Governing the Family in the Next Decades

The year 2008 has seen some of the most significant changes in the fabric of Indian commercial world. Ranbaxy, regarded as one of the most innovative and a true 'Indian multi national' was sold by their owners to a Japanese company and three Indians being listed in the Forbes list of top ten richest people on earth.

These events in many ways lead the way to what the future might see and towards a structural change by which India's commercial establishments have gone about business.

Reducing the emotional quotient in family businesses

Traditionally, Indian businesses have been controlled by members of a family. Ownership has always been an emotional issue and rarely companies have less than majority stake owned by the family, either by themselves or through friends and relatives, which law defines as 'people acting in consort'.

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Ownership and control is largely indivisible in Indian family businesses. Typically, such businesses are run on a 'control' model of governance as opposed to a market model. Family and relationship dynamics affect conduct of business to a significantly large extent. Suggested best practices of corporate governance that are advocated around the world are mainly targeted at large companies with dispersed or diffused ownership pattern, for example, recommended composition of board of directors and its main sub-committees.

The business landscape in India is rapidly changing in a global environment and traditional protection geography or politics provided is no longer a sustainable competitive advantage. Technology, globally aligned and distinctive strategy, smart sourcing, economics of scale and innovation are the key drivers that global companies would include in their quest for success. Companies need to make a large investment in change, innovation and strategy and need to share such plans and vision with a multitude of stakeholders for them to understand and value the

enterprise. If the gap between ownership and management is not bridged, family organisations' ability to share with employees including key managers outside of the family is restricted. This together with the emotional desire to control with majority ownership limits the ability of family businesses in India to grow beyond a certain size or its ability to innovate or invest in the future, which needs significant capital and management commitment including absorbing talent from outside of the family. Moreover, when the second or third generation moves in, the size of the enterprise gets divided amongst the family and many smaller enterprises start operating.

Indian business in the future, like it has happened in the rest of the world will not run for perpetuity and in all likelihood would be sold, merged or acquired at an opportune time to create value for the stakeholders. Owners would need to reduce their emotional quotient of investment in the business and like any other investment would need to realise the optimum value for all stakeholders.

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In 1993, Parle, the owner of Thums Up, Limca, Goldspot etc., controlled 70% of the market and sold its business of soft drinks to Coca Cola. There were a number of Indian soft drink manufacturers in early 1990s but none of them are any serious contender to the multi national players today. Parle realised that due to its inherent business and capital risks that plagued the industry, value of the business of soft drinks owned by an Indian company would be deteriorating and exited at a time when the value was at the peak. Other players faded out into oblivion.

Ranbaxy's ability to compete and grow beyond a size in generic drug business is limited compared to the vision of the owners. The Singh brothers made an unprecedented move by selling a majority stake of Ranbaxy to Daiichi for USD 4.6 billion, the highest amount any Indian business has ever received for its value. Whether the sale culminates into a transfer of ownership due to issues around marketing approvals in the USA is something only future will tell. The decision to sell by the family at the peak of its performance will be a key event of reference of value harvesting for growing multi nationals from India.

Developing a constitution - Succession planning in family businesses

Corporate governance is always about best corporate behaviour. Many argue that if values and morals are the key doctrine, why is codification a critical need. In the heart of corporate governance likes a system of ethics, morals and values by which an organisation and their founders live by. In growing economies these are regarded as ideal corporate traits and in more mature economies such ethical practices get codified as law.

Family businesses operate within the family council through tradition and family values and usually it is not formal or written. As families get larger and the second or the third generation enter the business arena, the traditional codes are questioned by the new generation and the edifice of family traditions start crumbling.

The introduction of talented managers from outside of the family into the core council would not be meaningful if a code of conduct for the family in dealing with the business is not evolved. There are groups in India, who have developed a robust system of recognition of family contribution and have been successfully applying them.

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It is believed that 65% of companies listed on India's National Stock Exchange are family-owned. With increasing privatisation, more family businesses are controlling larger sums of the economic wealth of the country. A family dispute in such families, therefore, affects several thousands of people and other stakeholders like government etc.

Grandhi Mallikarjuna Rao (GMR), based on his experience while dealing with NPAs (borrowers defaulting because family business does not perform and how the family members were affected) at Vysya Bank made him realise the importance of addressing the unique challenges of the family business. After much discussion and consultation among family members, the GMR group has drafted a family constitution model that spells out the group's mission, vision, conflict resolution mechanism, qualification of family members wanting to enter business, how to take care of those members who do not enter the business, discusses various what ifs

and specifically outlines a succession plan. This is an important step in ensuring the long-term survival of the group by insulating it from family disputes.

Murugappa Group has evolved their family council and have very effectively dealt with the agency gap – the issue of ownership and management within the family members by having a written family constitution and a family reference document.

Adhunik Group of Calcutta with a group turnover of over Rs. 2,000 crores with interests in steel, power and mining is a first generation business with six brothers forming the family unit. The family has nominated one of the brothers as the key driver for running the business with a unified control. The choice was a result of the competence, acumen and vision of the youngest brother who was accepted as the leader for the business.

This is contrary to the traditional concept of the eldest family member becoming a patriarch. In the event any family member wishes to withdraw for personal reasons, the family has formulated a mechanism for such separation. These reflect the changing face of modern Indian family business and reflects the maturing and transition of new family businesses to becoming global players.

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Embedding value into business

Post independence era (1947 to 1990s') saw a major change in public policy. Government was involved in all large investments including nationalisation of a number of key industries like coal, insurance, banking etc. and critical industries like banking and finance were very closely regulated by the government. The private sector had restrictions on growing beyond a point and a market share of over 20% was considered 'monopolistic'.

As industries were highly regulated and restrictive, those corporations which had a licence from the government to manufacture thrived. The term 'Licence Raj' was coined, a take away from the British Raj, where the British gave favours including land and licences to their loyal subjects A high barrier for new entrants was artificially created by the system. The country moved through a period of scarcity

created by uneconomic scale of operations and restrictions in capacity and imports. The market was assured and there was no need to innovate or invest in research or development of the product. This is probably one of the reasons that during this period, very little cutting edge product or services came out of India. The 1990s brought in an era of reforms and globalization.

The well educated first generation entrepreneurs in the field of Information technology and related services brought about a huge change in the perception of how Indian businesses create stakeholder value. The IT industry operating in a flat global environment was benchmarked against global competition and was involved in delivery of services to the best global companies. They brought in the best practices in business processes, an era of transparency and sharing, involving and rewarding key employees with ownership through stock options etc. Companies were focusing on value for all stakeholders and not cash for owners, which was the flavour of the earlier generation.

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The manufacturing and other service industries were also transformed as manufacturing was also being outsourced from the USA and Europe. The local market started to develop as the overall income of at least the urban and semi-urban population went up significantly. The ripple effect of the reforms went through most of the industries and there was a new buzz in the economy.

The focus of commerce and industry has shifted to creating overall value, which brought in innovation, transparency and collaboration. In industries like telecommunications, the largest competitors share infrastructure to reduce costs. Companies enter into partnership with service providers in IT or other key infrastructure space to enhance the value proposition to their customers while they remain focused on their core areas of operations.

These changes in business are now being embedded and are critical for Indian companies to survive in the next decade. Good governance, systems and processes are going to be the base line of the new generation companies. What will make Indian companies distinctive will be pursuit of quality and innovation, which needs to be deeply engrained in the soul of the enterprise to move to the next level

of value chain. Indian businesses are adapting to this very fast and this will create a sustainable value embracing good governance and best innovative practices.

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