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Between Profits and Social Purpose: Is there a Right Path for the Tatas?

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The design of the modern corporation is oriented to profit-maximisation. While globally there are foundations which own companies and work to a social purpose, the house of Tatas is different and has historically evolved in a different manner. Can it yet focus on social purpose?

In the past few years, the Tata group has been in the news for issues pertaining to governance. A large part of the debate has been about the peculiar ownership of the holding company, where a set of public charitable trusts hold a majority stake. While a part of the debate has been on the transition of leadership at both the trust level and the commercial arm, adequate attention has not been paid to the structuring of the holding, the chronology as to how this structure evolved, and the tensions that arise from the design of the structure.

We need to look at the issue from a larger perspective-that of organisations having objectives that are both commercial and socially responsible, and the tensions these bring because of their structuring. This article interrogates the House of Tatas from the perspective of structuring alone. It takes the personalities and rumours of conspiracies out of the debate.

Modern Corporations

The design of the profit maximising corporation has a long history. Refined over time, it is one of the most elegant forms of organisation. However, elegance should not be construed as desirable. It is elegant because of the only purpose with which the performance is measured-maximising residual claims to the providers of equity capital.

Theory sees a firm as a series of contracts (written and unwritten), where every contract specifies a consideration-a fixed amount for the services rendered or incentive payments for performance. Employees are paid a salary, the debt providers are paid interest, and the suppliers are paid the contracted price. Having received revenues from customers and having paid off all contractual obligations, the left over is termed as residue or profits.

In a modern corporation, the providers of equity capital are entitled to claim the residues. The objective of the firm is to try and minimise the contractual payments, maximise the revenue from the customers, and also maximise the residues or profits (Fama and Jensen 1983).

A Responsible Corporation

The nature of the corporation lies in maximising the residual claim of the equity investor-the profit - once all other claims are met. The modern stock market values a corporation afresh every day. Any firm that compromises on residual claims-that is, earns inadequate profits compared with its potential-is therefore considered inefficient, and its stock price is driven down. If the price is driven down beyond a point, a takeover becomes attractive to someone who believes they can deliver higher residual claims.

It is argued that the social responsibility of business is only to increase its profits (Friedman 1970). The design is expected to negotiate hard on costs and extract the maximum from the customers. The moderation for this extreme behaviour is competition and/or regulation.

Any other responsible and "fair" behaviour is possible in two situations. In the first, shareholders are satisfied with the current level of residual claims. This usually happens when they are aligned with the objective beyond profits and there is no possibility of a hostile takeover. In the second, such "responsible" behaviour is perceived to create long-term value for the investor. A responsible corporation is not a choice, unless the shareholders are aligned.

Gandhian Idea of Trusteeship

On multiple occasions, M.K. Gandhi espoused the idea of trusteeship for the business houses. Gandhi's position was interesting-he was willing to accept that businesses were structured to earn profits. However, he was against the accumulation of wealth by businessmen

beyond their needs. The trusteeship model envisaged that the wealth generated by business would be held in trust and redistributed (Chakrabarty 2015). Given Gandhi's position against mechanisation, he implicitly rejected big businesses, while not rejecting profits.

This idea of trusteeship translates into a fair labour code and no accumulation of profits. Gandhi did not advocate seizing businesses or their profits. He expected business people to be responsible and to redistribute the excess earnings. This is interesting because it keeps the model of the capital-centric firm intact and speaks only to how the profits that result from transactions are used.

Corporations that Defy Gravity

The design of the corporation as an entity that maximises residual claims will then follow Friedman's doctrine that its only responsibility is to maximise the returns to the equity shareholders (1970). However, some enterprises defy the pull of residual claims and can be "responsible".

Public sector undertakings (PSUs) are structured to deliver on multiple outputs. They offer equal opportunity for employment and equal opportunity in tenders and supply systems. They are accountable to Parliament on parameters beyond profitability. They are also subject to curbs on profit maximisation through price rationalisation, particularly in the case of oil marketing companies.

While PSUs are listed on the stock exchange and have private absentee investors, the ground rules are clear-the state will continue to exercise control, there is no chance of a hostile takeover, and a decision to disinvest is subject to parliamentary accountability. The market adjusts for this perceived "inefficiency". That is why the market capitalisation of comparable PSUs is lower than that of their private sector peers.

Beyond PSUs, some organisations commit to being responsible upfront-towards employees, towards supply chains, and often towards customers. These commitments could come from a management team, or they could be explicit commitments built into how residual claims are applied. When management shows such commitment, it adopts superior environmental standards and employee management, invests in research, puts intellectual property on an open-source platform, or follows non-exploitative pricing-even when opportunities to encash exist.

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Markets evaluate the firm on whether these adversely affect long-term returns. When investors think that returns do not justify the action, there could be a change of management-like the firing of Steve Jobs from Apple-or a takeover by a set of investors. In this case, commitment beyond the bottom line does not come from the design.

Alternatively, the larger purpose can be signalled through ownership structures. PSUs are a case in point. Closely held corporations, with shareholders aligned on the purpose, are also possible. If there is no public participation in equity, and so no listing on the stock exchanges, a decision to compromise on profits for a cause can be taken on a sustained basis. Here, the ownership moves towards a trusteeship model.

Complex societal objectives are difficult to communicate in very widely held organisations. If there are a large number of absentee investors, the objectives could be focussed, profit maximising, and value neutral. An individual who might not smoke, or support tobacco in her personal life, might invest directly or through a portfolio that includes a tobacco stock. Here the investor looks at the tobacco company as a data point that produces a good return, not at the negative implications of the business for the health of the consumer. If the investor were actively involved in the business, she would most likely have considered the societal objectives. As an absentee investor, however, she sees the investment as just a data point, and the morality of that investment therefore becomes value neutral.

This is illustrated in the sell-off of Vectura, a company producing lifesaving medicines for chronic obstructive pulmonary disease, to Philip Morris, a big tobacco company. The logic for the sell-off was that Philip Morris was offering the best price. It was the fiduciary responsibility of the people charged with governance to accept the offer, irrespective of the source of the funding (Ries 2026). This is what we mean by being value neutral. Their fiduciary duty is to act on behalf of anonymous individuals who collectively form the company's investor fraternity.

Alternative Structures

Is it necessary that all businesses are structured as for-profit corporations? Is it possible for businesses to challenge the centrality of capital? If a business runs largely on the basis of usership (or patronage), a co-operative structure can be envisaged. In a co-operative, capital receives a fixed contractual payment, and the residual claims are distributed according to the business that members do with the entity.

For instance, in a dairy co-operative, the residual claims are distributed according to the volume of milk supplied to the co-operative, rather than as a dividend on capital. This structure comes with constraints. It moves from an interchangeable measure (capital, measured in currency) to patronage-milk, in this instance-a specific commodity as the base. This requires membership to be open and voluntary, so that the co-operative can admit and let go of members based on their ability to supply milk. This arrangement is transactional.

> In the Social Business model, profits are barred from being distributed and are reinvested to grow the business. While the concept has been around for a while, it has not taken off.

Capital-centric corporations have both limited liability and entity shielding. The capital committed by a member is permanent and can only be traded on the stock market, without affecting the entity's balance sheet (Giuseppe et al. 2017). In co-operatives, entity shielding is not available, as members can withdraw their membership at will. This creates a horizon problem (Srinivasan and Phansalkar 2003), where members do not develop long-term commitment.

The co-operative form may be desirable but is inelegant and misaligned with multiple interests. There have been multiple attempts to bring the objectives and design of co-operatives into alignment, but the task is complex (Agrawal et al. 2003). Enterprises could also be set up as not-for-profits, without residual claims. These businesses would have a problem of growth, as fresh investment will not come in where there are no residual claims.

The concept of Social Business, espoused by Muhammad Yunus (Yunus et al. 2010), is an attempt to achieve societal commitment. Here a societal problem is given a business solution. In this model, profits are barred from being distributed and are reinvested to grow the business. While the concept has been around for a while, it has not taken off. It is also not recognised as a legal form of organisation, and the commitments made cannot be enforced in court. To that extent, it resembles a corporation that could have an internal commitment to being socially responsible.

In the United States, there are efforts to promote public benefit corporations. Several US states have passed laws that allow an alternative form of incorporation. At the same time, an initiative called B Lab is developing standards for certifying these benefit corporations. At present, B Corp certification is not mandatory for benefit corporations. Similarly, ordinary profit-maximising corporations can get a B Corp certificate, as with any other certification. With the emergence of long-term stock exchanges and social stock exchanges, the business community is recognising the need for a conversation about organisations that show greater responsibility beyond the narrow purpose of maximising shareholder wealth.

The House of Tatas

The Tata group has been in the news of late over listing, ownership pattern, and leadership succession.

In the structuring of the Tatas, the majority stake in the holding company, Tata Sons, is held by charitable trusts. This has been held up as an example of a trusteeship model. It is a unique model because the structure pre-dates the law that prohibits public charitable trusts from holding equity in commercial entities.

Going beyond the Tatas, the philanthropic arms that carry the names of business houses have all been structured differently. That is also the case with many international charitable foundations that emerged from business houses. Most charitable foundations do not have ownership stakes in the corporations. The corpus is created out of the financial wealth the corporation has generated.

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The Azim Premji Foundation and Nilekani Philanthropies were created out of personal wealth that the respective promoters earned largely through their entrepreneurial journeys. The same is true of the Gates Foundation, Omidyar and the Michael and Susan Dell Foundation. These honour the trusteeship model-wealth is given back to society.

There are alternative examples-the Ikea Foundation, which owns stock in Ikea, and the new perpetual trust the promoters of Patagonia created to own Patagonia (Ries 2026). Owning the businesses gives them the opportunity not only to dictate how the business is run in a socially responsible manner (including sacrificing profits for values), but also to apply the profits later to societal purposes.

This ownership structure is like the PSU structure in design. It represents the trusteeship model in the purest sense. It also comes close to the Social Business concept propagated by Yunus, as no profits are used for private enrichment.

However, the Tatas do not fit this model, for two reasons. First, the group was not established as an entity with a larger social purpose, but as a regular enterprise by J.N. Tata. The trusts' partial ownership of Tata Sons came from a later decision by Sir Ratan Tata and Sir Dorabji Tata to bequeath their holdings to a public charitable purpose. Second, there were other shareholders, like the Shapoorji Pallonji (SP) group, who did not express a charitable intent in their share ownership.

> We need to frame the Tata example within the trusteeship model. The wealth is held in trust to ensure societal distribution, not to control the commercial activities of the group in a social frame.

In this case, the Trusts' combined holding in Tata Sons is more than 60%, giving them a controlling stake. The Trusts, by virtue of their holding, have a say in the governance. But they ought not to drive these enterprises to look beyond profits, unless there is a consensus of all the shareholders. If the Trusts overlay their charitable work and dictate the direction of investments or the dividend policy of Tata Sons, they will gain a veto over the commercial arm's ability to to conserve capital for reinvestment and diversification.

The trusteeship model expects fair behaviour from the providers of services and the wider business community. However, this is not non-negotiable. The trusteeship model deals with the ethics of accumulation. It calls for redistribution after the profits are determined.

We need to frame the Tata example within the trusteeship model. The wealth is held in trust to ensure societal distribution, not to control the commercial activities of the group in a social frame. The Tata Trusts did not invest in Tata Sons to propagate a social purpose. The profits earned from the investment are to be applied for a social purpose.

The unbundling of the Tatas into a business house and a holding structure has to be done in the best interests of corporate governance. The minority shareholder, the SP group, is not aligned with the trusts' objectives. This has resulted in tensions between the charitable objectives of the trusts and the commercial objectives of the other shareholders. Historically, this tension did not surface because of the moral leadership that J.R.D. Tata, and later Ratan Tata, provided to the group. The SP group also did not press for liquidity during that time, because it did not see the need to unlock its Tata Sons holdings.

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The current problems in the Tata group stem from three independent issues, of which two are not related to the structure. The first is the leadership succession issue, on which there is no consensus. The second is the losses of some of the frontier (Tata Digital) and legacy (Air India) businesses, and how they are being recapitalised. This is a commercial question, related to leadership, but not directly related to the Trusts' holdings. The third is the SP group's need for greater liquidity on its shareholding.

From the design perspective, it would be better for the Tata Trusts to let go of their ownership of the Tata group and focus on charities. This would align with the law of the land, which prohibits equity investments by public charitable trusts, and remove the legacy exception. Unlocking the corpus tied up in the Trusts' holdings in the Tata group would serve their social purpose better. The Trusts would be able to use the corpus to manage a wider portfolio of safe investments, and Tata Sons would have the freedom to access markets for further resources. The Trusts would focus on their purpose, and the commercial arm would be more transparent and more accountable.

A more complex endeavour would be for the Tatas to convert the entire group into a set of public benefit corporations, with their mission directed by the holding company. For this, all the shareholders of the holding company would have to be aligned on the

societal purpose, and each group company would have to have its objectives reworked. This is impossible, as most of the companies in the Tata group are already listed and stable.

If the Trusts do not want to direct the societal purpose, the commercial arm should have the best possible governance, with the transparency and disclosure applicable to a large conglomerate that has multiple firms with minority shareholding. Listing Tata Sons would make the accountability framework for the commercial arm better. Unlike Ikea or Patagonia, Tata Sons does not dictate the non-commercial and societal commitments of the group. It is therefore best that the commercial design follows the best norms of governance.

> Ideally, the Trusts should disengage and sell their stake in Tata Sons, to create a corpus that is managed professionally to carry out their philanthropic activities.

Ideally, the Trusts should disengage and sell their stake in Tata Sons, to create a corpus that is managed professionally to carry out their philanthropic activities, without wondering whether that money may be needed for reinvesting in the commercial arm to grow the business.

Given the current regulations that prohibit charitable trusts from investing in equity, the earnings of the Trusts could be muted, and the size of the corpus might shrink in real terms over the long run.

Currently, the law permits public charitable trusts to invest only in specified safe instruments. The intent of the law is admirable, because it requires organisations that are expected to do charitable activities to hold the funds in trust, pending their application to a charitable purpose. However, it may be a good idea to distinguish between two kinds of not-for-profit organisations. For those classified as implementation agencies, this ring-fencing could continue. For philanthropic foundations that fund other non-profits, there could be leeway. They could possibly manage their corpus the way a pension fund operates-with a mix of diversified investments, to ensure that the corpus grows regularly.

The second-best position for the Trusts is not to sell the holdings but to continue as an absentee investor-keeping the holdings intact and doing charity on the dividends passed up from the group.

Summary and Conclusions

We examined the design of for-profit organisations and the trusteeship model. We used these discussions to locate the Tata group in the context of the current internal conflict in the House of Tatas. Our conclusion is that, on design grounds, the charitable arm of the Tatas should separate from the commercial arm. This would be in the best interest of governance of each arm, as they work at distinct (cross) purposes.

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