“FAMILY OWNED BUSINESSES: ISSUES RELATING TO SUCCESSION PLANNING”

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Abstract

In the lives of family owned businesses, the issues of successors and succession reigns supreme. While more is written about this area of family business than any other, it is often the most neglected area of activity by the typical family business owner. The researchers use the primary data (in addition to secondary data) through a questionnaire of 15 questions administered to the owner of family owned businesses. The paper highlights the issues involved in family business. This paper enumerates the strategies adopted by various family owned business houses for their growth and success. The paper provides constructive suggestions to improve the operations of family businesses. The paper looks deep into the issue of succession planning

Key words: **Family business, Succession planning, family conflicts**

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INTRODUCTION

India has an almost unique system of promoters who own and manage much of the corporate sector. There are mammoth of promoter groups that have been around for decades such as Tatas, Birlas, Mahindras, Bajajs, Goenkas and Godrejs. There are relative newcomers such as the Ambanis of Reliance, the Mittals of Bharti, the Agarwals of Vedanta, the Biyanis of the Future Group, the Singhs of erstwhile Ranbaxy, etc.

The common thing between Reliance, Godrej, Bajaj, Birla, are that they are all family run businesses. Families businesses can be defined as one where owner has power to take strategic decisions, succession is based on family relation and the owner has full liberty to appoint his relatives to any position he wants. Family owned firms are “organizations where two or more extended family members influence the directions of the business through the exercise of kinship ties, management roles or ownership rights”. The family business is popularly defined in terms of three characteristics (Astrachan et al., 2002: Klien et. at., 2005):

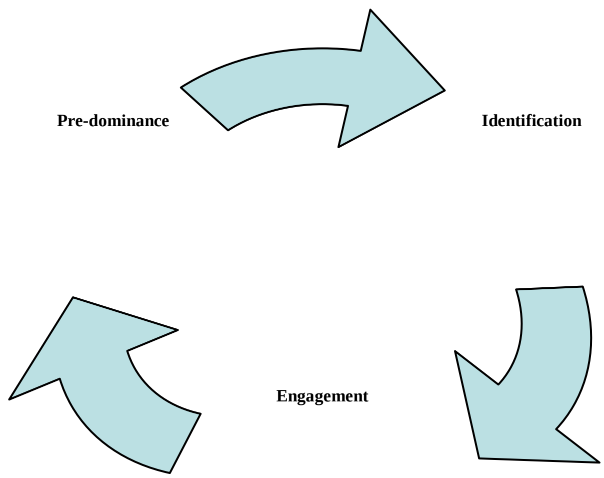

Fig 1: Characteristics of Family Business

(a) Pre-dominance: A proportionally pre-dominant control of the business by a family in terms of ownership, management and governance;

(b) Engagement: An overwhelming engagement by a family in the business, in terms of the successive generations involved, the percentage of family members involved, the active nature of such involvement, and the continuity of the involvement across generations;

(c) Identification: A display of loyalty, commitment and pride by the family members in the business and symmetry in the values of the family members and the business employees.

The above characteristics point to a family business that is the repository of a family's wealth and property is sustained over successive generations with a pre-dominant engagement of the family members, and has an organizational identity shaped and controlled by them.

Some experts studied the family business from three angles, i.e.

(a) A family owned business;

(b) A family owned and managed business; and

(c) A family owned and led business

Usually, family business governance is based on periodic assemblies of the family, family council meetings and constitution of the family. The Indian family business dates back to the latter half of the nineteenth century, which also marks the beginning of business in India. It is not surprising that family run businesses currently account for a whopping 95 percent of all Indian companies. Considering that 1/3 of the companies listed in Fortune 500 fall under this category. The Indian economy currently is in a state of rapid development, is burgeoning with innumerable small and medium sized family-run enterprises. In India, family businesses initially stated in the 1890s as a means to promote import substitution and attain economic freedom from the British. These business enterprises were the vital part of India’s freedom struggle, and as a part of the Swedeshi movement, got special healing and subsidies from the government.

REVIEW OF THE LITERATURE

There is a considerable currency of literature available on family business. Many studies were conducted abroad but only few studies were conducted in India. It should be noted that, even with this maturization of the field, a variety of definitions of "family business" continue to serve as the basis for the research and articles within this body of literature (Littunen & Hyrsky, 2000). For the purposes of this study, a family business is one in which family members dominate the ownership and management of a firm, and perceive their business as a "family business." Furthermore, this research study recognizes all first-generation family firms as included in the definition. This definition is consistent with that of many prior studies (Dreux & Brown, 1999; Gersick, Davis, Hampton & Lansberg, 1997; Litz, 1995). Lussier &Sonfield (2004)in their study determined that succession planning increased both with generations and with the family firm's years in business. Gurucharandas (1999) outlined the structure of Indian business, competitive advantage of joint family business, the characteristics of successful Indian company and the problems of family business at different stages. Miller Danny et. al.(2005) stated that the starting tips for family firms on their way to getting great were: flowing passion, using initiative, do sweat the small stuff, communicating face to face, making decision with people. There publication covered interesting issues on family business. The study had covered great businesses, examined several issues and concluded with the four Cs. They were Continuity, Community, Connection and Command. In a study by Dyer (1988), it was found that 80% of First Generation Family Firms had a “paternalistic” management culture and style, but that in following generations more than two-thirds of these firms adapted a “professional” style of management. “Paternalistic” management was characterized by hierarchical relationships, top management control of power and authority, close supervision, and distrust of outsiders. “Professional” management involves the inclusion, and sometimes the predominance, of non-family managers in the firm. Similarly, McConaughy and Phillips (1999), studying large publicly owned founding-family-controlled companies, concluded that descendent-controlled firms were more professionally run than were founder-controlled firms. These writers suggest that first-generation family managers are entrepreneurs with the special technical or business backgrounds necessary for the creation of the business, but the founder's descendents face different challenges--to maintain and enhance the business--and these tasks may be better performed in a more professional manner, often by non-family members. Both Dyer (1988) and McConaughy and Phillips (1999) found an earlier basis in Schein (1983), who also suggested that subsequent generations in family firms tend to utilize more professional forms of management.

OBJECTIVE OF THE STUDY

The objectives of the present study are:

(i) To examine the challenges, strengths and weaknesses in family businesses

(ii) To study the view and perception of fifty owners of family businesses regarding the succession planning;

(iii) To offer constructive suggestions and strategies to improve the operations of family businesses

(iv) To analyze the issue of succession planning in the family businesses

STRENGTHS AND WEAKNESSES OF INDIAN FAMILY BUSINESSES

Most family businesses cannot be categorized as either completely healthy or unhealthy; each has certain strengths and weaknesses. There are lots of dimensions in a family business and whether a particular dimension is strength or weakness depends on three factors such as

(i) The degree to which boundaries between the family and the business are managed;

(ii) The health of each system; and

(iii) The degree to which adaptability and learning is inhibited or encouraged in the boundary interface

The dimensions of a family business and the strengths and weaknesses associated with them are mentioned in the table mentioned below:

Table 1: Strengths and Weaknesses of Indian Family Businesses

S. No.	Dimensions	Strengths	Weaknesses
1	**Infrastructure**	Flexible; entrepreneurial; innovative and informal	Confusing; unclear; resistance to change; lack of management development; no organization chart.
2	**Leadership**	Informal authority; entrepreneurial; ambitious; creative	Autocratic, avoids letting go; resistant to structure and systems
3	**Succession**	Training can begin early; mentoring a life long process; can choose when to leave	Inability to choose a successor; family issues get in way
4	**Ownership**	Closely held; family owned; high degree of control	No outside board of directors, may sacrifice growth for control, not accountable to stockholders; high premium on privacy
5	**Roles**	Flexible; multiple roles; dual relationships; quick decision making	Role confusion; nepotism; dual roles interfere with learning and objectivity; family birth rights can lead to unqualified family members

			in jobs
6	**Complexity**	Can foster creativity; rich interplay of roles and goals	Must be managed to avoid confusion; drain of resources and energy
7	**Involvement of family**	Employees committed; loyal; shared values and belief system; family spirit; family name; family dream; strong sense of mission/vision	Can’t keep family issues out of business; can’t separate work and family; rivalries; inability to balance family’s and business’s need for liquidity; lack of objectivity; inward looking

CHALLENGES IN FAMILY BUSINESSES

Large business houses spanning three or more generations face the challenge of growth and sustenance due to different issues in family businesses. Every family business has faced or will face challenging issues. Even when they seemingly do everything ‘by the books’, the challenges may seem over whelming. The family owned businesses have to face major challenges such as:

(i) Splits: There are splits like a clash between father and son or other members of the family leading to a division of the company. For e.g. the Birla Group divided into many companies after the death of Mr. G. D. Birla.

(ii) LPG: Liberalization, Privatization and Globalization pose a great challenge to the family owned businesses. So it has to be faced by the family businesses with a new set of strategies.

(iii) HR Issues: Retaining the Indian brain is a major difficulty of Indian companies they have to tap the untapped resources, give them industry standard pay packages and other remuneration, delegate authority to them and give them space to work.

(iv) Transnational Attack: Foreign companies are more professionalized, focused, organized, and able to bear shots and they pose a great challenge due to their global threats of product and service quality.

(v) Restructuring: The changed business scenario requires a great amount of change in the overall business operations and activities, but for most of these business houses changes was painful, costly and forced. Very few could change from within, due to lack of initiative taking ability.

(vi) Lack of Professionalism: Lack of professional management and clashes between professional CEO's and family members who control the business. Divorce of ownership from management is always a contentious issue in such companies, though the need for appointing a professional manager is extensively accepted, problems arise in terms of clashes of styles and approaches towards running the company.

(vii) Other Challenges: The other challenges include:

*Seniority, rank and gender;

*Children do not like to face challenges;

*No encouragement from parents' side;

*Brothers and sisters often reluctant to grant authority to their siblings;

*The younger child possesses better skills than that of the elder;

*Children are very good with numbers but not with people;

STRATEGIES ADOPTED BY BUSINESS FAMILIES FOR THEIR SURVIVAL & GROWTH

The major strategies adopted by business families for their survival and growth are mentioned herein below:

(i) Understanding the realities: The family owned businesses have realized that the economy is moving from sellers' market to buyers' market. Business families have adapted themselves to the new realities; and new product launch, better customer relationship management, better after sales service have become the benchmarks of the new strategies.

(ii) Research and Development: Till few years back, the research and development was neglected by business families. But now with increased competition, Indian business families have realized that creativity and innovation are the survival strategies, without which business families cannot face competition from MNCs.

(iii) Raising capital base: Indian business families have raised their capital base in their businesses so that fears of takeover can be kept as bay. Before liberalization process started, the Indian business families were running with a low capital base which made them vulnerable for takeovers. But after liberalization process, business families have raised their capital base to 26 percent or above and in many cases as high as 45 to 50 percent to gain complete control over the management of their businesses.

(iv) Consolidation of business: Indian business families have now consolidated their business by selling non-viable and non-core businesses such as Raymonds sold their steel division to Thyssen of Germany and cement division to Lafarge of France. Even TATA Steel sold their cement division to Lafarge to concentrate on steel business.

(v) Managing the pace of change: Day by day new technology is coming up. Most of the companies have realized that managing, understanding and adapting to changes are the challenges they have to face and business families are readying themselves for this.

(vi) Appointment of Professional Managers: Business families have realized that business should run by experts and specialists and the concept capital stake and managerial stake should be clearly defined and understood. So, many Indian business families are taking back seats and professional managers are running the show.

(vii) Mergers and Acquisition: With globalization and government rules and regulations, moving ahead requires strategies like mergers and acquisitions. For e.g. TATA has acquired Cores.

(viii) Succession Planning: A critical task of succession is transferring the knowledge of the previous generations. Many business families' scions are educated, are trained abroad and they return to take over. They begin at the management trainee level to gain experience. A senior family member acts as a mentor for them.

SUCCESSION PLANNING IN FAMILY OWNED BUSINESSES

In the lives of family owned businesses, the issues of successors and succession reigns supreme. While more is written about this area of family business than any other, it is often the most neglected area of activity by the typical family business owner.

The troubles and conflict associated with developing a feasible, logical, and agreeable succession plan are immense. For the family business owner, the ability or willingness to manage and direct the interactions between the extraordinarily complex areas of personal, family, management, ownership, and estate issues can be scary. Moreover, these issues are often further obscured by, or in conflict with, other family members' personal wants and needs. Add to that the owner's possible fear of losing control and position, both in the business and in the family, and it's no wonder then why avoidance and denial are the principle responses to succession planning.

A general observation regarding majority of family-owned businesses in India is that families need to justify the decision to choose members as successors, especially in listed companies. There is a demand for greater professionalism in the business and a divorce between ownership and management. There is a need to learn lessons from the private sector which has made considerable progress in the area of succession planning. Succession is not for one person — it is about creating a huge talent pool from which it will be possible for the board to select one person. Globalization and exposure to global influences determines the succession. A large number of second-generation businessmen, future inheritors and new entrepreneurs have been educated abroad from prominent universities. This has given them exposure to a number of global economies and they have returned to their roots with a vision for India that spans the next half century. For those inheriting businesses, the need to protect the brand of the corporation as well as their own family is important. They are ever more aware that succession is a crucial aspect of business continuity which needs to be deliberated through in advance and handled carefully

Succession planning is about securing the future and making leadership decisions based on anticipated changes to company strategy and the market and economic environment in which it operates. It is important to continually assess whether the previously identified

CEO designate is still the ‘right’ person for the job. Succession planning does not mean crowning the next CEO before the time is right, but building a systematic process that engages the senior management and board in the discussion. Actually the objective of succession planning and talent grooming is to de-risk the business and is a strategic function for family business leadership to ensure sustainability.

Succession planning is all about deciding who will lead the company in the next generation. Businessmen may be reluctant to face the issue because they do not want to relinquish control, feel their successor is not ready. Nevertheless, it is essential that the succession process be carefully planned before it becomes necessary due to the owner’s death or other incapability.

There are few issues which are to be managed by succession planning such as:

(i) Who’s going to manage the business when owner no longer work the business?

(ii) How will ownership be transferred?

(iii) Will the business even carry on or will you sell it?

(v) Succession planning in family businesses can be especially complicated because of the relationships and emotions involved, and

(vi) Most people are not those comfortable discussing topics such as aging, death, and their financial affairs.

Certain things are essential for family business succession planning to get the succession planning process underway and ensure a smoother transition from one generation to another. The important ones are:

(a) Start business succession planning early.

(b) Involve your family in business succession planning discussions.

(c) Look at your family realistically and plan accordingly.

(d) Get over the idea that everyone has to have an equal share.

(e) Train your successor(s) and work with them.

(f) Get outside help with your business succession planning.

Due to a lack of transparency, family members may develop different views on how the business should be handled after a death; it only takes one dissatisfied beneficiary (second spouse, in-laws, non-involved family members) to start a long drawn out battle. This can result in costly litigation, family breakdowns and the owner's wishes being lost in the shuffle. We find a case of YES Bank where Kapoor Family is in conflict.

We do not find succession planning in most American family businesses. They believe that succession planning as traditionally performed doesn't work very well to anticipate today what the job will require years in advance. Also the person family is picking today will still be of the caliber required years in advance -- no scandals, no illnesses. If anything changes in the business or with the people, the plan doesn’t work. And today we are living in a dynamic environment where the world is changing faster than ever before.

GUIDELINES FOR SUCCESSION PLANNING

(i) It is not just selection. On the other hand there should be a development through job rotation, mentoring and formal training programs.

(ii) It must take into account the cultural environment of the organization.

(iii) It should be tailored to suit the needs of the organization. For example, if the skills necessary to manage the company in the changed environment are not available in family, there may be no option but to bring in an outsider.

(iv) It should develop key candidates, in anticipation of future openings.

(v) It must be consistent with the future strategic direction and vision of the company.

(vi) It should be driven by the line function and not HR executives.

REASONS FOR FAILURE OF SUCCESSION PLANNING

(i) High potential candidates are illogically identified.

(ii)When one person leaves, instead of moving decisively and appointing a successor, the portfolio is split among two people at the next level, leaving people totally confused.

(iii) The designated replacement may be far from ready to take over. The assessment may be more positive than what it should be.

(iv) Promotions are made keeping in view the organizational needs, but totally ignoring the employee aspirations.

(v) The process lacks transparency and confuses talented people who may decide to leave.

(vi) Outside hires are brought in indiscriminately without explaining the rationale to insiders.

(vii) Many executives make excellent No. 2s and act as a fine complement to their CEOs but fail miserably when they move into the corner office.

(viii) The qualities that a successful business unit head has and what he should have as a CEO after promotion are different. Business unit heads may not have strategic vision or the ability to communicate effectively with external stakeholders.

STRATEGIC PLANNING PHASE FOR OWNERSHIP SUCCESSION

Ownership Succession strategic planning phase involves who is actually going to control the business. Here owners must meticulously rely on sound business principles and criteria to make their decisions. Attempts to “maintain everything equal amongst the children” usually spell ruin for the perpetuity of the business as well as family harmony. Questions include:

(i) Who is best able to control this business?

(ii) How should the transition of control best be implemented?

(iii) How will active and non active family owners be differentiated?

(iv) When should this process begin?

(v) What criteria should be used to select who should control?

(vi) What can best finance this ownership model?

RESEARCH METHODOLOGY

Research Type	: Empirical
Type of Sampling	: Convenience Sampling
Sampling Unit	: Family Owned Businesses
Sampling Universe	: District Moradabad, Uttar Pradesh
Sample size	: 50 Family owned businesses
Data Type	: Primary as well as Secondary Data
Data Source	: Survey through questionnaire and review of literature.

Scope of the study : The scope of study is related to Family owned businesses engaged in export of brass handicrafts in Moradabad district in Uttar Pradesh. The scope of the research shall be in reliance with the methods and instruments of research used in this study. Special attention has been given to carry out the research in a manner such that it contributes to the overall study of problems of family owned businesses.

The paper is not confined to any particular area; on the other hand it is applicable to whole India. However, opinion of various businessmen and entrepreneurs in Moradabad and Jaipur districts of Uttar Pradesh and Rajasthan has been taken about the pros, cons and issues of Family owned businesses. Their views have been incorporated in this paper. The paper also takes the references of various articles written by various experts on family businesses.

ANALYSIS AND INTERPRETATION

Fifteen questions were asked from the respondents (usually owners) of fifty family owned businesses. The responses given by respondents are mentioned in Table 2

Table 2: Responses in Yes or No

S. No.	**Statements**	**No. of Respondents (Total 50)**		**Percentage of Respondents**	
		Yes	No	Yes	No
1	Have a company mission statement	40	10	80	20
2	Company mission statement has been updated in last five years	4	46	8	92
3	Have a written succession plan	4	46	8	92
4	Have a family business plan	4	46	8	92
5	Place more importance on the success of your business than family relationships	32	18	64	36
6	Feel that your children take over the business when you retire	48	2	96	4
7	Have any children capable of	40	10	80	20

	running your business				
8	Have children's spouses working in your business	14	36	28	72
9	Have written rules of entry that govern the hiring of family members	4	46	8	92
10	Have formal family business meetings	23	27	46	54
11	Think your spouse could run the business if something happened to you	25	25	50	50
12	Plan to leave your children equal shares in the business	48	2	96	4
13	Require that your children working in the business follow the same work rules as non family employees	45	5	90	10
14	Pay your children prevailing wages for their work	19	31	38	62
15	Have open communications with your children in the business	39	11	78	22

After going the above survey we come to the following analysis:

(1) 80 percent of the businesses have their mission statement in writing but 92 percent have not updated it in last five years.

(2) It is a sorry state of affairs that only 4 percent of the businesses have succession plan and family business plan in writing. Also they don't have written rules of entry that govern the hiring of family members. Majority of them have not thought about succession planning though 96 percent feel that their children will be their legal heirs.

(3) 64 percent of the owners feel that they keep business and family separate and they do not allow any interference from the part of family members. Though the family members are working in the family businesses but they work like any other employee of the business (90 percent). However they get some extra benefit in the form of remuneration (62 percent) i.e. they get high remuneration as compared to other employees of the firm.

(4) Majority of the owners feel that when they retire they will divide their business in equal proportion among their children (96 percent)

SUGGESTIONS FOR IMPROVING THE OPERATIONS OF FAMILY BUSINESSES

The challenges and problems can be taken care of without going into drastic mode of getting an outsider to manage the business, though sometimes it may be necessary, but have a strong communication network by the CEO with the family and the non-family members in the business. The following suggestions will help the family businesses to improve their operations and face the challenges in the competitive environment:

(1) Non participative family members: Every family has non-participative family members; these are the members of the family who are given a share in the business for reasons that make no business sense most the time. Other non-performing family members could be sisters, brothers in law, maternal relatives etc. These members are not directly from the family and some times have no concern even for the family they are only interested in the returns they receive. These members have to be conveyed clearly of their ‘non-participative’ status in the business and must be kept out of matters related to business. They should not be allowed to sit on the Board and give advice of matters related to business.

(2) Authority must be clearly defined: Every family members needs to be told clearly about his/her role in the business and over stepping into other peoples authority especially those of non-family professionals must be discouraged. Also, among family members even if a younger member of the family is at a position, his authority should not be overlooked by other elders of the family.

(3) Attitude of accepting change: Family businesses in India have operated in a protected business environment for a very long period of time. They are a little slow when it comes to accepting change as compared to their counterparts across the globe. The younger members in the family understand the importance of change and they must try and convince the elder members and non-participative members on the importance of change and the increase in earning capacity after the change.

(4) Giving priority to non-family professionals: No family owned firm can have enough aptly trained family members to look after all the functions of the business. As family owned firms grow in size they also need professionals at top positions. In order to grow, family owned firms need to strictly put in HR policies that are same of both non-family and family members.

(5) Family emotions must be kept outside the purview of the business: It is very difficult to keep emotions out of anything. There are lots of emotions which interfere in the actual working of the business. The head of the family has a very large role to ensure that the emotions (such as ego clashes, sibling rivalry, hurt among the earlier generation, dissatisfaction, feeling of being left out, etc.) stay out of the business.

(6) Succession planning and fair to all: Succession planning is something that all the family owned firms must start doing. By succession planning we mean finding a role of each family member in the group with out having to divide the group. Being fair to all in the succession planning is absolutely not possible because all children do not the same caliber and skills to handle the business functions. These family members should be compensated in other terms like giving them a fixed income or giving them property which is worth same in value etc. What need to go to who should actually not be decided by the family, this job should be handled over to an outsider who will not be biased in his assessment.

CONCLUSION

There is a need to teach the right values to the next generation. Some could become artists, some doctors but they are also likely to be shareholders. Shareholding is like partnership and it is important to know what values they represent. There is a need to first determine what the future is, say in the next 10 years, and then start working backwards to get there. Because the governance system from one generation to another shifts dramatically. This shift is very difficult for founders. Many founders are very brilliant and see a great opportunity that is not seen by others. They capture the opportunities and build the business step-by-step. But succession is a different process. There is a need to think ten years ahead. That might be very tricky for many people. Family businesses firms are predominant in any economy over the globe. Their contribution to capital markets and GDP of country they belong to is significant. Overall the performance of family owned businesses have been at par with non-family corporations. High standards of corporate governance, modern management with technology support and a long term strategy are key drivers for family business. Family business as a viable form of enterprise would continue to flourish in the era of globalization too. Though it is very easy to give advice to family businesses on how to overcome challenges and become global players, but the road is not so easy. Collective effort is required on the part of all family members.

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