The Road to Dominance*

C.P. Chandrasekhar

India's economy may be heading to recession, but India's leading business group Reliance Industries Limited (RIL), controlled by Asia's richest man Mukesh Ambani, appears to be holding out well. Though revenues of the group in the last quarter of 2019 rose only by 1.4 per cent relative to the corresponding quarter of the previous year, net profit rose by a comfortable 13.5 per cent. What is remarkable, however, is the reason why the group has managed to notch up this performance when times are bad. A disaggregated picture of the group's business reveals that its traditional areas of strength, stretching from oil to petrochemicals, recorded a decline in revenues of 10.6 per cent in that quarter. But this was offset by new areas such as digital services (including telecom) and retail, which recorded revenue increases of 36.2 per cent and 27.4 per cent respectively.

The story of the rise of Reliance from an entity absent in the list of groups constituting Indian monopoly in the years till the 1960s, to one that dominates that category is a case study that captures India's post-Nehruvian business history. An aspect of that story was the willingness of Dhirubhai Ambani to adopt a high risk strategy that focused investments in a few linked sectors starting from synthetic fibre to the production of synthetic fibre inputs and the hydrocarbon intermediates that went into the making of those inputs, before finally entering the refining and extraction of petroleum. Large investments in a few capital intensive, vertically integrated segments could, due to adverse environmental shifts, policy changes or errors in decision making, damage a fledgling enterprise and spell bankruptcy.

The elder Ambani, in ways that have on more than one occasion invited criticism, took that risk and successfully traversed that high-risk trajectory to generate large profits and garner substantial investible resources that were deployed to ensure that an entity missing in India's early, post-Independence business history became the leading business group in the country. Central to criticism of Reliance's growth strategy was the allegation that the group had been able to win government support and sway policy in its favour, in its effort to beat the competition. That cannot, however, take away from the fact, that unlike many of the older business groups, Reliance leveraged technology, scale economies and vertical integration to achieve success.

Remarkably, in the later phases of Reliance's growth, it dropped its focused investment strategy and came to resemble the typical India business group—vastly diversified into unrelated areas through investments in media businesses, telecommunications and organised retail. Such diversification into areas outside those considered "core competencies", weakened many a traditional business group. What the finances of Reliance Industries indicate is that this group has not suffered from such consequences. Rather new areas like telecommunications and retail are making up for the fall in profitability in traditional areas of business varying from oil to chemicals.

Reliance's success in the new areas has also been the result of aggressive investment and predatory pricing, facilitated by the capital accumulated in its traditional business, massive borrowing and government policies favouring its interests (claims the competition especially in the telecommunications and retail sectors). The effect of this combination has been that, despite market disrupting growth and predatory pricing, the new businesses are not bleeding. The most surprising piece of information revealed in the recent quarterly results was that the standalone revenues of RIL subsidiary Reliance Jio, which aggressively entered and disrupted the market for mobile telephony, rose by 62.5 per cent from Rs. 831 crore in the fourth quarter of 2018 to Rs.1,350 crore in the fourth quarter of 2019. This is reported at a time when a host of exits and failures have reduced the mobile telephony business to a three-firm oligopoly, and two of those three—Airtel and Vodafone-Idea—are reporting losses, are severely burdened with debt and are hard put to make the investments to ensure their customers reasonable connectivity. In fact, speculation is rife that a Supreme Court's order, upholding the huge claim of the Department of Telecommunications that telecom companies that had underpaid dues on account of licence fees and spectrum usage charges by adopting a wrong definition when computing their 'adjusted gross revenues' would challenge the viability of two of three of the remaining service providers in the industry: Vodafone and Airtel. The worst hit by the Supreme Court judgement is Vodafone, which is required to pay around Rs. 50,000 crore. Airtel too is hard hit, having to pay up around Rs. 35,000 crore.

Besides the sheer scale of the payments due, however legitimate they may be, Reliance's competitors are at a disadvantage because they have managed to acquire or retain their current shares in the market by relying on massive debt to finance expansion and acquisition and neutralize the losses resulting from price cuts to match the aggressive pricing policy adopted by Reliance. Since these companies would have to borrow more to meet the Supreme Court mandated payments, they may not be able to survive in the industry. Financial markets have already signalled their belief that the exit of Vodafone is inevitable, reducing the industry to just two players. Because of the benefit of a late start, Reliance Jio is the least affected by the Court judgement, having to pay only a paltry amount, strengthening its effort at becoming the dominant player. Not surprisingly, it has opposed the request of the other telecom companies for waiver of penalties and interest included in the DoT's claim and/or permission to make staggered payments.

A similar aggression is seen in retail as well. At the 42nd annual general meeting of RIL held in August 2019, Chairman Mukesh Ambani unveiled an ambitious "New Commerce" platform. The background to the initiative was an effort beginning 2006 to establish a presence in retail, which had led to the opening of more than 10,000 stores (labeled Reliance Fresh, Reliance Smart, Reliance Market and Reliance Digital) across the country, and the launch of a range of in-house brands such as Best Farms, Good Life, and Reconnect. Together with partnerships with other players in textiles, personal care, digital products and food, this effort the company claimed had secured "its position as the most preferred retailer in India". The aim of the New Commerce platform is to connect this brick-and-mortar retail structure to a huge number of unorganised retailing units linked through the network created by its telecommunication arm Reliance Jio. These kirana stores will use mobile point-of-sale (MPoS) devices and Jio's 4G network and offer offline and online services to shoppers as well as procure supplies from producers and wholesalers.

A fall-out of this aggressive growth strategy in different phases of RIL's rapid expansion has been the accumulation of substantial debt to supplement own capital to finance huge investments and cover early stage losses. Reliance Jio, for example, has reportedly "invested" Rs. 3.5 trillion to mobilise a subscriber base of 340 million users in less than three years. The group's debt now stands at a net figure of Rs. 1.5 trillion. Focus on addressing that debt burden appears to be the next stage in the conglomerate's strategy. At the 42nd Annual General Meeting, Ambani announced an end to the promoter-led investment cycle in areas varying from petrochemicals to telecommunications and retail. Future investments would be largely funded by external sources rather than the promoter's capital or debt. For example, RIL and BP are together planning to invest Rs.35,000 crore in natural gas fields in the Krishna-Godavari Basin block of the Bay of Bengal. Underlying this call for a partial halt to its investment thrust is a plan to transform RIL from a heavily indebted enterprise to a zero net debt company in 18 months. To meet this ambitious debt reduction goal, Mukesh Ambani announced that chunks of equity of firms in different spheres would be sold to strategic partners so as to write down debt. The process is underway. Thus, Saudi Aramco is to acquire a 20 per cent stake in the group's oil and petrochemicals division, which has been valued at $75 billion. Though yet to be officially confirmed, rumours have it that Reliance Industries, India's largest conglomerate, is planning to sell up to 26 per cent of equity in Reliance Retail to a foreign e-commerce entity.

These manoeuvres involve another declaration from RIL. The group is clearly stating that it has arrived at the top and now plans to stay there through consolidation, measured aggression, and, perhaps, more help from the State.

*** This article was originally published in the Frontline Print edition: February 14, 2020.**