

FAMILY MANAGEMENT, CORPORATE GOVERNANCE & SUCCESSION PLANNING

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INTRODUCTION

The family firms still dominate business life around the globe, and they are especially important in the emerging markets of Asia and Latin America. Germany, Japan and the US were quick to adopt the corporate form of organisation as they industrialized in the late 19th and early 20th centuries, and today their economies are hosts to giant, professionally managed corporations like Siemens, Toyota, Ford, and Motorola.

INTRODUCTION

Indian firms, by and large, continue to be family-run. And that, too, by the Bania families of the traditional trading castes. It is predominantly the Aggarwals and Guptas in the North, the Chettiars in the South, the Parsees, Gujarati Jains and Banias, Muslim Khojas and Memons in the West, and Marwaris in the East, and, in fact, across the country. Of these, the Marwaris have been the most successful. Fifteen out of the twenty largest industrial houses in 1997 derived from the Vaishya or Bania trading castes. Eight of them were Marwaris. Of the 128 merchant Marwari sub-castes in Rajasthan, only five became big and prominent in national commerce. These were the Maheshwaris, Oswals, Aggarwals, Porwals and Khandelwals.

INTRODUCTION

India has also seen some very influential families in business. These families have made a lot of difference in the business and industrial culture of the country. These families have existed for over hundred years and have influenced the economic and political situation of the country. The big old business houses in India include Tatas, Birlas, Bajaj, Reliance, Mahindras and Wadias. J.R.D. Tata was group chairman in 1939, Ratan Tata, his nephew, heads it today. G.D.Birla's great-grandson, Kumar Mangalam, presides over India's sixth biggest business group. Anand Mahindra and Rahul Bajaj are expanding on the base inherited from their grandfathers.

What is a Family Business ?

A Family business is one that is owned and managed (that is controlled) by one or more family members.

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.”



DISTINCTIVE FEATURES OF FAMILY BUSINESS

- ❖ Owners define the value of the company.
- ❖ Relationships in a family business built on trust between owners and managers and between owners and the Board of Directors..
- ❖ Often, family members' interest has a priority over the core business objective, that is, “maximizing the value of the firm.”
- ❖ A person born in the family gets an automatic membership of the business and legality is not affected by the minority ownership of the member.
- ❖ Entrenchment of management is more common in family business.

LIMITATIONS OF A FAMILY BUSINESS

- ❖ Over dependence on the owner-founder and other family members
- ❖ Lack of a qualified successor within the family
- ❖ Lack of management talent in the family
- ❖ Family infighting
- ❖ Unlimited moral liability /Accountability of the family

WEAKNESSES OF A FAMILY BUSINESS

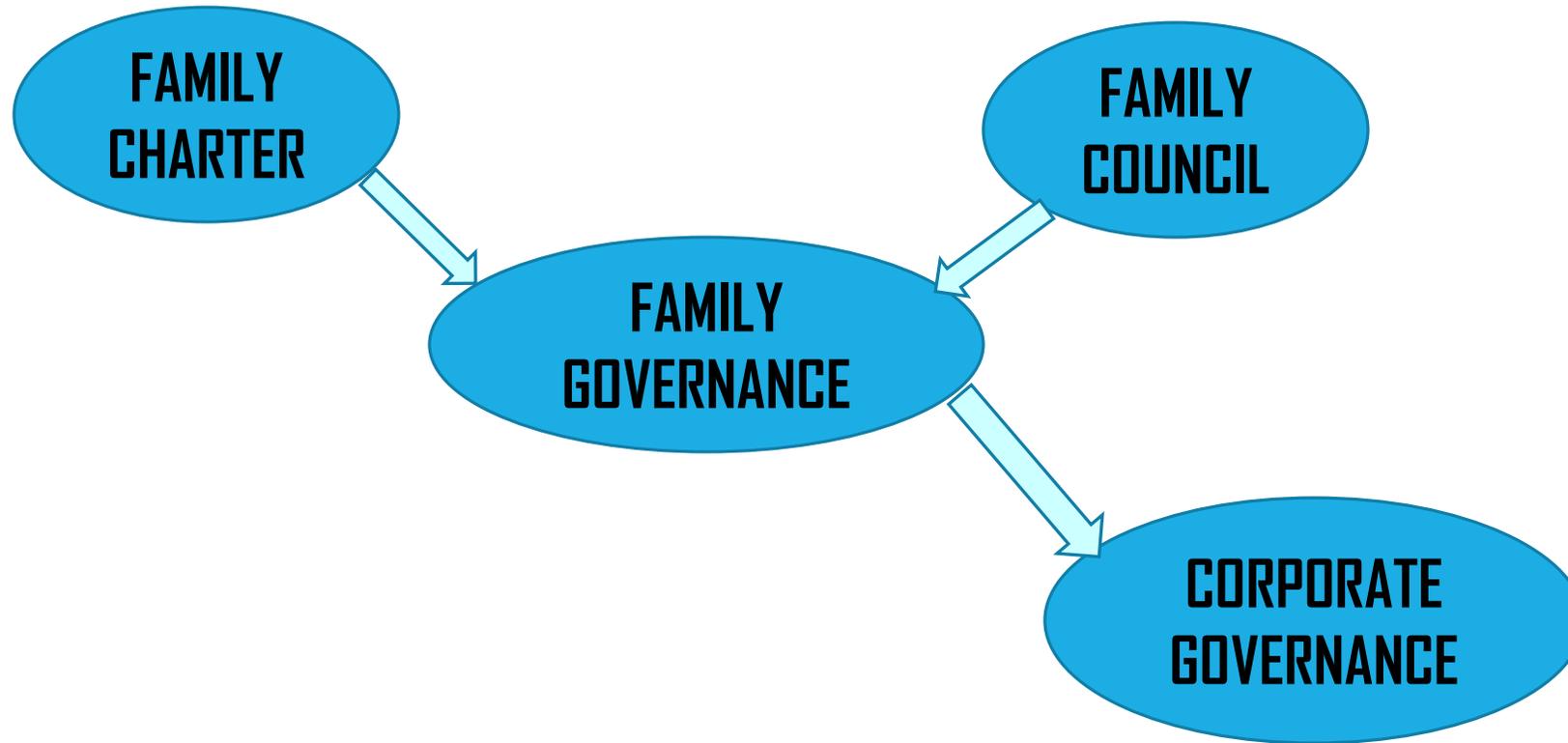
- ❖ Lack of motivation for professional managers
- ❖ Lack of liquidity
- ❖ Professional management is subservient to family's interest
- ❖ Quality of family governance determines the corporate governance
- ❖ Lack of clarity on ownership and the financial position of non-listed family-controlled holding companies are material credit weaknesses.
- ❖ Absence of succession plan
- ❖ Induction of younger members without consideration of competence

FAMILY BUSINESS CONFLICTS

- ❖ Emotional Concerns versus Business Performance
- ❖ Family Needs versus Business Demands
- ❖ Desire for Stability versus Change
- ❖ Justice Conflict
- ❖ Work-Family Conflict
- ❖ Role Conflict
- ❖ Identity Conflict
- ❖ Succession Conflict

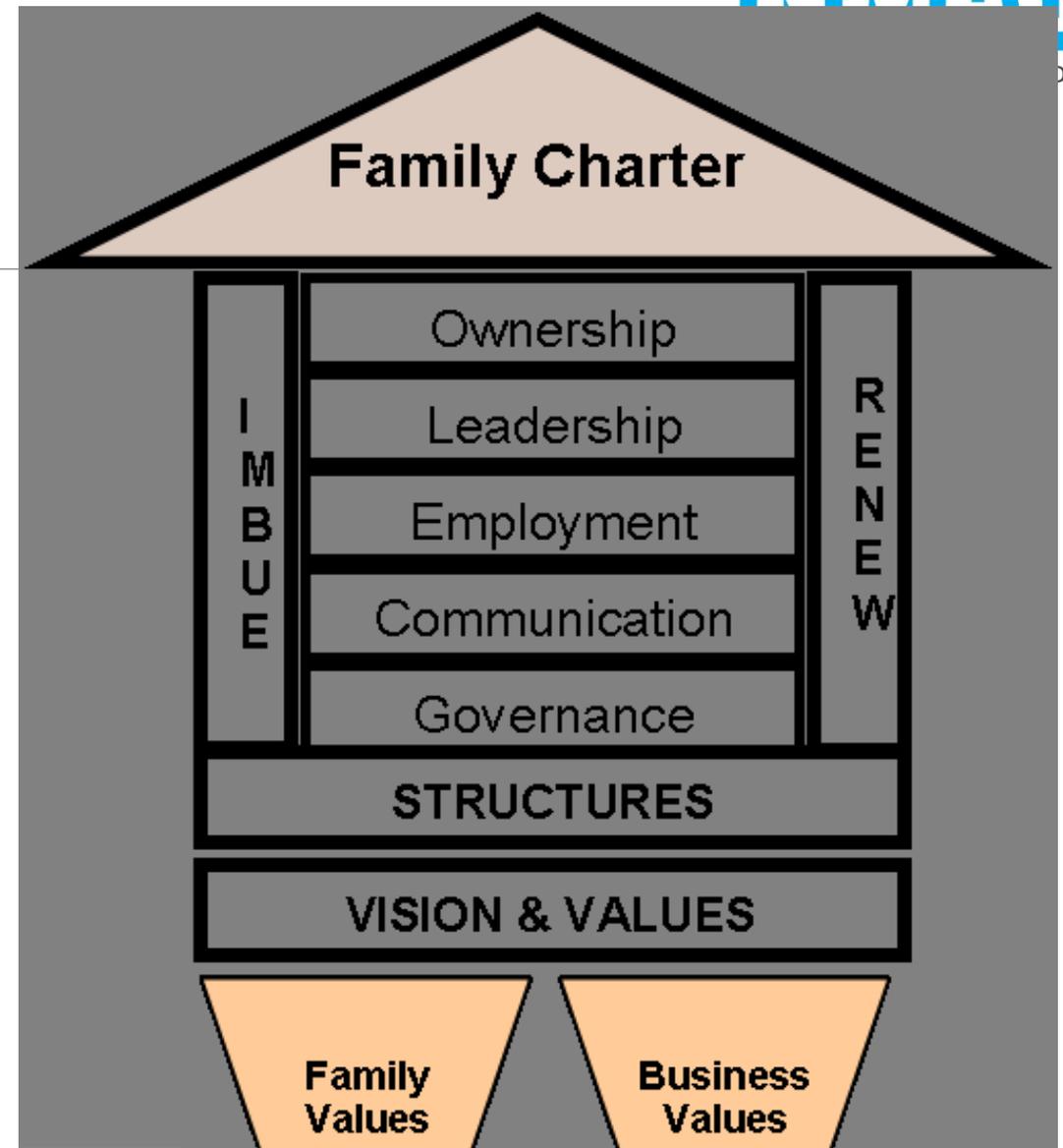


CORPORATE GOVERNANCE IN FAMILY BUSINESS



FAMILY CHARTER

- ❖ It is used as constitution of the family
- ❖ It describes family values and beliefs
- ❖ It documents a code of conduct for family members
- ❖ A documented code of conduct helps to keep the strong bondage among the family members and to articulate the role of each family member.



*IMBUE = Inspire

FAMILY COUNCIL

- ❖ Usually all adult members of the family are members of the Council.
- ❖ It may have two tier structure.
- ❖ It meets 2 to 4 times a year to discuss various family issues including business issues.
- ❖ It is a forum to settle family issues.

KEY SUCCESS FACTORS OF FAMILY BUSINESS

- ❖ Family members are likely to share the same ethos and beliefs on how things should be done. This will give them an extra sense of purpose and pride – and their business a competitive edge.
- ❖ Commitment to family values and beliefs
- ❖ Emotional attachment to business.
- ❖ Key people are related to one another.

FACTORS ENSURING SUCCESS OF FAMILY BUSINESS

- ❖ Family Leader commanding respect and acceptability.
- ❖ Family's reputation inspires investors to invest in the business.
- ❖ The brand-building exercise is important in family businesses.
- ❖ Documenting the experiences of the family at every stage would also help to provide future generations a good record of what has been done so far.
- ❖ Chalking out clear succession plans well in advance and making them known to the family members and shareholders, helps avoid uncertainty and disappointment.

(CONTD.)

FACTORS ENSURING SUCCESS OF FAMILY BUSINESS (CONTD.)

- ❖ Building a sense of family pride would greatly help to sustain family businesses.
- ❖ Professional management: Only competent family members are inducted in the business.
- ❖ Regular family meetings must be held, and the families should not get together only at social functions/ occasions.
- ❖ Regular Skill Upgradation Programmes for Family Managers for which there should be appropriate allocation from the Budget.

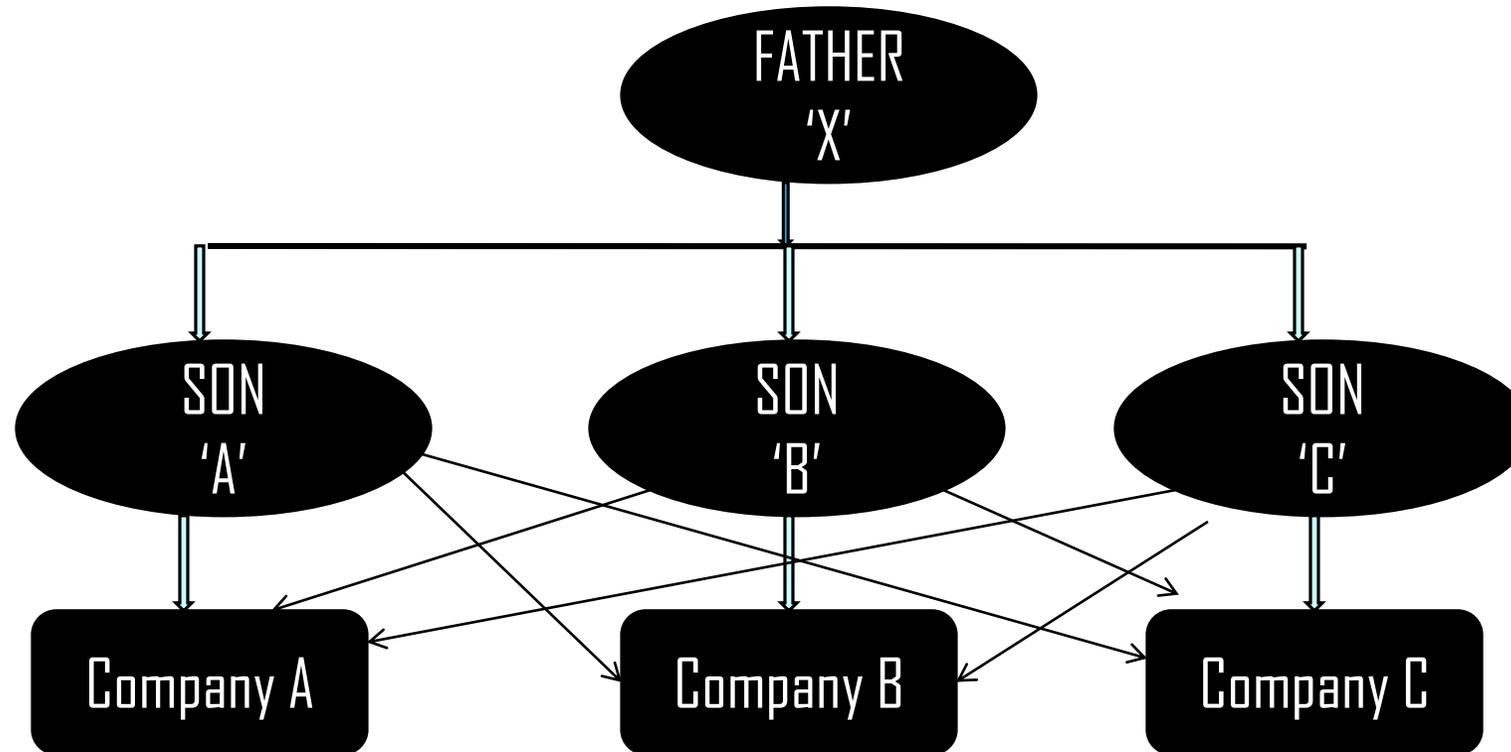
(CONTD.)

FACTORS ENSURING SUCCESS OF FAMILY BUSINESS (CONTD.)

- ❖ MIS report should be prepared on at least quarterly basis for distribution among the family members. The report should be represented in such a manner that it conveys the detailed functioning of the business.
- ❖ Ensuring that there is smooth communication between various generations of family members, and between the family's men and women.
- ❖ The business interest and the family interest must not be dependent on one another. Business Interest should remain unified even in the absence of a common family interest.

MAJOR ISSUES TO BE TAKEN CARE OF....

❖ Cross-Holdings in family entities



MAJOR ISSUES TO BE TAKEN CARE OF....

Distribution of Assets and Allocation of Surplus

- There should be normally no distribution of Business Assets among family members during the continuance of Business
- In case , withdrawal of one's own share is permitted, it should be allowed to a limited extent
- Business Assets should not be utilized for the social purpose of the family

Allocation of Duties & Responsibilities

- This decision should be taken carefully keeping in mind the interest of the business without any favouritism on following criteria:
- Education
- Capability
- Interest
- Experience
- Family interest

FAMILY BUSINESS MODELS

Family First

- Business decisions favour equality and unity as fair
- Differences in contribution aren't recognized
- A happy, united family is good for the business

Business First

- Business decisions based on what's best for the company
- Professional principles for compensation, promotion and recruitment are seen as fair
- Principles are followed even if it leads to unequal treatment of family members

CHECKS AND BALANCES IN INDIAN CORPORATE ENVIRONMENT

In case of Family Business, presence and effectiveness of appropriate checks and balances are important considerations:

- Clear fiduciary obligations to minority shareholders
- Board of Directors with a majority of truly independent directors prepared to challenge the family, if necessary
- Culture of shareholders activism, with a supporting financial environment, able to shake up poorly performing companies
- Regulatory framework

Clause 49 – Applicable to Listed Companies

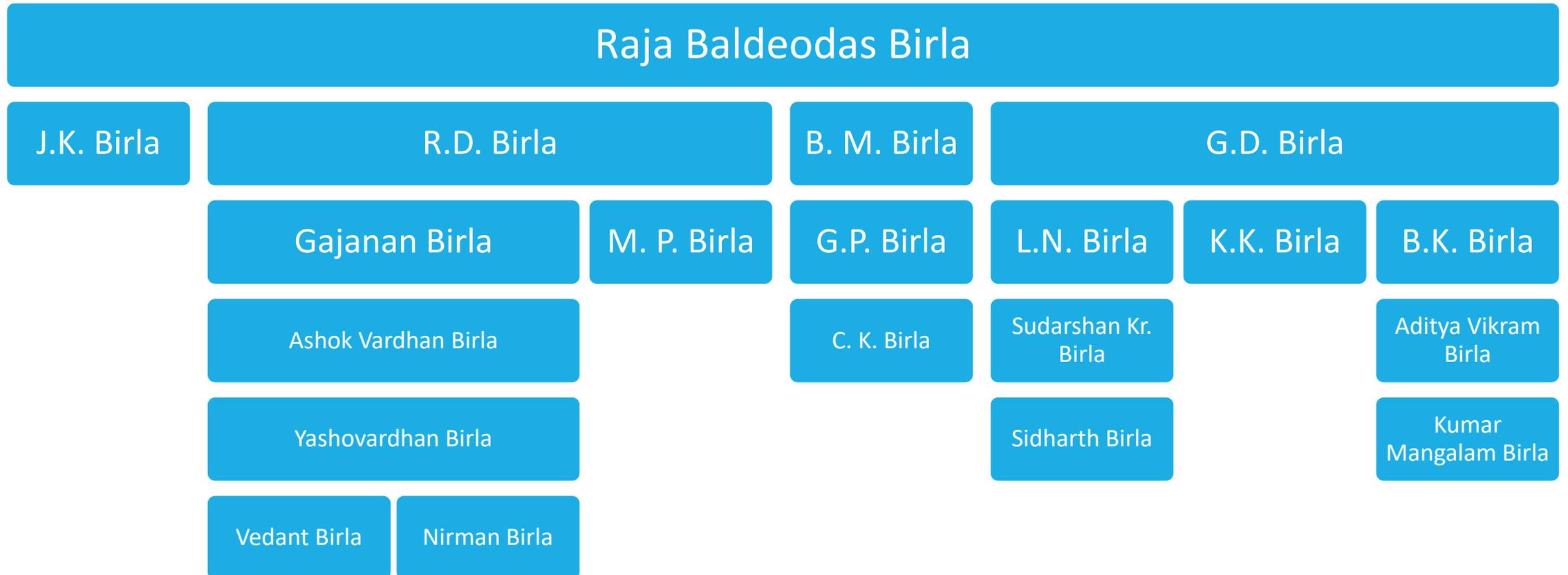
- **Board Composition**
 - At least 1/2 the Board should consist of non-executive directors
 - If the chairman is an executive director, at least 1/2 the board should be independent directors (otherwise 1/3)
 - At least 4 board meetings per annum
 - Specified information to be presented to the Board
- **Audit Committee**
 - Qualified and independent audit committee
 - At least 2/3 members & Chairman – Independent Directors
 - At least 4 meetings per annum
 - Role of the Audit Committee comprehensively defined

THE BENEFITS OF CONSIDERING FAMILY ADVISORY BOARD

- ❖ High powered talent and expertise not available in house
- ❖ Information based, objective evaluation of needs, talents and opportunities
- ❖ Assistance with tough decisions about business and family
- ❖ Strengthening of business planning process
- ❖ Objective problem solving
- ❖ Guidance for enhanced, innovative strategy
- ❖ Objective assessment of family members and key non-family personnel performance
- ❖ Helps keep the family focused and define boundaries between family and business.

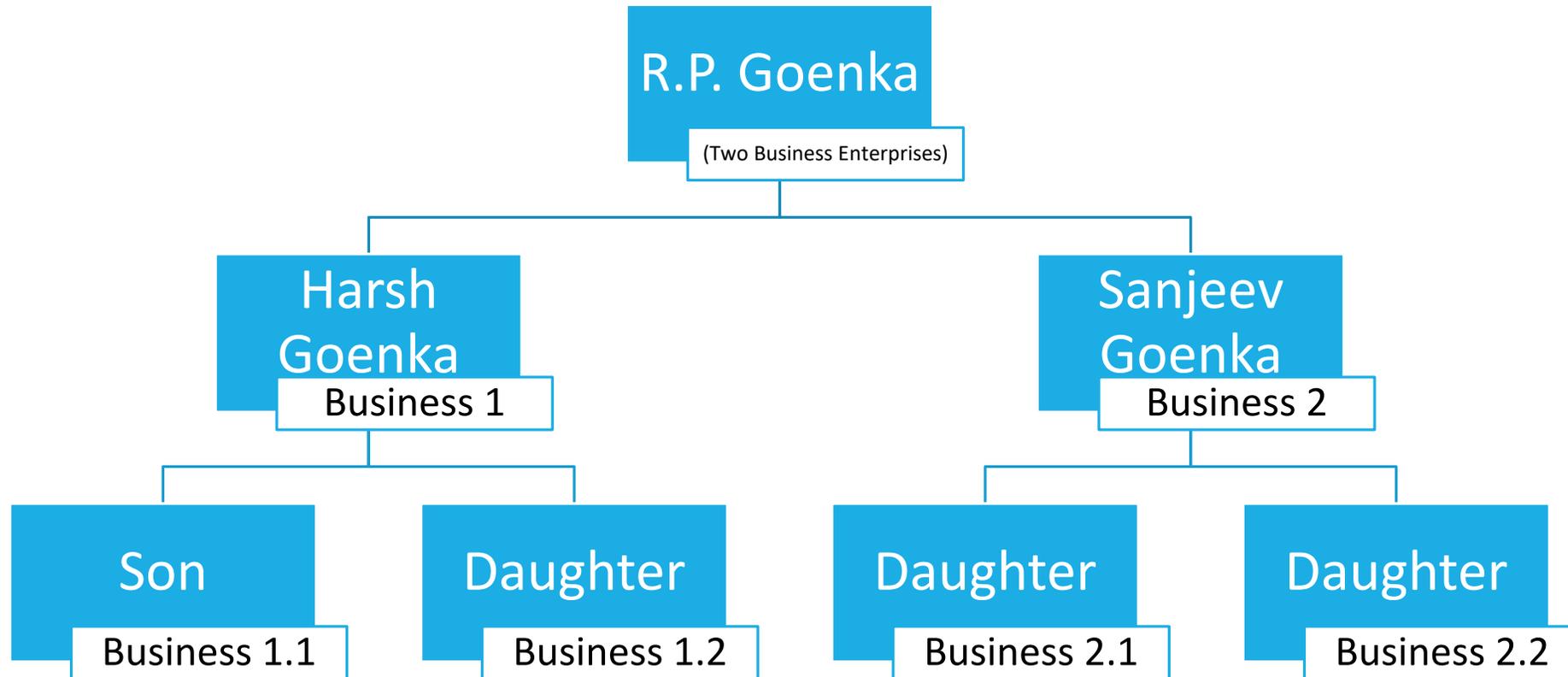
SUCCESSION PLAN

❖ BIRLA GROUP : Grand Father – Grand Son Model



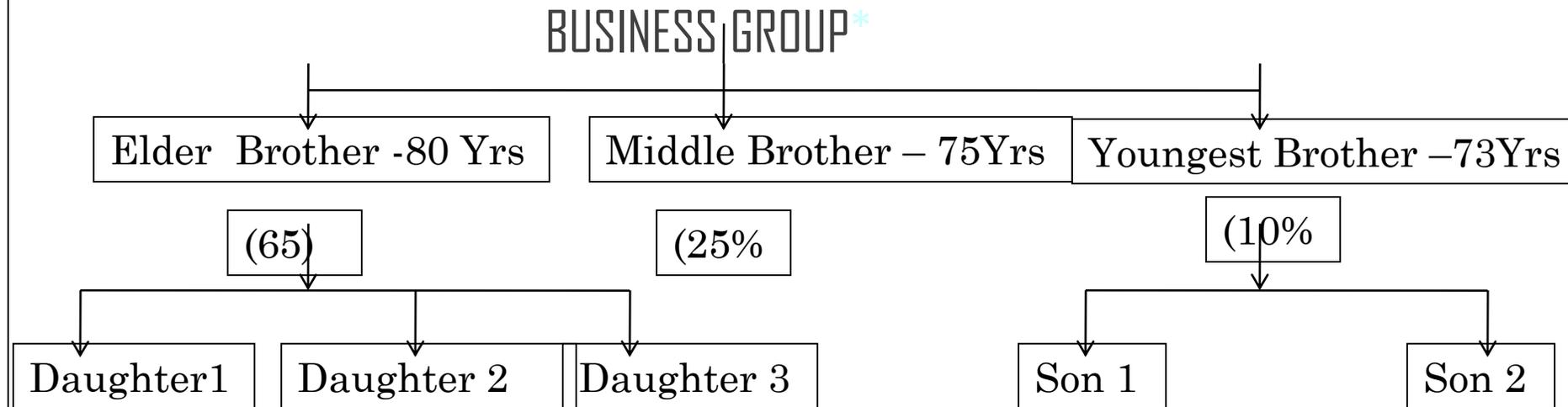
SUCCESSION PLAN

❖ R P GOENKA GROUP : Goenkas Model



SUCCESSION PLAN

CASE STUDY



* The Business Group has:

- Rs. 5000 Crs Turnover
- Rs. 100 Crs Profit
- 10,000 Employees

SUCCESSION PLAN

CASE STUDY:

Two Sons of the Youngest Brother were given 3 following opportunities for investment:

1. Rs. 10 Crores: Loss
2. Rs. 25 Crores: Loss
3. Rs. 40-50 Crores: Loss

Q. How the Succession Plan should be framed so that the Business Group should not suffer?

Contd...

SUCCESSION PLAN

SOLUTIONS:

Alternative I: Segregation Between Ownership & Management

Alternative II: Creating a Trust and transferring the Business to the trust . Thereafter, appointing the professional, unbiased and capable trustee to manage the business on behalf of the beneficiary children of three brothers.

Alternative III: Corporate Culture

- Daughters can also be in Board
- Shareholding to decide Board Seats
- Independent Professional Board

Alternative IV: Offload the Business (Unleash Value)

HINDU SUCCESSION ACT

General rules of succession in the case of males:

- ❖ The property of a male Hindu dying intestate shall devolve according to the provisions of this Chapter-
 - a) firstly, upon the heirs, being the relatives specified in class I of the Schedule;
 - b) secondly, if there is no heir of class I, then upon the heirs, being the relatives specified in class II of the Schedule;
 - c) thirdly, if there is no heir of any of the two classes, then upon the agnates of the deceased; and
 - d) lastly, if there is no agnate, then upon the cognates of the deceased.

HINDU SUCCESSION ACT

Distribution of property among heirs in class I of the Schedule:

- ❖ The property of an intestate shall be divided among the heirs in class I of the Schedule in accordance with the following rules:
 - ❖ **Rule 1**-The intestate's widow, or if there are more widows than one, all the widows together, shall take one share.
 - ❖ **Rule 2**-The surviving sons and daughters and the mother of the intestate shall each take one share.
 - ❖ **Rule 3**-The heirs in the branch of each pre-deceased son or each pre-deceased daughter of the intestate shall take between them one share.
 - ❖ **Rule 4**-The distribution of the share referred to in Rule 3-
 - ❖ (i) among the heirs in the branch of the pre-deceased son shall be so made that his widow (or widows together) and the surviving sons and daughters get equal portions; and the branch of his predeceased sons gets the same portion;
 - ❖ (ii) among the heirs in the branch of the pre-deceased daughter shall be so made that the surviving sons and daughters get equal portions.

HINDU SUCCESSION ACT

Distribution of property among heirs in class II of the Schedule:

- ❖ The property of an intestate shall be divided between the heirs specified
 - ❖ In the order in which each category is listed
 - ❖ in any one entry in class II of the Schedule so that they share equally.

HINDU SUCCESSION ACT - Definitions

❖ **CLASS I Heirs** are:-

- ❖ sons
- ❖ Daughters
- ❖ Widows
- ❖ Mothers
- ❖ son of a pre-deceased son
- ❖ daughter of a pre-deceased son
- ❖ son of a pre-deceased daughter
- ❖ daughter of a pre-deceased **daughter**
- ❖ Widow of a pre-deceased son
- ❖ Son of a, pre-deceased son of a predeceased son
- ❖ Daughter of a pre-deceased son of a predeceased son
- ❖ Widow of a pre-deceased son of a predeceased son.

Note:- If there is more than one widow, multiple surviving sons and daughters, or multiples of any of the other heirs listed above, each shall be granted one share of the deceased's property. Also if the widow of a pre-deceased son, the widow of a pre-deceased son of a pre-deceased son or the widow of a brother has remarried, she is not entitled to receive the inheritance.

HINDU SUCCESSION ACT - Definitions

- ❖ **CLASS II Heirs are:-** Class II heirs are categorized as follows and are given the property of the deceased in the following order:
 - ❖ Father
 - ❖ Son's daughter's son
 - ❖ Son's daughter's daughter
 - ❖ Brother
 - ❖ Sister
 - ❖ Daughter's son's son,
 - ❖ Daughter's son's daughter,
 - ❖ Daughter's daughter's son,
 - ❖ Daughter's daughter's daughter.
 - ❖ Brother's son,
 - ❖ Sister's son,
 - ❖ Brother's daughter

HINDU SUCCESSION ACT - Definitions

- ❖ **"Agnate"- one person is said to be an "agnate" of another if the two are related by blood or adoption wholly through males.**
- ❖ **"Cognate"- one person is said to be a cognate of another if the two are related by blood or adoption but not wholly through males**

HINDU SUCCESSION ACT

General rules of succession in the case of female Hindus:

- ❖ (1) The property of a female Hindu dying intestate shall devolve according to the rules set out in section 16 :
 - ❖ (a) firstly, upon the sons and daughters (including the children of any pre-deceased son or daughter) and the husband;
 - ❖ (b) secondly, upon the heirs of the husband;
 - ❖ (c) thirdly, upon the mother and father;
 - ❖ (d) fourthly, upon the heirs of the father; and
 - ❖ (e) lastly, upon the heirs of the mother.

HINDU SUCCESSION ACT

General rules of succession in the case of female Hindus:

- ❖ (2) Notwithstanding anything contained in sub-section (1)-
 - ❖ (a) any property inherited by a female Hindu from her father or mother shall devolve, in the absence of any son or daughter of the deceased (including the children of any pre-deceased son or daughter) not upon the other heirs referred to in sub-section (1) in the order specified therein, but upon the heirs of the father; and
 - ❖ (b) any property inherited by a female Hindu from her husband or from her father-in-law shall devolve, in the absence of any son or daughter of the deceased (including the children of any pre-deceased son or daughter) not upon the other heirs referred to in sub-section (1) in the order specified therein, but upon the heirs of the husband.

HINDU SUCCESSION ACT

The Hindu Succession (Amendment) Act, 2005 is to remove gender discriminatory provisions in the Hindu Succession Act, 1956 and gives the following rights to daughters:

- ❖ The daughter of a coparcener shall by birth become a coparcener in her own right in the same manner as the son;
- ❖ The daughter has the same rights in the coparcenary property as she would have had if she had been a son;
- ❖ The daughter shall be subject to the same liability in the said coparcenary property as that of a son;
- ❖ The daughter is allotted the same share as is allotted to a son;
- ❖ The share of the pre-deceased son or a pre-deceased daughter shall be allotted to the surviving child of such pre-deceased son or of such pre-deceased daughter;

HINDU SUCCESSION ACT

After 20th December 2004

- ❖ Female Property part of HUF (Joint Hindu Family)
- ❖ Held by her
- ❖ As a Co – Parcener
- ❖ Capable of being disposed of by testamentary disposition

HINDU SUCCESSION ACT

HUF Property – Succession – MITAKSHARA LAW

- ❖ Where a Hindu dies
- ❖ After 20th December , 2004
- ❖ Interest in Joint Hindu Family Property shall devolve
- ❖ By testamentary or
- ❖ Intestate succession
- ❖ Not by survivorship
- ❖ As if the full partition has taken place immediately before death and
- ❖ Daughter is allotted same share as to a son
- ❖ Shares of predeceased son or predeceased daughter allotted to surviving son and daughter of such predeceased : and so on

ROLE OF CHARTERED ACCOUNTANTS, ADVOCATES & ADVISORS

- ❖ Impressing on Family Members, that in law there is little difference between a ‘public’ and ‘private’ company so far as compliance with operating Tax laws & economic laws is required including Labour Laws, Licensing and environmental laws.
- ❖ Be business consultants and advise members of the family on expansion projects and new avenues of business.
- ❖ Guiding the family members on importance of “Internal Controls” and transparency.
- ❖ Advise them on ‘business restructuring’ keeping in view that each member of the family has an independent area of operation to avoid clash of egos.
- ❖ Advise the patriarch or elders in the family on the importance of a ‘succession plan’.
- ❖ Assist in the creation of family councils / family foundations.

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