THE FAMILY BUSINESS NETWORK

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A JOURNAL ON FAMILY BUSINESS

FAMILY & BUSINESS: MATCHING INTERESTS

Family business has inherent strengths that can be optimally employed if the paradoxes are effectively managed

Family businesses unlike widely-held companies have not only to stay competitive in business but also keep the family together. The twin challenges notwithstanding, Indian family businesses have maintained an impressive track record. Nearly 95% of all Indian companies are family run. Almost every big business conglomerate in the country is family owned and about half of the 30 companies on the BSE Sensex are controlled by their founding families. However, there are paradoxes in family business that mandate the close attention of those at the helm of affairs to ensure business continuity.

A question often asked is: can 'family' and business' support each other in the increasingly competitive business environment. Addressing this issue at the recently held CII-FBN XIII International Convention on Family Business titled 'Family Business as Paradox', Mr Farhad Forbes, Immediate Past Chairman, CII FBN India Chapter and Director, Forbes Marshall Private Ltd, said that 'family' and 'business' complement each other and do not necessarily function in an "either or situation".

CORE STRENGTHS

The essence of family business lies in the unity of purpose. Stating this at the convention, Mr M V Subbiah, Member, CII-FBN India Chapter Core Group, Past President, CII, and Advisor, Murugappa Group, observed that "family business is much talked about but not adequately understood".

Portraying family business on a wide canvas, Mr Subbiah said that while individual aspirations are increasing rapidly, the spiritual capital residing in families is also fast eroding. These challenges could seriously undermine the continuity of the businesses. Families should take conscious steps to keep the members together. In the Murugappa family the members congregate on special occasions and offer prayers together. Mr Subbiah said that through these actions the younger family members take to the family traditions more easily which augurs well for the family's future.

Focusing attention on the innate strengths of family business, Prof. John Ward, Founder Chairman, FBCG, and Clinical Professor, The Kellogg School of Management, USA, said that in the West there is a general assumption that family business is not an efficient form of capitalism compared with widely-held companies. However, a closer examination of the strategies and outcomes of family businesses has revealed that family businesses in the US operate on an average 25% higher profitability than non-family businesses.

Ms Meher Pudumjee has been elected as the new Chairperson of CII-FBN India Chapter for Year 2011-12

Inside This Issue

1: Mr Farhad Forbes, Immediate Past Chairman, CII FBN India Chapter and Director, Forbes Marshall Private Limited, addressing the convention.
2: Mr M V Subbiah, Member, CII-FBN India Chapter Core Group, Past President, CII, and Advisor, Murugappa Group, making a point.

Further analysis of publicly-listed family businesses in the West has established that family business share value growth is far superior to those of widely-held companies, year after year.

Prof. Ward also pointed out that American mutual funds which invested in listed family businesses were seen to deliver superior returns compared with other mutual funds. Prof. Ward himself studied 1,000 largest listed companies in the world, of which 200 were family-controlled. "Those 200 companies gave 30% higher returns than the other 800," he said.

Family business scores high on longevity too. In explaining this, Prof. Ward referred to a study by the consulting firm Bain. The study covering Fortune Global 500 over a 14-year period revealed that only a third of them stayed on the list over the reporting period, while 28% of them disappeared through acquisitions, 5% went bankrupt and 34% did not grow as fast to be on the list. Notably, 50% of the family businesses continued to be on the list, while only 30% of the non-family business lasted the course.

PREPARING FOR THE FUTURE

In meeting the emerging challenges, family businesses tend to get ahead of themselves, which is something to be guarded against, observed Prof. Ward. Citing this, he said a study has proved that 35% of family businesses in the US intended to plan succession through co-CEOs. "This should be done not to avoid any conflict but for the right reasons," he said.

Referring to the issue of meritocracy, which is often seen as an impediment in family business management, Prof. Ward said that the employment rules within the businesses should be well defined such that the specific roles of family members in the business are unambiguously stated.

Referring to some of the paradoxes in family business, Prof. Ward said that values from a business perspective may be "functional" but acquire an "emotional" dimension from the family standpoint. Likewise, the financial strategy from the family perspective might be useful for survival, but from the business perspective will be aligned toward maximising share value.

Survival and continuity are indeed paramount to family, whereas in business there could be a "reshuffle of the deck of collection of assets to maximise value". Families may be more prudent, whereas businesses are more risk-taking, observed Prof. Ward.

"Is it necessarily true that if we organise business around family interests, as opposed to strategic needs, we are inherently compromising the value of the business," he asked. "Or would a business centered on family interests create economic value?"

Prof. Ward noted that ownership succession is another big challenge for family business. The moot question is whether all family members or only those actively involved in the business operations should be eligible for equity ownership.

When the family grows and later generations begin to feel distant from the business, what would become of the family, he asked. The larger question is, "How do we define family. What are the roles of friends and in-laws?"

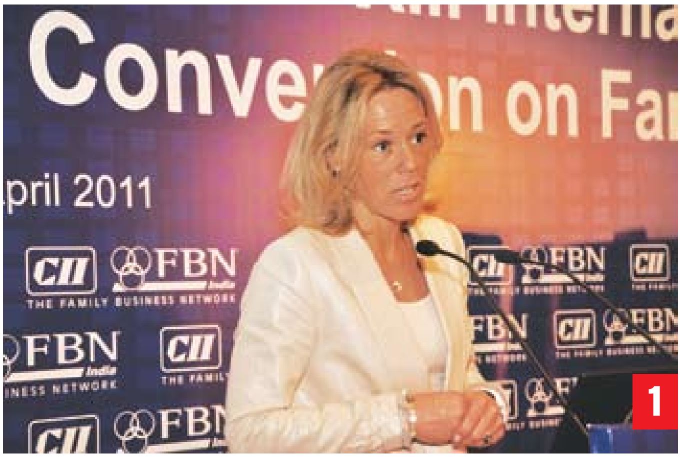
While the contradictions are many, Prof. Ward said that it would be prudent to promote mutuality of interests between competing forces. Efforts like this will enable a family to take an informed decision on whether the ownership should stay fragmented or there should be unitary control through a trust or super-share.

The contradictions are also seen in matters like professionalising of business operations, reinvestment of profits in business (as opposed to distribution of dividends), capital structure (family could be more risk-averse, especially on debt – opting for low to no debt vs leverage).

With respect to professionalising of business, the key question to be addressed is whether the career path of non-family members should be determined by merit or made subordinate to the family interests, said Prof. Ward.

Referring to the grand debate on whether a 'business first' approach will prevail over a 'family first' approach, Prof. Ward said that different cultures around the world have held different views on this issue. In Latin America, families tend to swing heavily on 'family first' whereas in North American families swing heavily toward 'business first', he said.

In matching up the family and business interests, Prof. Ward suggested that families would do well to get together



1: Ms Annelie Karlsson, Executive Director FBN Sweden, at the convention.
2: Prof. John Ward, Founder Chairman, FBCG, and Clinical Professor, The Kellogg School of Management, USA, conducting the workshop.

2-3 times a year and discuss all of the issues that could possibly go wrong and work out the solutions. This way the contradictions can be reconciled and synergies may be found between family and business. The question to be addressed is: "How is the family better off for owning the business, and how is the business better off being owned by the family."

Succession planning is invariably the most demanding of all challenges that meet family business. Where business is managed by people who believe they are "stewards of business" succession is a relatively smooth process but in businesses where those at the helm of affairs are loathe to "let go off control" succession will be a major challenge, said Prof. Ward.

In the instance of two friends who formed a company and worked like a family, how will the succession he handled? Ms Annelie Karlsson, Executive Director FBN Sweden, said that the children of the partners would be more like cousins, hearing the same stories around the dinner table.

Prof. Ward wondered how those involved in the business 24x7 would feel about those not actively involved in business. Also, when the family reaches the siblings stage, is there a risk of the siblings creating individual fiefdoms. The axiom suggested is: are we one family, one company or four families, four companies?

It need not be axiomatic to join one's parent business but work in all the businesses so that the experience gained is that much more enriched, said Prof. Ward.

When moving from siblings to cousins, the likely shift is from consensus to democracy. Plan for a decision making system that is less than consensus, noted Prof. Ward.

Prof Ward said that to avoid fiefdoms, it would help if members graduate from individual verticals to corporate governance. What is important is to have one family, one business.

Ms Karlsson explained that the governance of the business depends upon the model of ownership. It could be a single owner, or a few siblings owning it, or a large number of cousins having a share in the family business. However, when it comes to family businesses the issues can be broadly divided into three categories: family issues, ownership issues and business issues. The family issues are usually resolved by the family council. The ownership council takes care of ownership issues and business council handles business related issues.

She said the owners' council assists the owners' family with the governance of its ownership; not with running the actual businesses. The role of the owners' council is to clarify and define the owner voice. The owners' council should act as a link between the operating companies' supervisory boards and the owners, and not act as the supervisory board. The owners' council is the forum for succession planning and continuity of the business.

The owners' council is not considered a legal entity. However, advising, uniting, clarifying, engaging and providing helicopter perspective on shared wealth are the major roles of the owners' council.

The family council safeguards cohesion unity and continuity of the family. The purpose of the family council is to keep the family together, promote the business' name in society, contribute to the family's social responsibility, sustain the family's culture and traditions, and help the family members with education and personal development.

Underlining the importance of family constitution, Prof. Ward urged the participants to share their experiences in drafting their respective family constitutions. He said that in drafting the family constitution, family businesses should (i) take time to put down the processes, and (ii) make the process truly participative.

Providing a broad perspective on family constitution, Mr Arun Bharat Ram, Member, CII FBN India Chapter Core Group, and Past President, CII, Chairman, SRF Ltd, said that a family constitution should not be limited to business matters but instead cover all aspects including family values and culture.

Prof. Ward added that there is need for a good understanding of what is personal and what is collective. How flexible can the constitution be? He said that the main constitution should constitute a (i) family agreement that takes care of family concerns and insecurities, and (ii) business agreement that brings in meritocracy. This will lay the ground for best practices.

Mr Arun Bharat Ram said that in his family business reputation takes

A panel discussion in progress: (L-R) Mr Arun Bharat Ram, Member, CII FBN India Chapter Core Group, and Past President, CII, Chairman, SRF Ltd; Mr Sunil Kant Munjal, Chairman, Hero Corporate Service Limited; Mrs Pheroza J Godrej, Godrej & Boyce Manufacturing Co. Ltd; Dr Naushad Forbes, Director, Forbes Marshall Pvt. Ltd.

precedence over every other aspect including money. If there is a deviant member, the family should help to rehabilitate that person.

UNCONVENTIONAL PATHS

In keeping with the traditions and values, Indian family businesses have functioned as highly socially responsible entities. This is a major contributor to their business continuity and social acceptance. Touching upon this subject, Mr Sunil Kant Munjal, Chairman, Hero Corporate Service Ltd, said that his family encourages the elders to experiment. They also allow seniors to partner with outside firms so as to build different perspectives. We always accept the difference, he said.

Mr Munjal said that now there are more than 200 members in the family; everyone has an individual perspective on how things have to be done in terms of business.

Mrs Pheroza J Godrej, Godrej & Boyce Manufacturing Co. Ltd, said that the family started giving back to society by establishing hospitals and schools. The family supports outdoor activities like swimming and sailing. The family was actively involved in the establishment of the National Institute of Performing Arts. Now, the family is involved in environmental protection activities.

Mrs Godrej said that forests are the wealth of the nation and tigers are the symbol of it. Water, forest, tigers are all interconnected. The family supports CII–Sohrabji Godrej Green Business Centre. The center is a division of Confederation of Indian Industry (CII), and is India's premier developmental institution, offering advisory services to the industry on environmental aspects and works in the areas of green buildings, energy efficiency, water management, renewable energy, green business incubation and climate change activities.

The family also introduced 'Ganga' soap as a symbolic gesture in support of cleaning of the Ganga River. "We are not a family of activists, but we do support the social activities by giving time and money," she added.

Dr Naushad Forbes, Director, Forbes Marshall Pvt. Ltd, said that when he joined the family business in the mid-1980s the young generation wanted to move fast but the managers were not in favour of that approach. However, the family provided the freedom to the younger generation to take risks and move faster. That younger generation is now heading the family business. "Failures taught us how to develop products," he said.

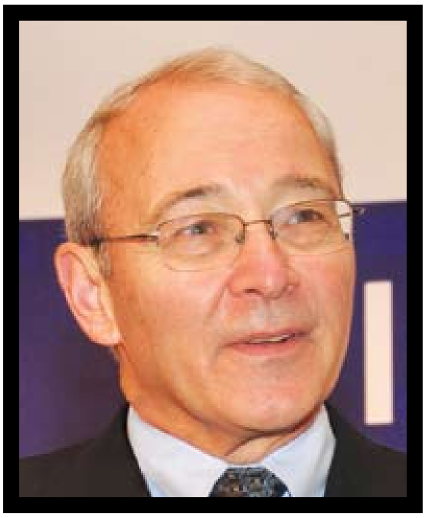
CONCLUSION

Prof. Ward said that while it might not be possible to anticipate all events, the question is how to create a system that handles new challenges. Also, it is important to note that the issues confronting family business are paradoxes and not problems. A family constitution and the presence of independent directors on Board will greatly address the paradoxical situations, he suggested.

A blend of 'business first' and 'family first' approaches will provide the Indian family businesses with the necessary strengths to forge ahead in business. ■

'INDIA HAS BECOME THE LEADER IN THE WORLD OF FAMILY BUSINESS'

Prof. John Ward, Founder Chairman, FBCG, and Clinical Professor, The Kellogg School of Management, USA, speaks about the challenges and opportunities that meet Indian family business, in an exclusive interview. Excerpts:



Prof. John Ward,
Founder Chairman, FBCG, and Clinical Professor, The Kellogg School of Management, USA

You have been associated with Indian family business for well over 13 years. In the course of the annual convention and through your other interactions with Indian family firms do you see any emerging patterns in Indian family business?

First of all the number of women in the programmes has increased significantly over the 13 years, particularly the number of younger women. At this convention I was talking to four young women all of whom are successors to their businesses. I didn't find that as frequently before.

The second major change is that families are able to organise their business in ways that are best for business instead of merely taking care of family matters and expenses. This is because the Indian tax laws have changed, and culture and habits have changed. More families are making the effort to separate business economics and family economics.

Family businesses are also increasingly concerned about being to attract and retain talent has escalated at a very rapid rate.

The other big change is that several family owners are beginning to believe that they don't have to be the operators. Young Indian family owners, particularly men, are able to say 'I don't need to be the managing director for my identity. I can do whatever that is best for the family and for the business'.

I think we are seeing more examples of family businesses owned by brothers who are concerned about not wanting to repeat an earlier generation's history of partitioning. So we are seeing a little bit more pro-activeness by sibling teams or brother teams to say how can we hold this together rather than how can we separate this.

I think the confidence of Indian business people is soaring as the economy has become so strong, and as the respect for India as a business centre has grown. The self-confidence, pride, enthusiasm of next generation Indian business leaders has grown greatly.

On the other side I am a little concerned that too much wealth is being generated too fast. I hope that some of the humility and the focus on building an institution and not building are retained. That is a trend that I am beginning to see. Building wealth for its own sake is beginning to be seen more often.

Would you say that capitalism has taken firm roots?

Yes, in many ways.

The other trend is that 13 years ago when the children of wealthy families went overseas, to the US and Europe, there were questions about whether they would come back to India. Now they are saying, they want to come back.

The sophistication with which business is being led is growing. More family businesses are aware that boards are not just things that you have to have but that boards can be designed in a value added way. There is a lot of recognition of that.

Most importantly, in the last 13 years India has become the leader in the world of family business in terms of family business knowledge, family business interests, family business study, and family business consideration.

13 years ago it was unknown to have family members come together and talk about family business issues. Today there are business schools that offer programmes on family business. There are the CII-FBN programmes that are conducted in different parts of the country. So the whole concept of India as a centre of family business and family businesses coming together to support each other has come a long way.

Some of the people who are part of the CII-FBN are so generous in terms of the care and compassion that they show for other family businesses. They support other family businesses, they visit each other's factories and facilities, and they talk to each other about personal experiences.

From a global perspective is there anything distinctly Indian about Indian family business? Are there any learnings from Indian family business that may be applied in other regions?

In the early years I used to think that for Indian family business to learn from the West about how to manage business had a lot of potential. But the West has so much to learn from India about how to manage family, how to work together as a family and extended family. Some of that comes from the joint family tradition but not necessarily completely, by any means.

So the way the Indian families have thought about family leadership -- the culture concept -- is very distinct and very powerful. The way Indian families have organised families and developed brother relationships, cousins and very closely connected families holds key lessons for the West and parts of Asia.

Today, is there greater knowledge sharing between family businesses across geographies?

FBN is contributing in a big way toward that. Of course, India's act of leadership in FBN which integrates the world of family business is active. India is getting very active in promoting research which will lead to sharing of ideas. We are beginning to see some evidence that Indian families are eager for their children to exchange experiences, and offer opportunities for internships.

There are regional differences when it comes to the 'business first' or 'family first' approaches. Is the 'business first' approach finding more takers in India?

That's probably the trend. I don't know if it is more 'business first' than it is less 'family first'. My concern area is with respect to the wealth motivation and not in terms of business motivation. Indian business leaders have always been thoughtful about the interests of the business, so I don't think it is more of that. Instead there is less balance between business and focus on family.

Are Indian family businesses opening up to independent expertise?

Yes. There are people here who have become family business consultants. There are professional organisations that are developing family business competence or interest. Law firms and accounting firms too are entering the domain. So there is a lot of expertise that is being developed, and there is growing interest in tapping this expertise.

We know that family business accounts for the bulk of business globally? But are they able to attract the best talent?

I think that is a challenge and I do believe that in some parts of the world family businesses are seeking and attracting the best talent. We see in the West more and more young people are interested in working for family businesses because they respect and appreciate some of the advantages.

I think that in India, to some extent, mid-sized family businesses do not believe they can attract the best and so they set their expectations too low. Over time, I hope, they can do what it takes to convince themselves that they can attract the best and retain the best. It will call for some change in management practices on their part.

Do you think there is need for sensitisation programmes on the emerging opportunities for professionals in family business?

Family businesses who understand and appreciate the advantages of family businesses are more and more trying to educate their management teams about the distinctiveness of family business. The real key of course is you have to walk the talk. If you are walking the talk and reinforcing that with education and orientation, that will prove to be very valuable.

The global business environment has changed over time. Business is about taking higher risks. Are Indian family businesses up for the challenge and sufficiently geared to leverage the emerging opportunities?

Indian family businesses think they have to leverage the opportunities. We have learned in other countries in earlier times that family businesses tend to be wiser if they grow incrementally. They don't feel they have to chase the biggest opportunities, all at one swallow, but the temptation to do that in India is high right now because so many people are doing it. But 10-20 years later when we relook this area we will see that family businesses that did this in a controlled way would have been more successful in the long-term.

What is your message to the emerging small family businesses?

To the small and medium family businesses, my message is, anticipate and plan. Plan for the future of the business, plan for the future of the family, and plan for the role of the family in the business. ■

STRUCTURING A TRANSITION PLAN

Many business owners unwittingly risk losing everything by failing to adopt the optimal transition structure. Stating this in an article published in Bangkok Post recently, Ian Pascoe, Managing Partner, Grant Thornton Thailand, wrote that more often family-owned businesses fail following the death of the founder. Unexpected events aren't the only source of failure. Just 30% of family-owned businesses survive the second generation, 12% the third generation and 3% the fourth, according to The Family Firm Institute.

Pascoe wrote that while the need for an effective succession plan is best started early, it is often precipitated by a shift in the owner's outlook toward business and life. In some cases, owners who were willing to bet the house on a new or rapidly-growing business become more reluctant to gamble with both personal and company assets as time goes on. In other cases, the need for a new generation of managers or a transition to the next generation impels the succession.

External change, such as market dynamics, can also bring an owner to a turning point. The business may need new strategic direction to maintain competitive advantage and maximise shareholder value. "The first step is to reflect on what you want for yourself and for your business. It's critical to establishing a personal agenda and identifying catalysts for change," he wrote.

This self-evaluation requires the owner to honestly answer questions:

- What are your personal ambitions? How long, for example, would you like to stay active in your business?
- Are your personal aspirations aligned with the objectives of your business?
- What is your appetite for risk and is it aligned with your company's strategic direction?
- What underlying challenges does your business face?
- Do they require capital?
- Is your management team capable of operating and growing the company?
- Do you need any personal liquidity?

Internal succession is the structure typically followed by family-owned businesses. Ownership and management are usually transferred to family members or to management through a management buyout or an Employee Share Ownership Plan (Esop).

In either case, a governance committee, such as a board of directors or family council, can smooth the transition from an organisation with a single owner to one with either a professional or family management team.

On the flip side, external succession may be a better option if the family members aren't interested in the business or there's a lack of confidence in the ability of family members or the management team. Financing and liquidity requirements are also a determining factor. "The most viable route for these situations is a triple-track process that simultaneously explores structures for a strategic sale, financial sponsor-led recapitalisation or initial public offering (IPO)," he asserted. ■

FAMILY FIRMS: SOLUTION TO UNEMPLOYMENT

Mr Mark Stepek, Chief Executive of the Scottish Family Business Association (SFBA), said in a recent interview to Herald Scotland that there would be zero unemployment in Scotland if each family business north of the border hired an extra three people.

He also criticised the main Scottish political parties for failing to put the family business sector at the top of their campaign agendas as a way to help lead the country out of its economic difficulties.

Mr Stepek, who now splits his time between researching his book, the SFBA, and his role as a lecturer in ethical leadership, said that family businesses are far and away Scotland's biggest wealth creators – and that the Scottish Government should introduce policies to help foster their growth.

As SFBA chief, he offers specialist help, support and skills to family businesses to enable them to grow and flourish over successive generations, and uses as a case study the failure of the Stepek family business itself. He said: "More than 45% of the UK's GDP is produced by family enterprises, and 50% of the entire private sector workforce in Scotland is employed by family businesses. This is an enormous slice of this nation's economic activity and it tends to be overlooked."

He claimed the focus of the Scottish Government and taxpayer-funded economic development agency Scottish Enterprise on high-growth companies is misguided and that Scotland's current unemployment level of around 220,000 could be obliterated if more jobs were created in the family business sector. "If each family business in Scotland employed three more people, there would be virtually zero unemployment here. The sheer numbers and the level of economic contribution of the Scottish family business sector needs to be taken seriously."

According to recent research conducted by Edinburgh University, 41 of Scotland's Top 100 businesses are family-owned and 25% of the 100 largest businesses in Europe are family firms. ■

ABOUT CII-FBN INDIA CHAPTER

CII along with FBN International has formed CII-FBN India Chapter with the aim of creating a nationally representative body of members of families owning and managing business in India.

MEMBERSHIP FOR CII-FBN INDIA CHAPTER IS OPEN TO BUSINESS FAMILIES ONLY.

CII MEMBERS

- For companies with annual turnover of above Rs. 100 crore
  - Primary Member Fees: Rs 25,000 per year
  - Additional Member Fees: Rs 5,000 per year
- For companies with an annual turnover of less than Rs100 crore:
  - Primary Member Fees: Rs 20,000 per year
  - Additional Member Fees: Rs 3,000 per year.

NON–CII MEMBERS

- For companies with an annual turnover above Rs 100 crore:
  - Primary Member Fees: Rs 37,500 per year
  - Additional Member Fees: Rs 7,500 per year
- For companies with an annual turnover of less than Rs 100 crore:
  - Primary Member Fees: Rs 30,000 per year
  - Additional Member Fees: Rs 4,500 per year

(Service Tax - 10.3% is applicable on the Annual Subscription Amount).

Academics and consultants are not entitled to full membership. Family owned consultants can be associate members without voting rights.

ABOUT FBN INTERNATIONAL

FBN International is the world's leading network of business owning families, promoting the success and sustainability of family business. FBN International unites some 1,700 family business members representing small & medium sized and multinational companies spread across 50 countries. FBN International organizes 75-100 events annually for family businesses worldwide.

FBN International is committed to giving and sharing experiences and insights in an atmosphere of confidentiality and trust. Located in Lausanne, Switzerland, FBN International is a non-profit association founded in 1990 by family business owners. It is a federation of chapters representing family businesses.

FBN International is first and foremost a networking organisation. Its success in this regard is built on three pillars: Advocacy, Education & Research. ■

CII-FBN India Chapter Activity Calendar 2011

Name of the Event	Venue	Date
Workshop on 'Building Stronger Business Through Strengthened Family Alignment'	Mumbai	16 July 2011
Workshop on 'Family Values – The Key to Legacy of Continuity and Success'	Kolkata	17 September 2011
Workshop on 'Preparing your Family Business for Strategic Change'	Chennai	22 October 2011
Workshop on 'Family Business Governance – Maximizing Family and Business Potential'	Delhi	17 December 2011
Sensitisation Sessions		
Sensitisation Session	Cochin	June
Sensitisation Session	Ahmedabad	8 July 2011
Sensitisation Session	Kolhapur	2 September 2011
Sensitisation Session	Jammu	26 November 2011

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