit 1: Evolution of Sectoral Shares in India's GDP



Source: Open Government Data Platform (Government of India)

The share of services in GDP had moved up to ~50% (Exhibit 1) by the start of the millennium. Manufacturing growth kept lagging and its contribution to GDP remained stationary at about 26 - 28% around the same time. The decline in agriculture seemed to be offset entirely by the rise in services. Prior to India's growth story at the start of the millennium, it was widely believed that manufacturing accelerates the growth of developing nations and is followed by a movement to the services sector at relatively higher income levels. However, services led growth in many low- and middle-income economies (including India) have challenged this pre-conceived notion. In the last few decades, services have been the primary engine of growth in GDP for many of the developing nations and have competed with manufacturing to provide impetus to employment and productivity.

India's growth story stands in stark contrast to China, another Asian country, wherein the manufacturing sector provided the impetus to economic growth. Most global value chains are heavily dependent on the Chinese for either key intermediate inputs or end-use products. The Chinese government significantly invested in infrastructure (such as airports, railroads, highway systems and electricity transmission lines) and opened trade to attract Foreign Direct Investment from developed nations. These policies helped Chinese firms to import technology and utilize existing labor (which it possessed in abundance) to manufacture a vast array of technologically adept products at extremely low prices. In contrast, India's focus on subsidization of tertiary education (even at the cost of primary education in some states) and the demand boom for services in the 1990s created a paradox of a relatively poor economy specializing in capital-intensive and skill-intensive sectors (Chari 2011).

In the pre-liberalization era in India, family firms typically operated in the manufacturing sector, albeit operating within the license-quota restrictions on production, imports, foreign exchange, private and foreign investments and high tariff rates. Many of the industries were off limits for the

private companies (mostly family firms), such as oil and gas, power generation and distribution, atomic energy and mining of certain minerals. Services industries like banking and insurance were completely nationalized. Therefore, it makes for an interesting study to explore the evolution of family firms in an environment where new opportunities arose in industries previously reserved for the public sector (such as telecommunications and power generation). This analysis also extends to industries where the market was opened to competition, restrictions on production were lifted and domestic and foreign companies could compete with existing players.

This study is an attempt to understand the changing portfolio of industries in which family firms operate in comparison to the non-family firms post the economy's liberalization. In-depth exploration of family businesses has largely remained wanting in the Indian context. Even though the contribution of family businesses to various economic indicators such as GDP, direct or indirect taxes paid or employment provided both in a pre-liberalization era to the modern day liberalized economy is sizeable (Bang, Ray and Ramachandran 2017), this disparity remains. Tracing the movement to services in the Indian economy, we aim to decipher the industries in which family firms are now operating and explore the heterogeneity within family firms to see if business group affiliated family firms behave differently from the standalone family firms. With the advent of IT and digitization, we also explore whether family firms have been able to adapt and compete against other corporations including large multinational corporations and state-owned enterprises in relatively newer but faster growing service sectors (such as IT Services and Telecommunications). We highlight variations in performance differentials between family firms (including both standalone and business-group affiliated firms) and non-family firms across the dominant service sectors and try to account for sector-specific characteristics (such as debt, capital requirements and the type of competition) to explain the superior performance of certain types of firms. Lastly, given the renewed criticality in analyzing the debt-taking behavior of firms, owing to the steep rise in the Non-Performing Assets in the banking and financial services sector since 2013/14, we explore the indebtedness of family firms in both manufacturing and services.

Using data of the companies listed on the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE), we study 4,589 companies over a period of 26 years. We find that family firms adapted well to liberalization, making significant foray into the services sectors, which were earlier dominated by the non-family firms only. Business group affiliated family firms were found to be valued higher than standalone family firms in the manufacturing sector and later in services too. Family firms performed well in traditional services sectors such as Trade, Construction, Shipping, Travel & Tourism and Publishing. When compared to non-family firms, family firms were found to have a stronger presence in the modern services sectors like Financial Services, IT & Technology Services and Telecommunications. We also find that family firms are financially much higher leveraged than non-family firms in the manufacturing sector.

The rest of the report is structured as follows: Section 2 describes the data; Section 3 analyses the growth of the services sector; Section 4 analyses the shift from traditional services to modern services; Section 5 looks at industry wise performance of firms; Section 6 analyses the debt situation of India Inc and Section 7 concludes and discusses the implications from the study.

2. Data Description

We considered all firms listed on the NSE and BSE from financial year (FY) 1991-92 till 2017-18[2]. Using data from Prowess Dx database, maintained by the Centre for Monitoring Indian Economy, and the proprietary family-non-family classification of firms from the Thomas Schmidheiny Centre for Family Enterprise, we arrived at a sample of 4,589 firms. All financial data such as return on assets, net sales, total assets, debt and market capitalization have been obtained from Prowess.

The Thomas Schmidheiny Centre for Family Enterprise classified firms listed on NSE and BSE into family and non-family on the basis of a minimum ownership of 20% equity shares by the family members and management control or succession/business continuity[3].The family firms were further classified into Family Business Group Firms (FBGF) and Standalone Family Firms (SFF) and the non-family firms into State-owned enterprises (SOEs), subsidiaries of Multinational Companies (MNCs), Other Business group affiliated firms (OBGFs) and Standalone non-family firms (NFFs)[4].

In our sample, 4,148 firms were family firms, accounting for more than 90% of our sample (Exhibit 2a). This highlights the importance of nuanced understanding of family businesses. Among the dataset of 4,148 family firms, FBGFs constituted 36% of the sample with the remaining being SFFs (Exhibit 2b). MNCs and SOEs dominated the non-family firms' sample (Exhibit 2c).

Group affiliations can provide strategic advantage to a firm in the form of access to cheaper sources of capital, loan guarantees, business contacts, beneficial dealings with institutional intermediaries, and timely supply of rich information about the group affiliates. Such strategic advantages can then be used to improve business plans, budgets, and make wise decisions pertaining to disbursing of the pooled resources. Hence, we explore the heterogeneity between FBGFs and SFFs to gain deeper insights into the industrial composition of family firms in India.

The sample is well represented by most industries as classified by the National Industrial Classification (NIC) codes (2008) at two-digit level. The firms are split into 3 key industrial sectors Primary (Agriculture and Mining), Secondary (Manufacturing) and Tertiary (Services) (Exhibit 2d). The Primary sector accounts for just about 6% of the firms. In this study, we analyze only the firms operating in manufacturing and services sectors, that is, firms with NIC codes greater than 09. All firms under the diversified industry category (NIC 2 Digit Code 34) have been classified as manufacturing in our study. This leaves us with a sample of 4,301 companies. The sample represents 62 industries across service and manufacturing sectors. There is heavy concentration in the top 10 industries as they represent ~59% of the total sample. Financial Services activities (except insurance and pension funding) and Wholesale trade (except motor vehicles and

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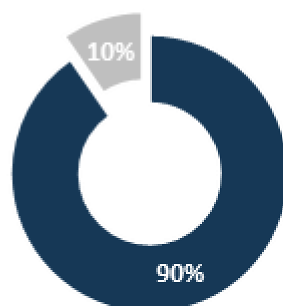
[2] Financial Year in India is from April 1 of the previous year to March 31 of the current year. FY 2017-18 refers to the period April 1, 2017 to March 31, 2018.

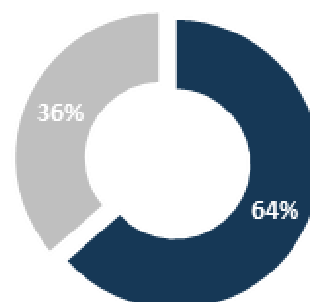
[3] Refer to the white paper "Family Businesses: The emerging landscape- 1990-2015" for a detailed description of the methodology used to classify the firms; http://www.isb.edu/sites/default/files/WP-FB-The-Emerging-Landscape_0_0.pdf and Appendix 1

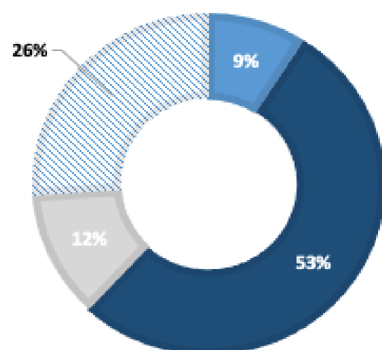
[4] For a detailed description of SOEs, BGs and MNCs see Chakrabarti & Ray (2016) and Appendix 2.

motorcycles) are the two most preferred sectors in the sample in terms of the number of listed firms (Table 1).

Exhibit 2: Dataset demographic







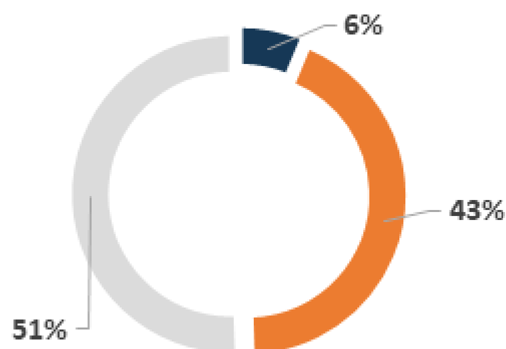


Table 1: Industries with the largest number of Family firms in the sample

Name of Industry	Number of Family Firms	Percentage of Family Firms	Total Firms
Financial service activities, except insurance and pension funding	696	88%	787
Wholesale trade, except of motor vehicles and motorcycles	509	93%	545
Manufacture of chemicals and chemical products	240	88%	272
Manufacture of textiles	222	98%	226
Manufacture of basic metals	189	96%	196
Manufacture of rubber and plastics products	156	94%	166
Manufacture of food products	151	95%	159
Computer programming, consultancy and related activities	143	85%	168
Construction of building	121	98%	124
Civil Engineering	105	88%	119

3. Manufacturing to Services

From 1950s to 1991, during the License Raj, heavy licensing in imports, investments and credit allocation meant that only few domestic firms were privileged enough to compete. Dependence on SOEs[5], which were built to ensure self-sufficiency in the post-independence era, meant only limited opportunities for private firms. SOEs especially dominated the services sector in industries like Banking & Financial Services, Telecommunications and Public Utilities up until liberalization. Even today, non-family firms dominate banking & financial services though their share in the sector has come down. Non-family firms also experienced a decline in the growth of their manufacturing figures in terms of total assets, market capitalization and net sales, post liberalization, in comparison to the growth rate of the services sector.

Family businesses were heavily focused on manufacturing in the pre-liberalization era but have caught on the services bandwagon as new opportunities arose post the government's move to open multiple sectors such as Insurance, aviation and telecommunications for private entry. We shall try to understand the movement of the firms from manufacturing to the services in the last 27 years.

3.1 Movement to Services

During the post-independence and license raj era, although India had its share of family businesses in manufacturing, the number was small, and the size of the firms was small too. In fact, this happened to the extent that the average manufacturing firm in India in 1990 was 10 times smaller than its counterpart in the US (Chari 2007; Kochhar, et al. 2006). Despite this, it was only in the late 1980s that growth in services picked up (due to multiple internal and external factors as discussed ahead). Prior to this impetus, manufacturing was the natural way to go for most of the Indian businesses (Dasgupta and Singh 2005).

In terms of net sales, market capitalization and total assets, there was a clear gap between the two sectors - manufacturing and services. In 1991, services accounted for a small share of the total activities of family firms in India (Table 2). The advent of opportunities in services due to domestic policies and global demand narrowed the gap significantly in all respects (Table 2 and Exhibit 3).

Firms owned by the state have had traditional advantages due to previously existing monopolies and large asset bases. The dominance of SOEs in the banking and financial services sector makes it imperative to remove the firms belonging to this sector from the sample and then analyze the data for family and non-family firms. ***We find that today, family firms dominate non-family firms on all three fronts (total assets, market capitalization and net sales) in the remaining aggregated services sector*** (compare rows D and H in Table 2).

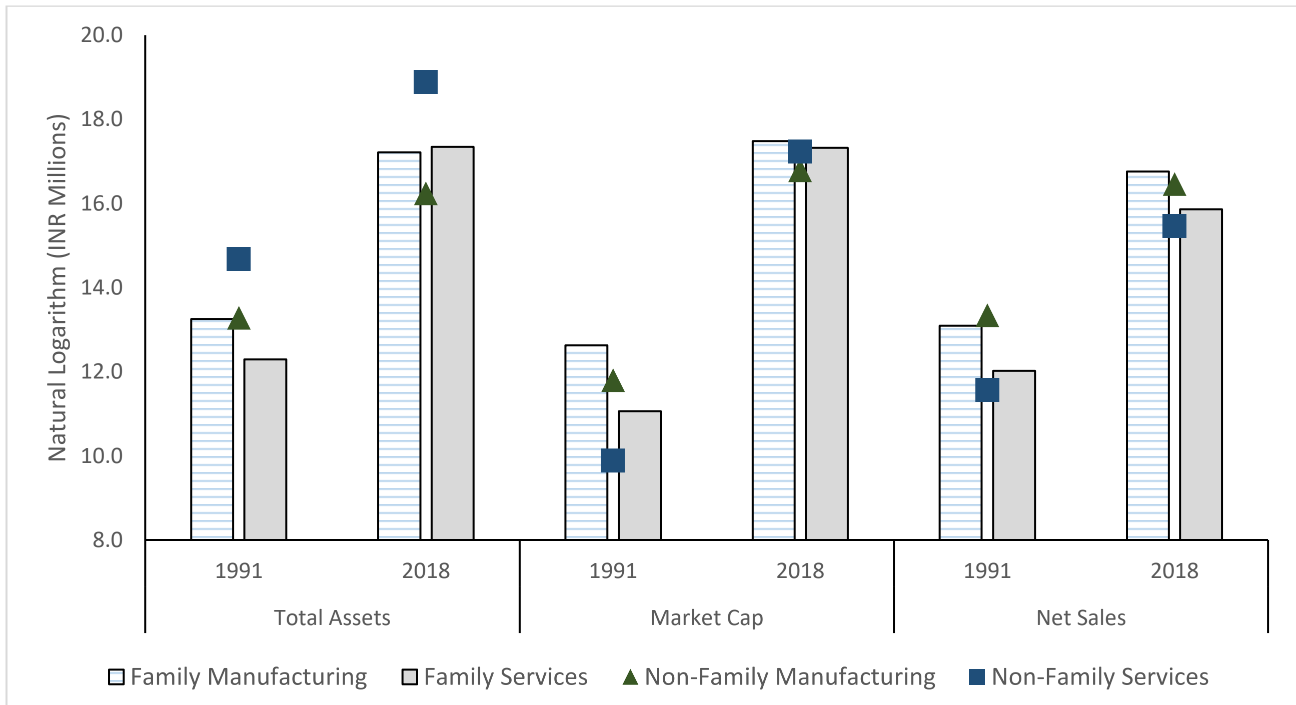
[5] India's Second Five-year Plan (1955 – 1960), Industrial Policy Resolution of 1956 and the Nationalization of Banks in 1969 and 1980 (specific to Financial Services) together contributed to the development and subsequent dependence on State Owned Enterprises (SOEs)

Table 2: Family Firms vs Non-Family Firms in India: Evolution (1991 – 2018)

		Total Assets			Market Capitalization			Net Sales		
		1991	2018	CAGR	1991	2018	CAGR	1991	2018	CAGR
	Family Firms									
A	Manufacturing (% Share)	570,794 **(72%)**	29,895,464 **(47%)**	**16%**	305,162 **(83%)**	39,218,315 **(54%)**	**20%**	485,938 **(75%)**	19,041,904 **(71%)**	**15%**
B	Services (% Share)	217,748 **(28%)**	34,142,352 **(53%)**	**21%**	63,450 **(17%)**	33,193,492 **(46%)**	**26%**	166,256 **(25%)**	7,760,120 **(29%)**	**15%**
C	Total	788,542	64,037,816		368,612	72,411,807		652,194	26,802,024	
D	Services (excluding banking & financial services)	138,945	17,458,017	**20%**	34,813	23,230,721	**27%**	103,322	7,741,668	**17%**
	Non-Family Firms									
E	Manufacturing	587,620 **(20%)**	11,312,069 **(7%)**	**12%**	133,176 **(87%)**	19,493,590 **(39%)**	**20%**	625,355 **(86%)**	14,110,051 **(73%)**	**12%**
F	Services	2,363,935 **(80%)**	159,498,150 **(93%)**	**17%**	19,521 **(13%)**	30,581,130 **(61%)**	**31%**	105,584 **(14%)**	5,218,929 **(27%)**	**16%**
G	Total	2,951,555	170,810,219		152,697	50,074,720		730,939	19,328,980	
H	Services (excluding banking & financial services)	312,433	11,441,729	**14%**	17,958	12,026,851	**27%**	103,014	5,216,207	**16%**

**All figures are in INR Million*

Exhibit 3: Evolution: Family vs Non-Family Firms (1991 – 2018)

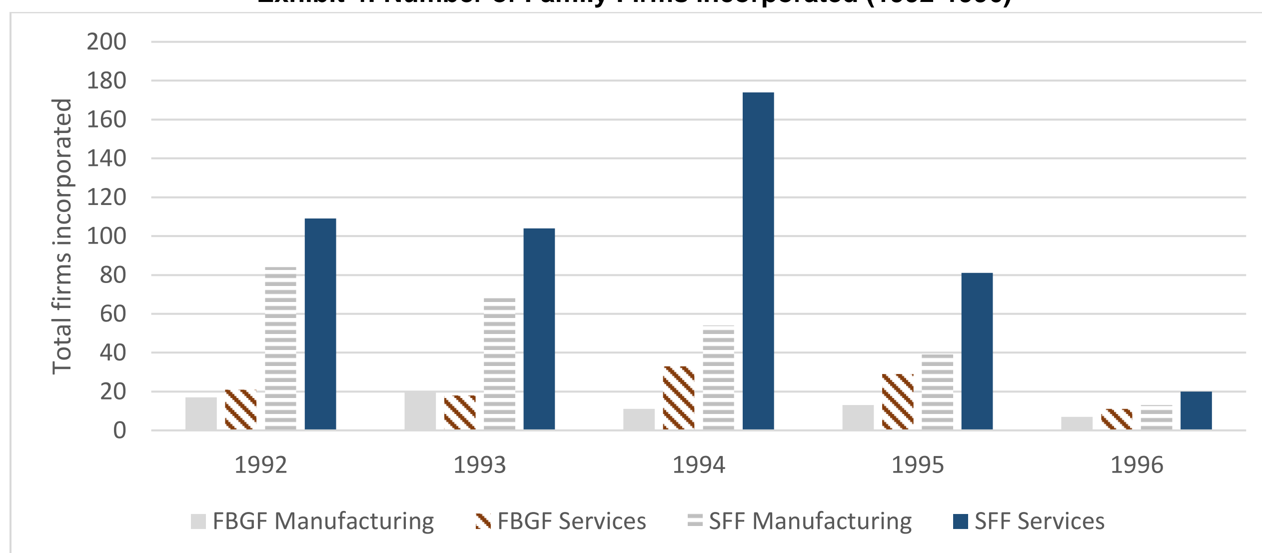


3.2 Standalone Family Firms led the growth in services

There was significant increase in the number of family firms that were incorporated post the 1991 reforms (as was the expectation post the implementation of the government's policies). Majority of the companies listed around this time were in the services sector and were SFFs. A look at Exhibit 4 clearly outlines the significant increase in the number of SFFs in the 5 years following liberalization.

Some of the reasons for the rise of SFFs in the services sector were: First, the capital and technology know-how that started to flow into the country post liberalization helped a lot of entrepreneurs and small business owners setup, scale their operations and get listed on stock exchanges. Second, percolation of foreign know-how and strong international demand for skill intensive services like communication services, business services (including IT), financial services and community services in the 1990s encouraged and helped Indian firms to specialize in this regard[6]. Third, India's education policies were heavily focused towards tertiary education which created an abundant supply of human capital. Lastly, foreign demand was also complemented by an increasing spend on services domestically. As the income elasticity of demand for services was already high, an increase in the average household income during this phase resulted in an increase in the composition of services as part of the average household expenditure basket. An increase in input usage of services by Indian firms domestically (such as higher usage of IT Services by Indian manufacturing firms) also contributed to this rise in domestic demand for services.

Exhibit 4: Number of Family Firms incorporated (1992-1996)



SFFs have seen a larger percentage change in the movement from manufacturing to services when compared to FBGFs (Table 3 and Exhibit 5). While SFFs have grown faster than FBGFs, they still trail the FBGFs in terms of the sheer size of assets and market capitalization in both services and manufacturing. FBGFs have clear advantages of size and scale. We repeat the analysis without firms from the banking and financial services sector, but our results do not

[6] For more, see: https://www.imf.org/external/pubs/ft/wp/2004/wp04171.pdf

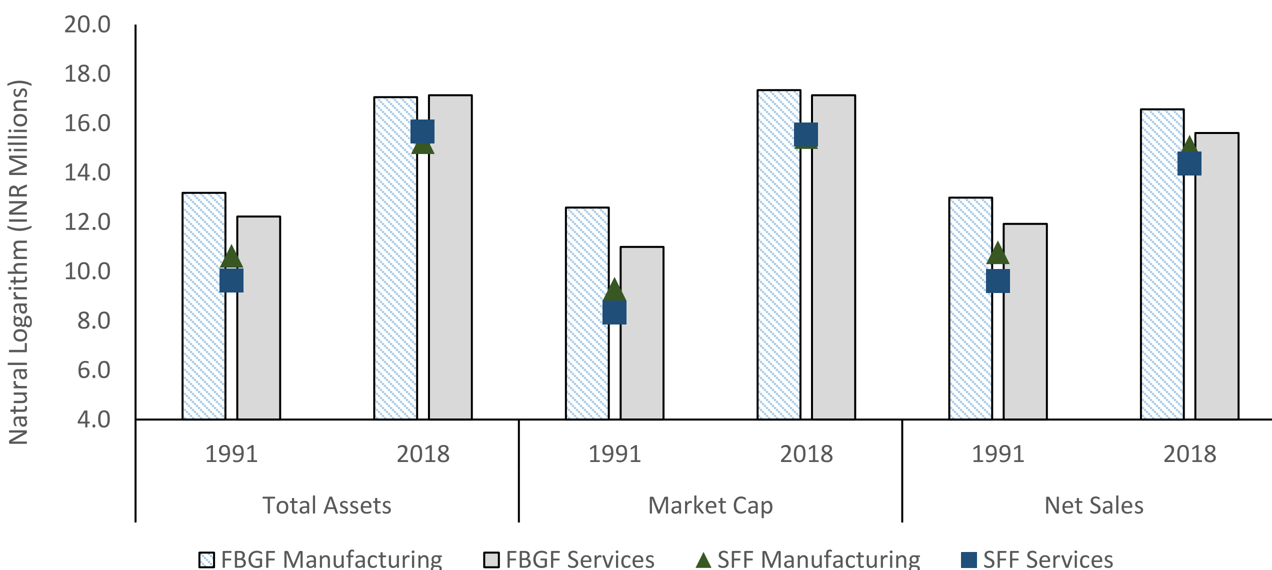
change. The dominance of FBGFs across services remains. ***FBGFs have clearly re-invented themselves as time has passed to establish their dominance in newer sectors and industries***.

Table 3: Family Firms Evolution (FBGFs vs SFFs) – 1991 to 2018

	Total Assets			Market Capitalization			Net Sales		
	1991	2018	CAGR	1991	2018	CAGR	1991	2018	CAGR
FBGFs									
Manufacturing	529,446 **(72%)**	25,752,001 **(48%)**	**15%**	294,315 **(83%)**	34,148,302 **(55%)**	**19%**	437,933 **(74%)**	15,611,812 **(72%)**	**14%**
Services	202,502 **(28%)**	27,818,288 **(52%)**	**20%**	59,316 **(17%)**	27,580,859 **(45%)**	**26%**	151,398 **(26%)**	6,033,829 **(28%)**	**15%**
Total	731,948	53,570,289		353,632	61,729,161		589,331	21,645,641	
Services (excluding banking & financial services)	128,173	14,798,839	**19%**	32,303	18,786,098	**27%**	93,123	6,019,966	**17%**
SFFs									
Manufacturing	41,348 **(73%)**	4,143,463 **(40%)**	**19%**	10,847 **(72%)**	5,070,013 **(47%)**	**26%**	48,005 **(76%)**	3,430,092 **(67%)**	**17%**
Services	15,246 **(27%)**	6,324,064 **(60%)**	**25%**	4,134 **(28%)**	5,612,633 **(53%)**	**31%**	14,858 **(24%)**	1,726,291 **(33%)**	**19%**
Total	56,594	10,467,527		14,980	10,682,646		62,863	5,156,382	
Services (excluding banking & financial services)	10,772	2,659,178	**23%**	2,511	4,444,623	**32%**	10,199	1,721,702	**21%**

**All figures are in INR Million*

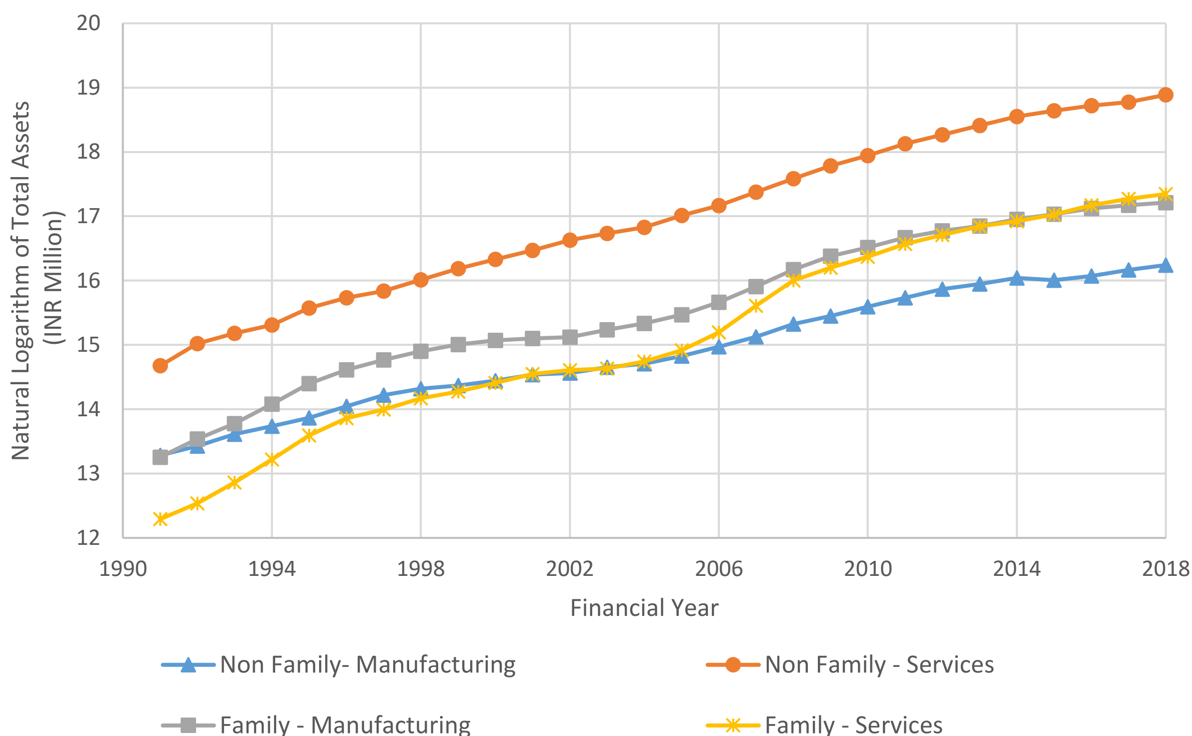
Exhibit 5: Family Firms Evolution (FBGFs vs SFFs) – 1991 to 2018



3.3 Trends in Asset Creation and Market Capitalization

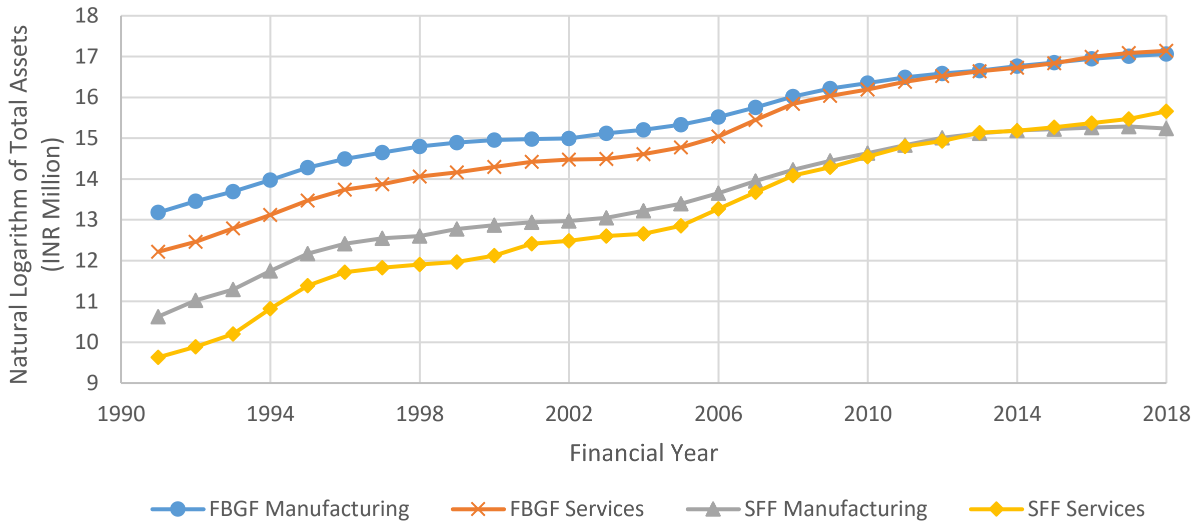
Non Family firms have continued to remain atop in the services sector, in terms of total assets, due to the continued hegemony of SOEs, particularly in the banking and financial services sectors. Family Firms in the services sector received a boost in the early 1990s due to liberalization and the bull phase of the market prior to the financial downturn in 2008. Post that, it has continued to grow at a more conservative level at pace with manufacturing (Exhibit 6a).

Exhibit 6a: Total Assets - Family vs Non-Family Firms



Within family firms, total assets of the services sector consistently grew faster than that of the manufacturing sector for both FBGFs and SFFs. A further, rather steep, slowdown in the asset creation among manufacturing firms was observed in 2016 (Exhibit 6b). The Insolvency and Bankruptcy Code (IBC) 2016 was introduced by the Indian government with its primary interest being to ensure the rescue and continuity of businesses in distress by allowing the creditors to gain control of the company (if necessary). This law has demotivated promoters from obtaining loans due to the fear of losing control of the company once the insolvency procedures are initiated by the creditors. This might have resulted in lower asset creation post 2016 especially among manufacturing companies in asset heavy industries. ***By the end of financial year 2018, total assets of both FBGFs and SFFs in services companies had surpassed the assets of manufacturing companies.***

Exhibit 6b: Total Assets - Family Firms



It is interesting to note that ***as we moved into the 2000s, the Non-Family manufacturing sector firms lost their favour with the investors***. The market value (in terms of market capitalization) grew slower than the market capitalization of the other three categories in the figure (Exhibit 6c). Coupled with the decline in growth of assets in these firms, this slowed growth stemmed from either a lower number of companies being incorporated during this period or a weak outlook for future growth for existing firms in the business.

Exhibit 6c: Total Market Cap - Family vs Non-Family

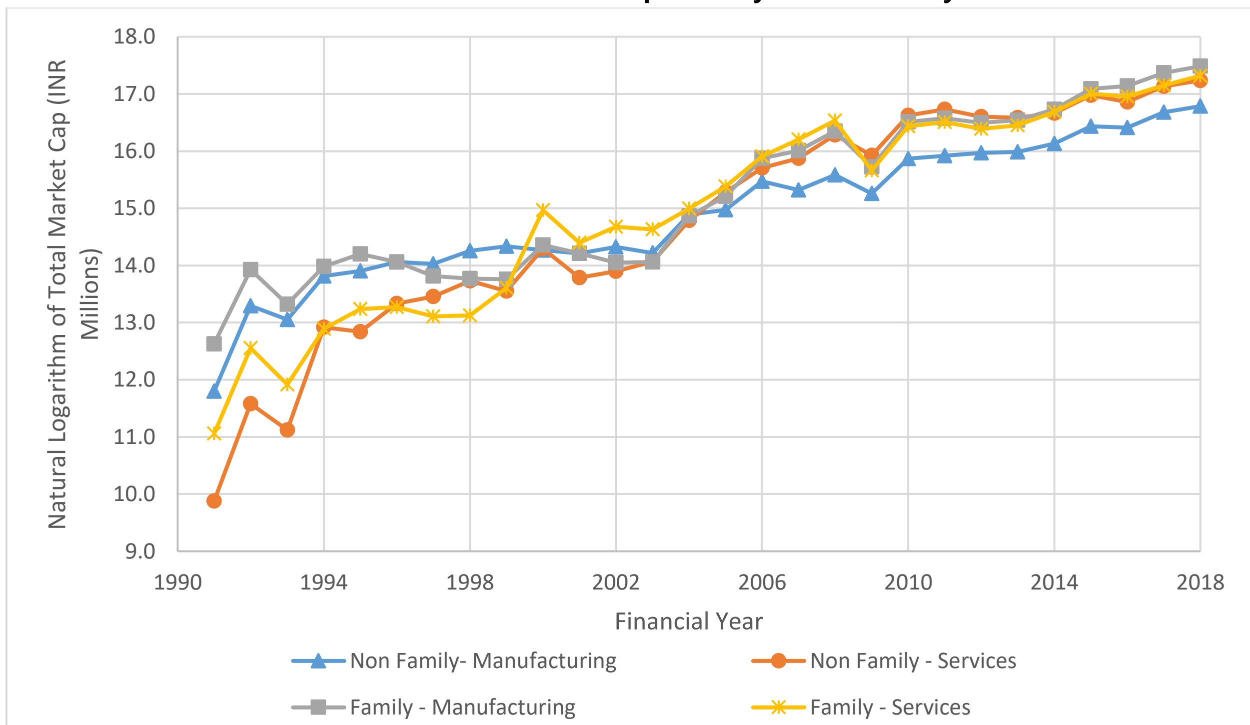
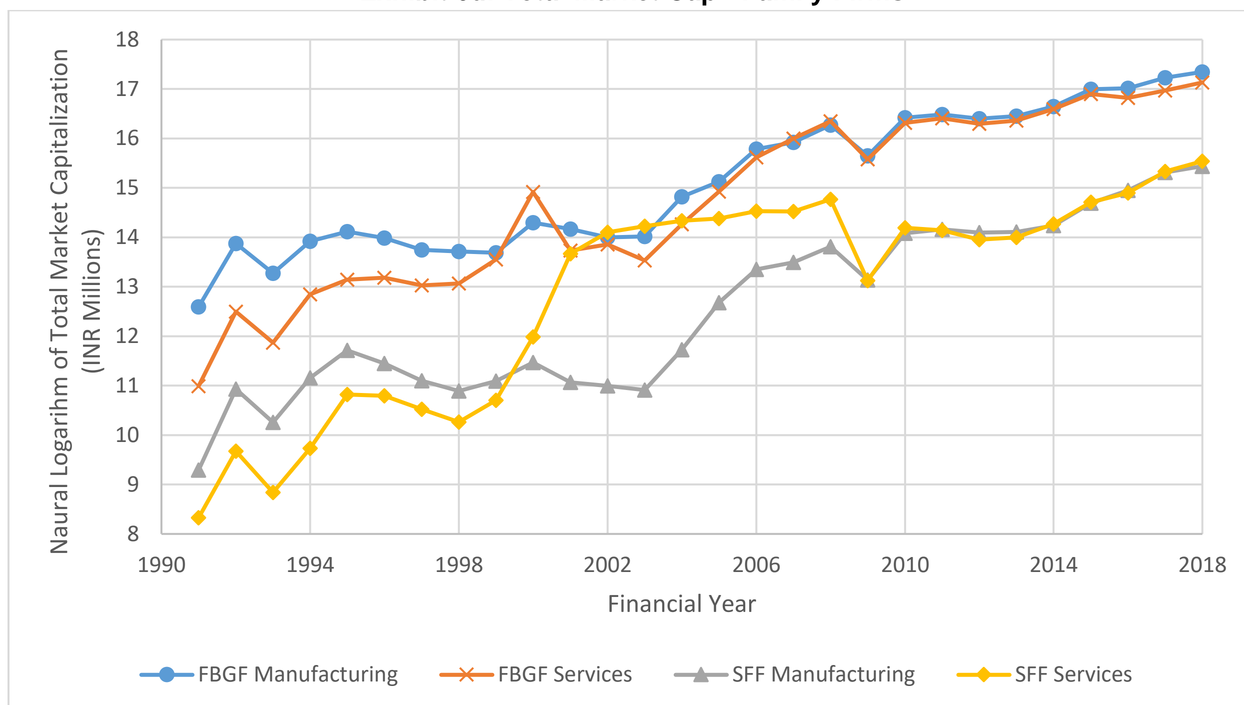


Exhibit 6d: Total Market Cap - Family Firms



SFFs underwent a valuation boom (along with a rapid increase in assets) in the early 2000s which can be correlated with the global bull phase of the market prior to the recession (from 2002-2007) along with increased global demand for Indian services during this phase. After the recession (2009 onwards), the valuation has settled into a steady growth rate (Exhibit 6d).

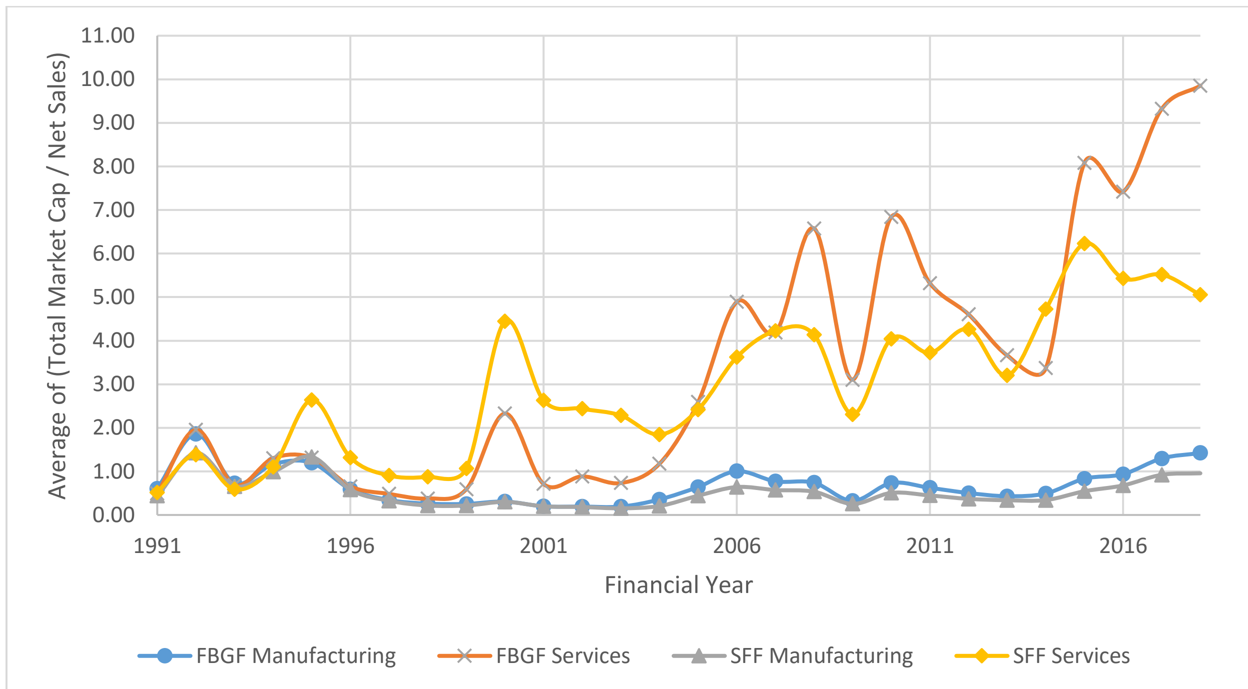
3.4 Family Business Group Firms are valued more by investors

Exhibit 6c shows that barring a few years, family firms have consistently been valued more by investors when compared to non-family firms. Also, FBGFs cumulatively have higher market capitalization than the SFFs even though the number of SFFs in our sample is more (Exhibit 6d). This is understandable as we saw that FBGFs are much larger in size, in terms of assets and revenues too (Table 3). To understand the value placed by the investors on the different categories of family firms, we analyze the market value of family firms relative to revenues. Exhibit 6e shows the ratio of market capitalization to net sales for FBGFs and SFFs in both manufacturing and services sectors, that is, for every rupee earned as revenue, how much does the market value the firms in these categories?

It is evident from the graph (Exhibit 6e) that ***family firms in the services sector have been valued much higher by investors than firms in the manufacturing sector***. In the services sector, from the early 1990s right up till the mid-2000s, SFFs were valued higher by the market. ***In recent years, especially post 2014, the FBGFs have seen an increase in valuation and overtaken the SFFs and are valued much higher than their standalone counterparts.*** This could be due to multiple reasons. Business groups are known to possess superior reputation in the market (compared to standalone entities) that helps them in multiple ways. For example, investors generally perceive such firms to be much more financially stable in the face of

uncertainty owing to this “reputation”. It is perceived that this reputation would assist them in accessing financial and value chain networks that aid their survival and growth. FBGFs are, on average, much bigger in terms of revenues, assets and even employees (though we don’t have the exact data for number of employees) than the average SFF. Owing to economies of scale, investors also generally value larger firms much higher (even when normalized for revenue). Hence, the investors may be willing to pay a premium for the FBGFs. ***FBGFs in the manufacturing sector have also been consistently valued higher than SFFs.***

Exhibit 6e: Relative Degree of Market Valuation – FBGFs vs SFFs



Note: The data has been winsorized to take care of the outliers for this graph.

4. From Traditional to Modern Services

An extensive analysis conducted by Eichengreen and Gupta (2010) helps us decipher India’s services growth. As per their research, services are divided into three Groups (Modern, Traditional and Hybrid). We have utilized the terminology and the definitions from their paper, as listed in Table 4 below, for further analysis in this study.

Factors such as high-income elasticity of demand and increased input usage of services by other sectors have contributed to the rise in services growth beyond the initial spurt in the 1990s. Increased exports in services and economic reforms as mentioned in the previous sections kick started the services growth for the economy. Productivity gains have appeared in the fastest growing sectors, with the effect spilling over to more traditional sectors that have benefited as well (Chari 2011).

Eichengreen and Gupta dispute the claim that services growth in the informal sector is just disguised manufacturing growth. They also prove that the contribution of modern services, viz. communications, business services and financial services has in fact risen to the point where it contributes more to growth of GDP than manufacturing. As family firms comprise over 90% of our sample, we expect family firms to have a significant presence in the modern services industries too, post liberalization.

Table 4: Service Sector Classification

Group	Description
I	**Traditional services**— retail and wholesale trade, transport and storage, and public administration and defense (tend to grow slowly – share in GDP has fallen in advanced countries)
II	**Hybrid services**—a mix of both traditional and modern services consumed by households; education, health and social work, hotels and restaurants, and other community, social and personal services are some of the Group II services whose share in GDP has increased at pace with GDP per Capita
III	**Modern services**—financial intermediation, computer services, business services, communications, and legal and technical services - whose share in GDP in the Organization for Economic Co-operation and Development (OECD) countries has risen significantly faster than per capita income.

Source: (Eichengreen and Gupta 2010)

Basis the above classification, it is reasonable to say that many of the newly incorporated family firms would have entered service sectors that have been classified as modern services (such as telecommunications and IT) to take advantage of the rapidly growing market. However, traditional service sectors would also have received a boost from a spillover effect. For example, given the advent of digitization/IT, sectors such as retail trade would have seen productivity gains owing to increased use of digital store management systems.

Looking at the data available with us, we indeed find that Financial Services, IT Services and Telecommunications have clearly led the way when it comes to adding the most market value across family businesses. Traditional and Hybrid services such as construction and trade also benefitted due to improvement in GDP per Capita and spillover effects from gains in modern services. This shows that ***family firms have been closely evolving along with the Indian economy and appear as adaptive, evolving and entrepreneurial***.

We further look at the distribution of assets between Family and Non-Family firms in the top 10 service sectors in terms of total asset share for 2018. These top 10 industries account for more than 95% to the total assets in the services sector.

Since Modern Services are more of a recent phenomenon, most of the growth at the macro level happened post the start of the millennium. Hence, these sectors have limited involvement of the government compared to some of the traditional service sectors. Thus, our apriori expectation is that the presence of family firms in modern services should be robust when compared to non-family firms.

4.1 Family Firms dominate modern services

Modern Services, such as Telecommunications and IT services, are completely dominated by family firms. Take for example the Air Transport industry. This sector has very significant family presence (Table 5). The only one public sector carrier, Air India, is an unlisted firm. While Air Transport as a service has existed since long, the way it operates today and its accessibility to the public have totally changed post the entry of private carriers, all of them owned by family firms, hence they are classified as modern services.

Table 5: Share of Total Assets – Family vs Non-Family Businesses

Service Sector	Share of Family Businesses
Financial service activities, except insurance and pension funding	10%
Public Utilities (Electricity, gas, steam and air conditioning supply)	17%
Telecommunications	96%
Civil Engineering	58%
Computer programming, consultancy and related activities	71%
Wholesale trade, except of motor vehicles and motorcycles	85%
Construction of building	95%
Warehousing and support activities for transportation	34%
Retail trade, except of motor vehicles and motorcycles	84%
Air Transport	100%

Financial services remain dominated by non-family firms in terms of total assets (due to SOEs). Non-family firms also have a sizeable share in Public Utilities, Warehousing and Transportation and Civil Engineering. The domination of non-family firms is either due to the strong government presence in these sectors or due to the inherent nature of these sectors. Differential resource requirements and distribution models may exist that favor either SOEs or MNCs (Warehousing and Transportation is favorable for MNCs owing to their much wider geographical outreach).

4.2 Family firms in Modern services are younger

Considering that it is only post the millennium that the modern services sector became the powerhouse that they are today, we also expect to see a slight bias towards younger firms in these sectors. Traditional and Hybrid service sectors would be dominated by relatively older firms (as some of them would be present from before 1991).

Indeed, ***Telecommunications, IT Services and Air Transport, that are all classified as modern services are dominated by younger family firms*** (Table 6). Firms in other sectors from Group 1 and Group 2, such as accommodation, trade and public services, are slightly older than firms from Modern services category. Financial Services, although classified as a modern service comprises of banks as well that have been around for many decades, and hence has a mix of older and younger firms.

Table 6: Age of Family Firms in Key Service Sectors - 2018

Sector	Average Age
Telecommunications	24
Air Transport	25
Computer programming, consultancy and related activities	27
Retail and Wholesale Trade	32
Warehousing and support activities for transportation	32
Financial service activities, except insurance and pension funding	34
Construction and Civil Engineering	34
Public Utilities (Electricity, gas, steam and air conditioning supply)	36
Accommodation	39

4.3 SFFs operate more in less resource-intensive industries

Resource-intensive sectors like Telecommunications, Public Utilities and Warehousing require significant capital investments (either in the form of upfront or a staggered outflow from the firm). We observe a higher number of FBGFs in these three sectors in contrast to most other sectors in the list where SFFs dominate in terms of number of firms. In the three sectors in which we observe a higher percentage of FBGFs, they also heavily dominate in terms of their share of total assets. Air transport as a service sector has a small number of companies (airlines) and the market leader is a standalone firm (Indigo Airlines), hence the bias towards SFFs (Table 7).

Industries such as Financial services, construction of building, computer programming and consulting and wholesale trade, where the capital resources required to start a business is lower, the number of SFFs is large but FBGFs still dominate in terms of size and have a much larger percent share of assets.

Table 7: Family Businesses: Standalone vs Business Groups (2018)

Service Sector	% of Firms		Asset Share (%)	
	FBGF	SFF	FBGF	SFF
Financial service activities, except insurance and pension funding	30%	70%	78%	22%
Telecommunications	68%	32%	100%	0%
Computer programming, consultancy and related activities	35%	65%	91%	9%
Civil Engineering	38%	62%	74%	26%
Construction of building	32%	68%	79%	21%
Wholesale trade, except of motor vehicles and motorcycles	24%	76%	80%	20%
Public Utilities (Electricity, gas, steam and air conditioning supply)	73%	27%	98%	2%
Warehousing and support activities for transportation	42%	58%	84%	16%
Air Transport	32%	68%	45%	55%

5. Performance of Firms in the Service Sector

As per the data from Prowess database, companies from 39 different sub-sectors in the services category based on NIC Codes[7] were present in our sample. Since the data for the Return on Assets (ROA) was spread across multiple decades, there were significant number of outliers and the distribution was significantly fat tailed. Hence, we have ignored the upper and lower quartiles from our analysis.

5.1 Top Performing Service Sectors for Family and Non-Family Firms

We compare the performance of family firms with non-family firms (in terms of ROA) in the key service sectors in the economy. We have selected the top 10 industries in services by total assets for further analysis. These 10 industries cumulatively account for more than 90% of the total assets and total market capitalization for 2018 and hence can be considered as representative of the market. We report the trimmed mean (with the middle 50% observations) and the standard deviation (SD) of the trimmed sample only in Table 8, to take care of the outliers.

We have highlighted the sectors where there is more than a percentage point difference in performance between the family firms and the non-family firms. Sectors such as Telecommunications and Air Transport have a few large firms and the mean may be biased towards performance of one or two specific firms. As outlined previously, the only non-family firm in Air Transport is the state-owned Air India which is unlisted and hence not part of our sample. State-owned and operated Mahanagar Telephone Nigam Limited (MTNL) is the only Non-family Telecommunications firm that is part of our sample for most of the time period analyzed (1991 – 2018).

Table 8: Average Return on Assets: Family vs Non-Family Firms (1991 – 2018)

Service Sector	Family Firms		Non-Family Firms	
	Mean	SD	Mean	SD
Financial service activities, except insurance and pension funding	1.3%	1.3%	0.9%	0.4%
Public Utilities (Electricity, gas, steam and air conditioning supply)	3.3%	1.6%	4.8%	1.2%
Telecommunications	-0.1%	2.9%	3.4%	1.2%
Civil Engineering	2.5%	1.6%	3.3%	1.3%
Computer programming, consultancy and related activities	4.2%	3.4%	9.8%	5.0%
Wholesale trade, except of motor vehicles and motorcycles	0.9%	1.2%	3.0%	2.0%
Construction of building	1.6%	1.2%	1.0%	1.1%
Warehousing and support activities for transportation	2.6%	1.5%	9.0%	2.1%
Retail trade, except of motor vehicles and motorcycles	1.8%	1.5%	2.4%	1.6%
Air Transport	-2.4%	4.3%	N/A	N/A

Non-family firms do indeed significantly outperform family firms in Public Utilities, IT Services, Warehousing & Transportation Support activities and Wholesale Trade. Several

[7] India's National Industrial Classification (NIC) 2008, based on the United Nations ISIC Revision-4, enables analysis and dissemination of data pertaining to economic activities across industries in a standardized way.
Retrieved from: https://udyogaadhaar.gov.in/UA/Document/nic_2008_17apr09.pdf

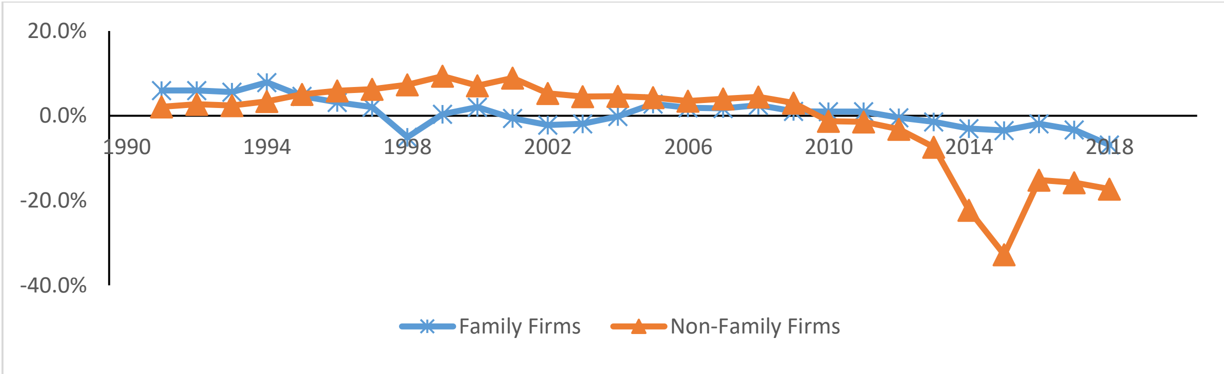
reasons have yielded the advantage to non-family firms in these sectors. Non-family firms (especially MNCs) have generally benefitted from advantages such as international presence and wider geographical networks (which is advantageous as it provides access to a wider ambit of customers and value chain partners in sectors such as IT Services and Transportation) or a higher proportion of exports-to-domestic sales ratio (for MNCs in Wholesale Trade). Sector-specific dynamics are also at play, as demonstrated by the trends in the Public Utilities sector. Family firms underwent significant capacity expansion in this decade followed by a lower than anticipated demand leading to a sharp reduction in the returns on assets observed for these firms (see section 5.2 also). While family firms have a higher average Return on Assets than non-family services in Financial Services and Construction Services, the differential is comparatively small.

Next, we explored the performance of both family and non-family firms in each of these sectors over the past three decades. We further find significant variation in the performance of either one or both the categories of firms (family and non-family) during this time period in two of these sectors - Telecommunications and Public Utilities. Hence, we specifically discuss the performance of firms in these two sectors over the years in section 5.2. In the rest of the sectors, we observed steady trends or differentials between the performance of family firms and non-family firms across the years and have hence they have not been detailed out further. Though we do not rule out that interesting insights may emerge from studying each of the sectors in-depth.

5.2 Sector-Specific Trends: Telecommunications and Public Utilities

Performance in the Telecommunications sector has been on a downward slope post the financial crisis (Exhibit 9a). For most of the period studied (1991 – 2018), there was only one major non-family firm (MTNL). The state-owned telco suffered huge losses in the past 10 years due to inefficiency in operations and the inability to match new competitors on price and performance. The sector has not been a comfortable ground for family firms to operate in as well. With newer generations of telecom technology (such as 4g/5g/LTE), capital requirements remain significantly high throughout the firm lifecycle. In addition, the Indian government has upped the purchase prices of spectrum for these companies.

Exhibit 9a: Telecommunications Sector (ROA) (1991 – 2018)

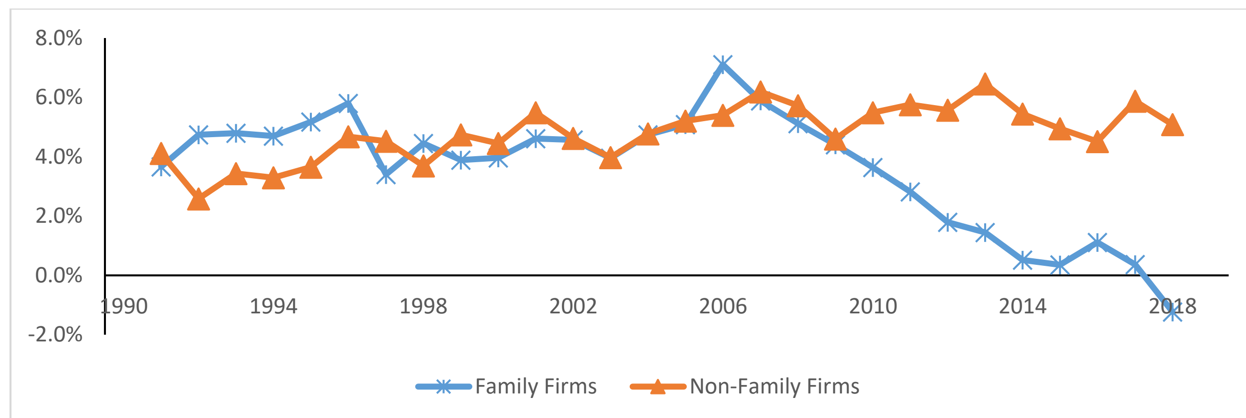


With the entry of Reliance Jio (backed by the Reliance Industries Limited), Average Revenue per User (ARpU) has fallen significantly owing to Jio's pricing strategies and attractive incentive

schemes to promote customers to switch networks. By 2018-19, the sector saw significant consolidation, with the number of active players in the voice call and mobile data segment going down to only 3 primary players (Airtel, Vodafone Idea and Jio). Though Jio is not a listed company on it's own and is a wholly owned subsidiary of Reliance Industries Limited (RIL). RIL is not included in the Telecommunications industry as it is a part of Manufacture of coke and refined petroleum products industry as per the NIC classification.

In the sector "Public Utilities (Electricity, gas, steam and air conditioning supply)", both family and non-family firms had been doing well (with average ROAs close to 3-4%) up till 2009 (Exhibit 9b). Non-family firms in the sector are essentially giant SOEs (such as National Thermal Power Corporation, National Hydroelectric Power Corporation and Power Grid Corporation of India). Post the year 2009, family firms have seen their performance deteriorate. Firms belonging to large business groups (such as Tata Power, JSW Energy, Torrent Power and Jaiprakash Power Ventures) have all seen a slide in their average ROAs due to capacity expansions, lower than expected rise in demand, and increased interest rates due to increase in their debt levels.

Exhibit 9b: Public Utilities (Electricity, gas, steam and air conditioning supply) (ROA) (1991 – 2018)



5.3 Top Performing Service Sectors for Family Firms – FBGFs and SFFs

We looked at the performance (in terms of ROA) of FBGFs and SFFs in each of the service sectors separately using the middle 50% values. We report the five sectors where the FBGFs and SFFs have performed the best. Smaller sized service industries were ignored (with a combined asset base of less than INR 10,000 Million in 2018).

In Tables 9a and 9b, we have highlighted sectors where there is more than a percentage point difference in performance between FBGFs and SFFs. Performance of Non-family firms has been included for comparison too. FBGFs have performed significantly better than SFFs in industries such as IT Services, Wholesale and retail trade and repair of motor vehicles and motorcycles and Sports activities and amusement and recreation activities (Table 9a). While SFFs have performed well in industries like Water Transport, FBGFs are not present in Employment activities and Travel agency, tour operator and other reservation service activities (Table 9b).

Table 9a: Top 5 Service Sectors (Average ROA %): Family Business Group Firms

Service Sector	FBGF		SFF		Non-Family	
	Mean	SD	Mean	SD	Mean	SD
Computer programming, consultancy and related activities	7.1%	4.1%	2.8%	2.7%	9.8%	4.9%
Wholesale and retail trade and repair of motor vehicles and motorcycles	6.7%	3.3%	3.0%	1.8%	4.4%	0.6%
Publishing activities	5.9%	2.9%	5.7%	2.8%	N/A	N/A
Specialized construction activities	5.7%	1.5%	5.1%	2.1%	0.2%	2.2%
Sports activities and amusement and recreation activities	5.0%	1.1%	0.7%	2.5%	N/A	N/A

Table 9b: Top 5 Service Sectors (Average ROA %): Standalone Family Firms

Service Sector	SFF		FBGF		Non-Family	
	Mean	SD	Mean	SD	Mean	SD
Publishing activities	5.7%	2.8%	5.9%	2.9%	N/A	N/A
Water transport (Shipping)	5.4%	2.5%	4.3%	1.9%	4.7%	1.8%
Specialized construction activities	5.1%	2.1%	5.7%	1.5%	0.2%	2.2%
Employment activities	3.9%	2.5%	N/A	N/A	5.8%	0.7%
Travel agency, tour operator and other reservation service activities	3.1%	1.0%	N/A	N/A	7.6%	1.2%

The takeaway from the variability in the performance of SFFs and FBGFs across these sectors is the implication of sector-specific attributes such as debt and capital requirements, distribution channels, degree of competition and firm structure. For example, we expected and observed FBGFs to perform better than SFFs in Computer programming, consultancy and related activities and Trade activities (Retail and Wholesale Trade). This was due to their ability to leverage their connections to different firms across the value chain across multiple business group entities and better suitability to the distribution channels for this industry A considerable number of customers in these sectors are Business to Business (B2B) implying the importance of networks and connections which business groups are known to excel at.

Publishing activities (such as books and periodicals) and Specialized Construction activities (such as drilling, construction installation and demolition of buildings) have generally been rewarding for both FBGFs and SFFs in the past three decades. Both Employment activities and Travel agency, tour operator and other reservation service activities only have a few SFFs (less than five), all of which have performed well over the years.

Industries where family firms have performed their best (in terms of ROA) are a mix of traditional service sectors (Trade, Shipping and Construction) and modern/hybrid services (IT Services and Sports and recreational activities). In the past three decades, while modern services have taken up the mantle in terms of economic growth, older and traditional sectors remain prolific profit churners for family firms and their investors.

6. Piling up of Debt

A rise in global indebtedness has worried central banks, governments and policy analysts alike across advanced and emerging economies. An increase in corporate borrowing coupled with a slowing economy implies that the firm bears an increasing proportion of interest costs to revenue ratio as revenues of the firm are not able to grow at the same pace as interest costs due to stagnation of consumer demand. This leads to many firms not being able to service their debt obligations[8].

6.1 Faster growth of Debt in Services Firms

Over optimism in sanctioning loans and improper due diligence of promoters are two of the major reasons highlighted for the rapid growth of NPAs by the former governor of the Reserve Bank of India, Dr. Raghuram G Rajan. Repeated defaulting by manufacturing firms has resulted in increased apprehensions amongst private bank lenders. Increased write-offs of NPAs along with the new insolvency code, categorization of NPAs, amendment of the "Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act or SARFAESI Act of 2002" in 2016 detailing stringent laws for recovery of NPAs and sanctioning of loans above INR 500 million have resulted in a lower gradient of debt curve for the manufacturing companies (Exhibit 10a). Insolvency and Bankruptcy Code, 2016 (IBC), withdrawal of the forbearance on asset classification effective 1st April 2015, and mandating banks to bear 15% of the bad loans in comparison to 5% required before 31st March 2015 also hit the banks hard which are now understandably "over-cautious" in extending credit[9].

During the same period, total debt of firms in the services sector has continued to grow at a similar pace, for both family and non-family firms. ***This has resulted in the cumulative debt of family firms in the services sector exceeding that of their counterparts in the manufacturing sector by 2016*** (Exhibit 10b). The services sector has continued to borrow at rapid pace even post the 2008 financial crisis. The 2008-09 downturn may have affected the ability of these firms to raise equity from the market owing to the reduced confidence of the investors. Given the hesitance of banks in lending to manufacturing firms, there may have been a favorable debt market for firms in the services sector (quicker disbursal and lower interest rates). Family firms in the services sector may have additionally preferred debt due to the ability to continue to retain control over the firm in comparison to raising equity where the stake of the family gets diluted. Hence, the services sector supplemented its growth plans via the debt market.

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[8] https://www.thehindubusinessline.com/opinion/columns/c-p-chandrasekhar/is-the-world-economy-spiralling-towards-another-debt-crisis/article28251944.ece#

[9] https://www.businesstoday.in/magazine/cover-story/massive-corporate-debt-may-slow-down-economic-recovery/story/217700.html

Exhibit 10a: Total Debt - Family vs Non-Family

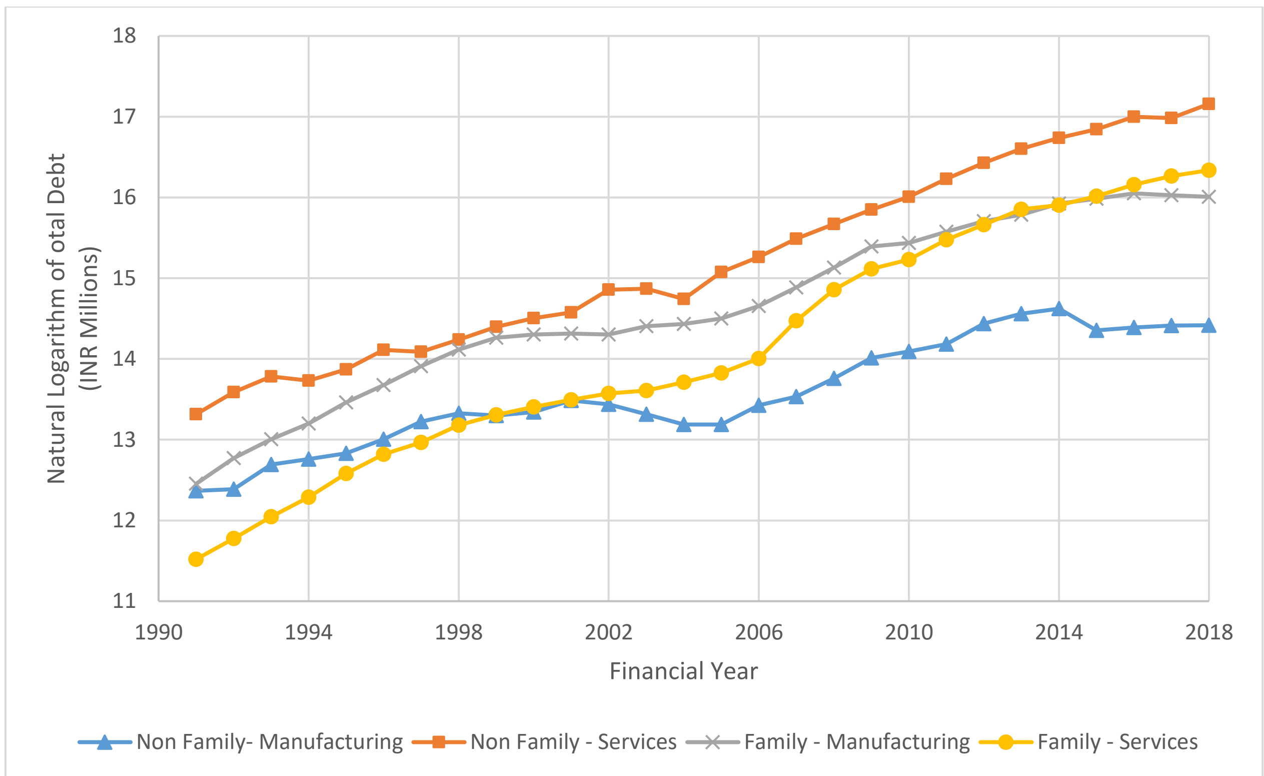
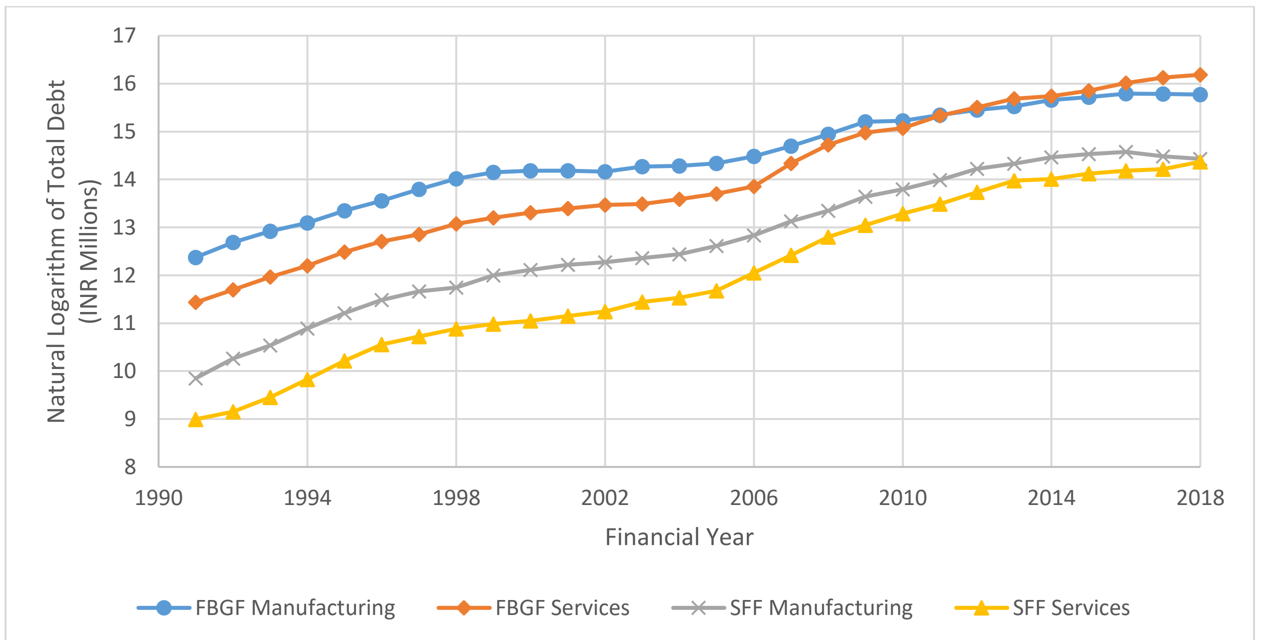


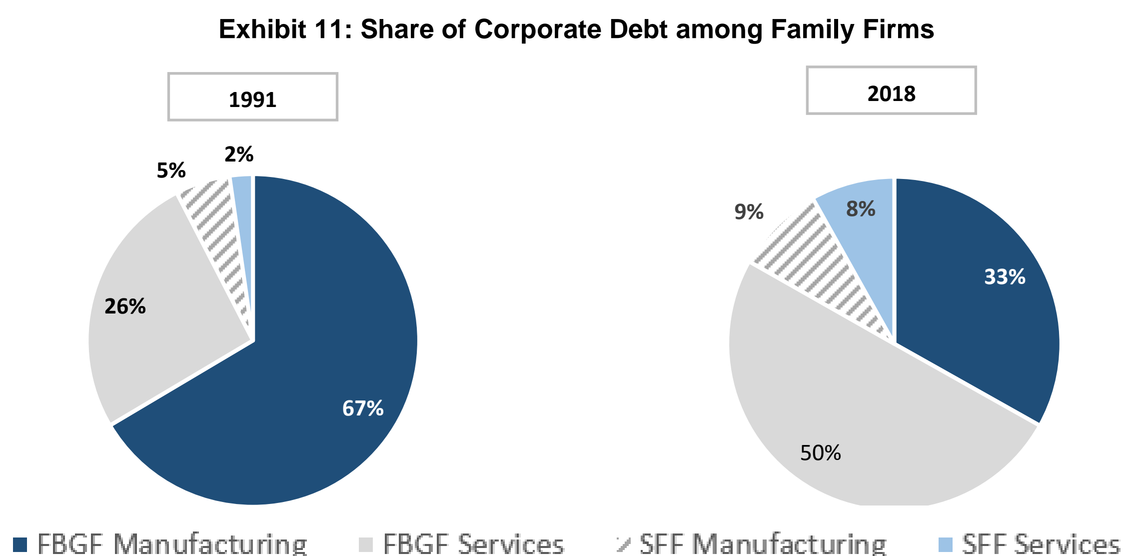
Exhibit 10b: Total Market Debt - Family Firms



6.2 Average Debt-Equity ratio has been falling

First, we inspect the total debt holding by family firms across manufacturing and services. At the time of liberalization, firms from the manufacturing sector dominated the total debt holding with more than 70% share of the total pie of debt taken by family firms. However, ***both FBGFs and SFFs have since increased the share of services in the total debt holding with FBGFs in services sector even holding a whopping 50% of the total debt of family firms in 2018*** (Exhibit 11). The reasons for this upsurge are a combination of the growth in the revenues of firms in the services sector in the 1990s and the debt crisis for manufacturing firms in the past decade as explained in the previous sections.

Exhibit 11: Share of Corporate Debt among Family Firms



While the data at the macro-level (total debt in Rupees) reveals domination of the services sector in the corporate debt market, the story may be different when we look at relative debt levels in terms of debt-equity ratio for the firms. This is because larger firms may be borrowing more in value but have a low debt equity ratio. When we look at the data on the debt-equity ratios for the companies in the sample, the distribution had a significant number of outliers. We have therefore winsorized the data prior to analysis. Also, for each of the categories below, we have ignored the top and bottom 10% values while calculating the mean to further reduce the effect of these outliers.

Post the liberalization of the economy, the central government took multiple steps to establish robust capital markets in the country in the next five years. Between 1991 and 1996, measures such as formation of the Securities and Exchange Board of India (SEBI), dematerialization of shares and permitting the buyback of shares were brought in. Gradually, over the next decade, as stronger capital markets were established, we expected the institutional changes to contribute to firms increasingly relying on equities to finance their growth. At the same time, there has been a steady decline in the corporate tax rates in the past three decades. As per the popular Modigliani Miller hypothesis, the attractiveness of debt goes down as the tax rates go down, owing to the benefits that arose from tax-free interest payments coming down. In addition, several standalone

firms were incorporated in the decade following liberalization. The SFFs do not have the advantages of such networks, nor an established credit history or the assets to provide as collateral. We expect that larger and older firms can leverage their existing networks, including relationships with financial institutions and strong financial and credit histories, to borrow significantly more than younger firms. Hence, at an overall sample level, we expected a reduction in the debt-equity ratio for the family firms in the sample as we move forward. This is indeed what we observe here (Table 10).

In Table 10, we also observe that ***family firms in the manufacturing sector tend to borrow significantly more than non-family firms***. Non-family firms in manufacturing are mostly composed of MNCs (more than 75% of non-family firm-year observations were MNCs in our sample). We expect that multinational companies have increasingly relied on equities and fund infusions from the parent company to finance their growth as the corporate tax rates have come down in the country. In addition, interest rates in developed countries have been much lower than interest rates in India over the past two decades which may have also contributed to the decline in the overall debt-equity ratios.

Among services firms, this trend is reversed as non-family firms are leveraged (in terms of debt-equity ratio) much higher than family firms. In our sample, a disproportionately higher number of non-family firms in services are from the financial services sector. These were approximately 40% of our total observations for non-family firms in the services sector. ***As financial institutions are generally leveraged to be much higher than other types of firms (especially large Public Sector Banks), we observe a higher debt-equity ratio among non-family services firms.***

Table 10: Evolution of Debt-Equity Ratio: Family Firms vs Non-Family Firms

	1991-2000		2001-2010		2011-2018	
Family Firms	**Mean**	**SD**	**Mean**	**SD**	**Mean**	**SD**
Manufacturing	1.08	0.69	0.87	0.75	0.77	0.70
Services	0.64	0.66	0.32	0.46	0.28	0.41
Non-Family Firms						
Manufacturing	0.96	0.69	0.36	0.49	0.23	0.37
Services	1.12	1.17	0.54	0.69	0.57	0.76

A similar ***trend of a reduction in the debt-equity ratio across the three decades is seen within different categories of family firms*** too (Table 11a). The structural difference between the manufacturing and service sector firms in terms of higher working capital and long-term capital requirements (for a manufacturing firm) can be attributed as the factors behind the traditionally higher debt-equity ratio of manufacturing firms. Services firms might need to borrow significantly only when they look to expand to newer regions/markets and have already somewhat gained a significant scale.

Within family firms, FBGFs are much larger in size when compared to the SFFs (Table 11b). The small size of SFFs may imply a reduced ability to provide collaterals, lack of a history of relationship with the lenders and an aversion or fear of debt. On the other hand, business groups have proved to be traditionally strong in managing networks and relationships (with financial institutions) that may result in an easier line of credit for firms affiliated with the groups.

Table 11a: Evolution of Debt-Equity Ratio in Family Firms: FBGFs vs SFFs

	1991-2000		2001-2010		2011-2018	
FBGFs	**Mean**	**SD**	**Mean**	**SD**	**Mean**	**SD**
Manufacturing	1.25	0.72	0.98	0.82	0.75	0.71
Services	1.06	0.90	0.53	0.69	0.39	0.52
SFFs						
Manufacturing	0.91	0.64	0.8	0.69	0.78	0.70
Services	0.4	0.45	0.24	0.36	0.24	0.36

Table 11b: Average size of Family firms – FBGFs vs SFFs (Assets – INR Million)

	1991	2018
FBGFs		
Manufacturing	1,190	46,907
Services	960	56,427
SFFs		
Manufacturing	213	5,072
Services	177	5,528

6.3 Debt-taking behavior of firms and the NPA Crisis in India

The Indian Banking system has been plagued by a steep rise in the Non-Performing Assets in the past decade. However, as we see in Table 10 and Table 11, there has been a reduction in the average debt-equity ratio across almost each category or sub-category of firms as we move across the three decades. The total amount of debt taken by these firms has nonetheless increased during this period (Exhibit 10). How do we reconcile these facts together?

A few prominent Indian bankers and economists have claimed that several of the loan accounts which went unserviceable in the past decade were sanctioned by banks between 2006 and 2008 when the growth outlook of the economy was extremely positive. However, slower growth and reduced consumption demand in the following years contributed to many of these firms not being able to service their debt obligations. As per the RBI Financial Stability Report in June 2017[10], large borrowers (one who has aggregate fund-based and non-fund-based exposure of 50 million and more) accounted for more than 86% of the Gross NPAs of the scheduled commercial banks. This was disproportionately larger when compared to their corresponding share of 56% in Gross Advances. In our analysis in the previous section, we removed the outliers from the sample to get an idea about the general trends in the debt-taking behavior of the listed companies in India. Given the data on large borrowers contributing to the NPA Crisis, it is extremely likely that the ***outliers are more likely to result in NPAs and defaults***. Total debt is also likely to be dictated by the larger accounts and hence is not as strongly correlated with the average debt-equity ratio of the overall sample of companies. This explains the disparity between our findings in the previous section and the debt crisis in the country.

[10] https://rbidocs.rbi.org.in/rdocs//PublicationReport/Pdfs/0FSR_30061794092D8D036447928A4B45880863B33E.PDF

A recent McKinsey report[11] shows that in India, companies are under significant stress, much higher than the other ten countries in Asia studied in the report, to service debt obligations. In 2017, a startling 43% of the companies in India had an interest coverage ratio of less than 1.5. While falling interest rates will bring a sigh of relief to the companies, the situation is still dire for companies with a high debt-equity ratio.

With increasing NPAs and the debt crisis threatening the corporate sector, it may also be a good idea for the firms to take on debt more cautiously as the stock market now tends to reward firms with lower or no debt in their balance sheets[12]. A case in point is Reliance Industries Ltd. that has been rallying on the stock exchange ever since its Chairman Mukesh D Ambani announced at the company's annual general meeting held in August 2019 that Reliance will be a "zero-net debt firm within the next 18 months". Analysts have argued that Reliance is in a position to become debt free, thereby, sending its share prices soaring[13].

7. Conclusion

The changes in the portfolio of industries dominating the Indian economy post liberalization in 1991 piqued our interest to study industry wise trends in family and non-family firms. The rise of standalone family firms and their unique characteristics, as opposed to business group affiliated family firms, entailed that we study SFFs separately from FBGFs. Our study has thrown interesting insights on the growth, size, performance and leverage of the firms in different ownership categories by industry. Some of the key conclusions of our study are as follows:

7.1 Key Conclusions

Family Businesses transition to services and subsequent dominance: Family firms witnessed a significant shift into services from a prior bias towards manufacturing as liberalization happened, unlike non-family firms (a significant number of which were already into services). A number of Standalone Family Firms were incorporated in the late 1980s and the first half of the 1990s. These firms took advantage of the newfound demand from both global and domestic fronts for services. Exports became easier and households increasingly spent on services on account of higher disposable income. Supply of both financial and human capital was available in abundance due to an increase in the number of foreign investors in India (owing to liberalization) and India's focus on tertiary education. Fast forward to 2018 and family firms are leading in the manufacturing sector and most of the services sectors (excluding financial services). Family entrepreneurs have proactively restructured and diversified their businesses where new opportunities have arisen and taken advantage of them.

[11] https://www.mckinsey.com/~/media/McKinsey/Industries/Financial%20Services/Our%20Insights/Signs%20of%20stress%20Is%20Asia%20heading%20toward%20a%20debt%20crisis/Signs-of-stress-in-the-Asian-financial-system.ashx
[12] https://www.business-standard.com/article/markets/debt-free-firms-make-up-57-of-all-market-cap-why-dalal-street-loves-them-118053100546_1.html
[13] https://www.businesstoday.in/current/corporate/infographic-can-mukesh-ambani-bring-reliance-industries-debt-down-to-zero/story/375813.html

Dominance of Family Business Group Firms in Services too: From 1991 to 2018, the dominance of FBGFs has remained and is possibly here to stay until a considerable period of time. Business Group firms, on average, were larger and borrowed more than their standalone counterparts. Business Group firms maintained this dominance across both manufacturing and services (across traditional and modern services). They were also, on average, for the same net sales, valued higher than standalone firms in the manufacturing sector over the past couple of decades and recently overtook the average valuation of standalone firms in the services sector as well.

Transition to Modern Services: Post the rapid influx of IT and Digitization in the early 2000s, modern services have taken up the mantle to be the new growth driver and add the maximum value to the country's GDP. For Family Firms as well, Financial Services, IT & Technology Services and Telecommunications have been some of the strongest sectors in the past 25 years. Family firms also have a more dominant presence (in terms of share of total assets) compared to non-family firms in most of the modern services sectors. We also see a bias towards presence of younger family firms across these newer sectors (especially Telecom, Air Transport and IT Services).

Traditional Service Sectors continue to perform: There has been a significant upsurge for family firms in the value added through newer sectors such as IT Services, Telecom and Air Transport. However, traditional sectors have continued to generate consistent results for Indian Family Firms. Indian Family firms (both Business Groups and Standalone firms) have done considerably well in sectors such as Trade, Construction, Warehousing and Logistics.

Upsurge of Debt in the services sector: New regulations post the financial crisis of 2008-09 and the sharp rise in NPAs between 2009 and 2016 have meant that growth in total debt of the family firms in the manufacturing sector has slowed down considerably. Service sector family firms have increasingly felt the need to borrow to fund expansion amongst stagnating consumer demand. Among Family Businesses, Business Group affiliated firms are found to carry significantly more debt than Standalone Family firms in the Service sector.

7.2 Implications

Diversification is beneficial but must be planned: Diversification into booming sectors (e.g. Modern services) may appear to be an attractive proposition for firms but without necessary strategic resources (intangible assets) (Ng 2007; Strategy for New India @ 75 2018), business groups and their respective ventures may end up failing leading to a negative impact on their market capitalization and profits. Prominent Indian Business groups (such as Aditya Birla Group) have attempted to diversify from pure manufacturing to a mix of both manufacturing and services but their ventures in the services sector have struggled to gain momentum and reach a stage of consistent profitability.

Caution while analyzing family firms in the services sector in developing economies: When the performance of family firms is being analyzed over a longer period (30-50 years) in a developing economy context, a time-series analysis must be treated with caution. Family firms are strongly influenced by the stage of industrial development in the economy. For example, an improvement in a services firm's performance during such a time of rapid industrial change might be partly

credited to factors such as changes in the country's institutions and the government regulations and warrant a deeper analysis to ascertain what led to the change.

Stringent monitoring of debt: India needs regular monitoring of debt with respect to firms in the corporate sector. The NPA crisis saw institution of significant regulations from the government, but most of it was reactive, after the crisis happened. With services now bearing a lot of the corporate debt, increasing interdependencies between sectors in the economy and threat of a financial slowdown[14][15], the government and the central bank needs to be proactive to prevent another NPA Crisis, this time led by services firms, which could be disastrous for the economy due to their higher GDP contribution.

Niti Aayog, the government's policy think-tank, recently came out with a document "Strategy for New India @ 75" which outlined a strategic plan to create clean, sustainable and inclusive economic development in the coming decades through recommendations on industrial policy. Further reducing the documentation and regulatory approvals for opening new businesses, enhancing credit for MSMEs, readying an Industry 4.0 compatible workforce and promoting Start-ups are some of the suggestions outlined in the document to improve the manufacturing output and create new employment avenues for the workforce. The outlook towards improving infrastructure by holding a sector-specific view, improving governance via data-driven decision making, modernizing agriculture and promoting service sectors which help in alleviation of the groups lying in the lowest economic strata are also important measures to reach the goal of sustainable development. While the above-mentioned policy suggestions seem to be the correct remedy for the industrial economy, fluctuations in demand and challenges in successful on-ground implementation mean that it remains to be seen whether the government's vision of 2022 is able to materialize or not. Both developed and developing economies have shown merit in constituting a strong industrial policy that provides direction to the economy and bails it out in case of economic slowdowns and recessions. India's overdependence on services, buildup of an informal sector and failure to move a sizeable chunk of the workforce out of the primary sectors validate the need to possess the same.

The dependence of the Indian economy on family firms has been appropriately encapsulated in the current and prior studies by the Thomas Schmidheiny Centre for Family Enterprise. Given the willingness and ability of family firms to adapt to new and rapidly growing sectors, the government must ensure that it provides an apt environment for Indian family firms to thrive. The formulation of the Industrial Policy would be the first step towards the same. The Indian government's disinvestment targets for the next couple of years also outlines the willingness to shift the locus of power towards private firms (which mostly comprises of family firms). The current leadership would need to be cognizant of the fact that the economy may not be able to grow at the envisioned rate without Indian family firms performing as well as they have over the previous two decades.

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[14] https://www.businesstoday.in/current/slowdown-blues/slowdown-blues-slump-in-indian-economy-spreading-to-services-sector/story/371057.html

[15] https://www.livemint.com/Industry/G8tbcgdtcYPYVk1PHmvmaO/RBI-asks-banks-to-closely-monitor-loans-to-telecom-sector-as.html

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Appendix 1: Identification of Family Firms

In the literature, family businesses are generally classified on the basis of ownership, management and succession or business continuity. In the family business literature, 79 percent of the studies used ownership, 53 percent used management control, 28 percent used directorship, 15 percent used self-identification, 9 percent used multiple generations and 7 percent used intra-family succession intention, as the criteria to define a family firm (Machek, Kolouchová and Hnilica 2015).

The Thomas Schmidheiny Centre for Family enterprise, Indian School of Business, identifies a firm as family firm if the first condition of significant ownership is met and any one of the other two conditions are met:

a. An equity ownership above 20 percent by family members or family-controlled firms as on date (2018) or the last shareholding data available. The cutoff of 20 percent was deemed to be appropriate as it has been found that individuals/families are able to control companies with much lower shareholdings due to large number of other shareholders that are widely scattered or financial institutions as shareholders that are not interested in the management of the company (Bagchi 1967) [16].

b. Family member as chairman of the board, or two or more family members[17] in the board of the firm. Once it was established that a Family has more than 20 percent shareholding in a company, it was determined if the family also exerts management control on the company. Wherever the Chairman of the Board, the Chief Executive Officer (CEO), the Managing Director, or a person in the board of directors was also a promoter and member of the family holding more than 20 percent stake in the company, that company was considered to be a Family Business.

   In cases where the information about the Board of Directors was not available or it was difficult to determine whether the individual is a family member or not, the Annual Report of the company and the website, especially the History section and the Team/ Management/ Leadership sections, was explored to gain clarity.

c. Multiple generations or multiple members of same generation actively involved in business. If a classification could not be arrived at through conditions (a) and (b), then the website of the company, along with search on the internet to get more information about the company was explored. But if there was ambiguity in step (b), as there were companies where a family owned more than 20 percent shares, but the company was managed by a non-family CEO or Managing Director, in such cases, whether the stake of the company was being passed on from one generation to the other and the members of the family were involved in the company as owners, even if it was not in a leadership role, was checked for.

The above criteria have been primarily used to classify companies into Family and Non-Family businesses.

[16] No significant changes were observed when the ownership cutoff was relaxed to 15 percent or increased to 25 percent.

[17] Family members were many times identified using the 'surname' matching approach when any conclusive evidence of relationship was not available. See (Machek, Kolouchová and Hnilica 2015) for a primer on the approach.

Appendix 2: Ownership classifications

Businesses in India are characterized by many differing ownership structures. Prior literature on BGs does not distinguish between family and non-family business groups. Similarly, the prior literature on family businesses either focus on business groups or family firms irrespective of whether they are a part of a group or not. BG affiliated firms are usually bound together by various multiple ties such as common ownership, directors, products, financial, or interpersonal ties. Moreover, there is typically a core entity or dominant coalition, offering common administrative or financial control, or managerial coordination among the member firms (Granovetter, 2005). We believe that the family firms that are not affiliated to any business group will behave differently than the group affiliated ones.

SOEs or public sector undertakings as they are commonly referred to in India, are legal entities that are created by the government in order to partake in commercial activities on the government's behalf. It can be either wholly or partially owned by a government and is typically earmarked to participate in commercial activities. Examples include Indian Oil, NTPC, ONGC and Coal India.

MNCs are firms that have entered India through foreign direct investment. These firms make investments through which they acquire a substantial controlling interest in a domestic firm or set up a subsidiary in a foreign country (Markusen, 1995). Examples include Nestle, Cadbury and Microsoft.

Other Business group affiliated firms (OBGFs)- One key characteristic of Business Groups in the literature is 'kinship' amongst top management. Business groups affiliated family businesses are therefore BGs in the true sense and have been classified as Family Business group firms (FBGFs) in this study. The other firms that meet the criteria of business group affiliated firms to a large extent but the top management in the various affiliated firms are not related in any way have the 'kinship' that a family has missing. They are hence classified separately as OBGFs. Examples are the ICICI Group, IVRCL Group, Larsen and Toubro Group, among others.

BG affiliated firms which were SOEs or MNCs were classified under SOEs and MNCs, not under OBGFs. For example, the companies under the State Bank of India group would be a part of SOEs.

Standalone non-family firms (NFFs) form the remaining set of firms in the dataset. These firms are usually characterized by distributed ownership and a high degree of professionalization. Examples include Infosys, ITC and Global Trust Bank Ltd.

SFFs are family firms that are not part of a business group.

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The Thomas Schmidheiny Centre for Family Enterprise brings together faculty and practitioners from India and abroad with the broad aim of combining theory and practice to enhance research and innovation in the field.

Family businesses make a major contribution towards wealth creation, job generation, and increasing competitiveness in countries around the world. As such, the unique challenges and opportunities faced by them are rapidly becoming an important subject of management research.

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