

FAMILY BUSINESS



MODULE 5

Meaning and definition



- Family business and small business are not the same. May large corporates are family owned like Tata, Godrej, TVS, Vardhaman etc
- They are businesses that are owned, controlled and managed by one or more family members.
- Family firms are organisations where 2 or more extended family members influence the direction of the business through the exercise of kinship ties, management roles or ownership rights and/or the owner intends to pass on to a family heir.



Structural definitions:

- Focuses on the firms ownership or management arrangements eg: 51% ownership by family members

Process definitions:

- Focuses on how the family is involved in the business – its influence on company policy, desire to perpetuate family control of the business etc.
- (see page 289 Poornima's book)

Reasons to create formal history



- Founders vision and mission
- Historical accuracy
- Honouring long time employees
- Thanking customers and vendors
- Background for the uninformed.

Benefits of creating history



- Accurate history recording
- Acknowledging contributions of different people
- Contribution of the firm to the society
- Succeeding family members can refer back to the and heritage and feel motivated
- Documenting companies contribution to the society boost the confidence of suppliers, vendors, bankers, employees, investors
- Strengthen ties within family members
- Improves company image and PR
- Portions of history in brochures videos etc can serve as advertisements

Characteristics of family business



- Legacy: it creates a legacy which brings in a sense of pride and accomplishment. Building on strengthening the legacy is a strong motivator to the new generation
- Key employees: key non-family employees cherish the unique working environment created by family business. Workplace tends to be less formal, hierarchical and more personal.
- Patience: family businesses tend to be more long-term driven than by short term results/goals. They deploy 'patient capital'

Characteristics of family business



- **Values:** family businesses tend to pass on their beliefs and values to the next generation. They uphold these values and the work culture would reflect it.
- **Relationships:** many employees are treated as extended family members and a strong bond develops.
- **Sucession:** they favour passing the business to next generation which can be motivating as well as rewarding.

Types of family business



Basically 3 types:

- Family-owned business: a for-profit business where controlling number of voting shares are owned by members of a single extended family or owned by member but influenced by other members of the family.
- Family owned and managed business: same as above in terms of ownership but controlling interest permits family members to decide on objectives, policies, strategies etc. this business has the active participation of the family member in the top management and the family has ultimate management control.

Types of family business



- Family owned and led business: same as above, the family member is in the board and is in a position to lead the company in terms of direction, culture, and strategies.

Importance of family business



- Contributing to economic development: play a crucial role in the economic development of any country. Large scale retail and service sectors are generally owned by family businesses. (see page 287)
- Spirit of entrepreneurship: they contribute to various families initiating and coming up with new ventures
- Trust lowers transaction cost: partnership within the family helps sort out conflicts amicably within the family itself with an interest in safeguarding family business. Outside partnerships often end up in problems

Importance of family business



- Quick decision-making: as size of the managing group is small decisions are quicker and timely
- Information as source of advantage: information strategies about the business remains a secret to the family and they need not be revealed to anyone outside the family
- Community and philanthropy: most family businesses are very active in their community support the community with financial support employment opportunities. They help community with philanthropy.

Importance of family business



- Financial rewards: family businesses tend to reward both family and non-family members with better rewards than what they could get elsewhere.
- Labour pool: they have access to labour pool of family members who are more loyal and committed to the business. They are also more flexible in performing on different functions and filling-in for others.

Responsibilities of shareholders



Legal responsibilities by virtue of being shareholder

- 1. Elect directors of the company's board annually
- 2. Appoint auditors of the company annually
- 3. Change corporate by-laws when needed, though infrequently

Non-legal responsibilities:

- 1. Monitor business performance and be knowledgeable about company operations.
- 2. Monitor financial performance and be knowledgeable about income statement, balance sheet etc

Responsibilities of shareholders



- 3. Attend shareholders' meeting and other important functions to indicate family's support to business
- 4. Ask questions to management in appropriate forums and make suggestions without interfering with their work
- 5. Understand board member qualifications and participate in screening of board members
- 6. Check whether shareholders feel they are properly represented in the board
- 7. Be a positive ambassador of the company by publicly talking and supporting it.

Responsibilities of shareholders



- 8. Keep company info in strict confidence and recognise that shareholders are not entitled to information on demand
- 9. Ask for only affordable and reasonable remuneration from the company and for responsible employment and other opportunities for family members.
- 10. Generate business leads and provide additional investment capital
- 11. Develop spouses and children to be responsible towards the business.

Rights of shareholders from managers/b



- 1. Timely information on company goals , strategic important org changes and basic financial status
- 2. Openness by the managers/board to shareholder views on the above in appropriate settings like shareholders meetings
- 3. Ability to participate in election of board members, appointment of auditors, and development of by-laws
- 4. Develop fair policies that protect shareholders interests
- 5. Acceptable economic performance by the company including reasonable dividends and capital gains

Succession in Family Business



- Decision concerning the future operation and management of the business is called succession planning.
- Many family businesses go out of business after a decade. 30% survive into 2nd generation and only 16% to the 3rd generation
- Life expectancy of a family business is years

Barriers in succession planning



- Hurdle in succession planning is usually the founder himself, he hangs on. Attempts to succeed is seen as a greedy move to swallow the business.
- Sibling rivalry
- Family members' fear of losing status
- Aversion to death, fear of loss or abandonment

Those who do not make succession planning leave behind an unnecessary burden on those who are left behind

Key factors in succession



- Pressures and interests inside the firm:

1. Family members:

- Pressure to get, control business
- Pressure to select family members as managers
- Pressure to nominate heir
- Pressure to build a dynasty
- rivalry among various members of the family.

2. Non-family members:

- Rewards for loyalty
- Sharing of equity growth and success
- Professionalism
- Bridging family transition

Key factors in succession



- Pressures and interests outside the firm:
 1. Family members:
 - Income and inheritance
 - Family conflicts and alliances
 - Degree of involvement in the business.
 2. Non-family members:
 - Competition
 - Market, product, supply and technology influence
 - Tax laws
 - Regulatory agencies

Developing a succession strategy



- It involves several important steps:
 1. Understanding contextual aspects like
 - time- earlier start, the better, need time
 - type of venture
 - capabilities of managers
 - entrepreneur's vision
 - environmental factors
 2. Identifying successor qualities
 3. Written succession strategy

Pitfalls/challenges of family business



- Conflicting goals/values
- Conflicting personalities
- Expectations
- Work ethics
- Employment of family members
- Compensations
- Reluctance to plan
- Element of time (tough to manage family com as time passes)

Strategies to improve capability of fam



- Need of professionalism
- Joint family
- Replenishing entrepreneurship
- Good management
- Ability to change
- Strategic plan
- Active board of directors- will help assess 4 key foundations for business health. CEO's reading succession, critical family relations, ownership structures, management structures

Role of board



- Board must simulate, provoke challenge and support leaders
- Typical CEO of fam buss holds the post for a long time like 20 yrs
- Not many are brilliant enough to hold it that long leadership is a big problem in fam buss
- Advisors must focus on the company's macro long term issues
- Advisory board must have outsiders like 4:3
- Friends, former employees, paid advisors/accountants must not be on the board
- Hold frequent off-site family meetings and have mechanisms to resolve conflicts

Improving family business performance



Certain core business values are responsible for good/bad performance of family businesses.

Dysfunctional critical **core business values** impacting family businesses adversely are:

- Training: formal training, additional training, and working fob for sometime overlooked.
- Future outlook: concern for future and necessity to change seriously lacking.
- Accountability: performance criteria and evaluation and de with non-performers lacking.
- Finances: chronically cash poor because of overdrawing and Vulnerable to business downturns
- Addressing the issue: structured approach to evaluate core like training, future, accountability, finances, decision-making process, internal communications, method of conflict resolution compensation, operating procedures.