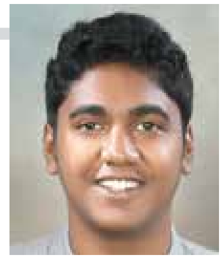
Family Business Code (FBC) for Listed and Unlisted Family Businesses in India

While family businesses are a key part of any nation's industrial system, evidence shows very few survive across generations. Only way companies can sustain and grow across generations happens when they adopt good governance practices covering both family and their business areas. In this paper, we present a governance code for family-owned businesses, both listed and unlisted.

Dr. TR Madan Mohan
Managing Partner, Browne and Mohan
Bengaluru
mmohan@browneandmohan.com

Ms. Sharadha V
Junior Consultants, Browne and Mohan
Bengaluru
vsharadha@browneandmohan.com



Mr. Mukund Mohan K
Junior Consultants, Browne and Mohan
Bengaluru
mukundk@browneandmohan.com

INTRODUCTION

India has a rich business history with a significant number of businesses still being controlled and managed by families (Chahal and Sharma, 2020). Family Business in India contributes to over 70 percent of its GDP. An article on the Hindu business line quoted the Credit Suisse 2018 report stating that India has the third-largest number of family-run businesses in the world after the US and China with 111 publicly listed family-owned businesses with a combined market capitalization of $839 billion. Besides this, as of 2017, it reports India to have 10.68 lakh active unlisted private limited companies and 66,063 unlisted public limited companies. However, CII observed that only 13 percent of the Family businesses survive till the 3rd generation and only 4 percent go past the third. Without agreed-upon operating norms, families have less direction when conflicts arise (Sinha and Govindaraj, 2020). The family members embrace several roles, with thin lines between executive and governance facets. This sometime can lead to conflict and jeopardize the sustainability of the business. Interlocking directorships, intermediate relationships and tacit dependencies which are quite common among family business may affect quality of governance. Good corporate governance of both family and their business are key to survival, growth and sustenance.

Germany, Switzerland, Italy, Belgium, GCC block and many other countries have a governance code for family-owned businesses (AIDAF, 2017, Buysse, 2009, Continuum and Prager Dreifuss 2008, Cuomo, et al. 2016, FBCG 2016, FBNed 2003, FRC 2018, Rinvest Institute, 2015). The code is a list of mechanisms and rules (or expectations) to which everyone adheres to in a family business. A family business code covers the governance mechanisms for family, interfaces with corporate governance at the business level, professionalization, limits on insiders, remuneration for family and family members, succession and social responsibilities. Family business code assists family-owned businesses to adopt a holistic approach to balance family and business interests and successfully preserve the business for generations to come. India does not have a governance code or a national guidance specifically for family-owned businesses.

India's culture, traditions entwined in community practices and values instilled within family businesses make the governance complex and unique. It is not uncommon to see family board restricted to first-born or male progenies only. Such restrictive practices are leading to family disputes between the siblings or between successive generations. Protracted litigations are likely to affect the performance of the business units the family owns.

Family business owners and their board recognize they need a list of mechanisms and rules (or expectations) to which everyone adheres to in a family business. What they need is a code that is cognizant of the size and development of both family and business and effective enough to meet the evolving business context. They desire to have a family business code that covers the governance mechanisms for family, interfaces with corporate governance at the business level, professionalization, limits on insiders, remuneration for family and family members, succession and social responsibilities. Their interest in investing and adhering to a family business code is to adopt a holistic approach to balance family and business interests and successfully preserve the business for generations to come. Family business owners and the boards lack a touchstone for common decision-making to build profitable and sustainable businesses, define boundaries and

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rules for family and business interactions, and mechanism to preserve long-term ownership of the businesses. Lack of a standardized family business code is also limiting GRC professionals in their assessments of a family business and identifying what areas need improvements. Towards filling this gap, we have attempted to a family business code for Indian family-owned businesses.

METHOD

We first analysed family business code of Germany, Switzerland, Italy, Belgium and GCC countries, and listed common measures. We then conducted a questionnaire survey reaching out to members of ICAI, ICSI, family business owners, academicians, legal professionals across India. Wherever possible we also conducted telephonic interview to get feedback on the measures and their applications to Indian business environment.

FAMILY BUSINESS CODE DIMENSIONS

Based on telephonic interviews and questionnaire data, 12 dimensions emerged as family business code measures for Indian family businesses.

Family business goals refer to the family unwritten and written objectives of doing business and include vision, core values and practices that are embedded in governance and policies of its business including successions plans, way of carrying on day-to-day activities of the business, business ethics, loyalty, employee welfare and social relevance.

Family governance structures refer to dispute resolution mechanisms and family business council (FBC) or cousin consortia (CC) or other forms, both informal and formal, that family business used to manage their business and family interests. Governance structures bring in professionalism to a family business. This includes family board (size 5-8 members), tenure and rotation of family members, equal representation amongst all family branches or otherwise, women representation on FBC, Succession rights of wife and daughters to FBC, FBC composition of family and non-family, non-family and nominated members (with and without voting rights), and family board activism (collective process and access to information and decision-making).

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Family governance processes includes number of board representation amongst different siblings, voting rights, nominations, decision rights, meeting rules, accountability of FBC, removal of members from FBC, decision-making, intra-family buying & white knight limitations, if any (restricting one family to buy shares of one family tree and vest complete control) and financial reporting and proprietary audits (both internal and external), Compliance and technological changes and advancements to be overlooked by one member each for the entire business.

Conflict and dispute resolution include conflict resolution mechanisms that sets means and processes for resolving conflicts amongst family members and the businesses owned by the family. This may include advisory and dictatorial roles, formal and informal dispute resolution mechanisms within FBC and amongst family members, internal member's mediation mechanisms, third party professional involvement, and options on when to litigate. The Family council or the family business board (cousin's consortia) can create or nominate an individual or a group of family members to address the conflicts. Family business board can also refer to external arbitrators or trusted advisors to provide an objective or neutral suggestion. Finally, in case the recommendations are unaccepted, the family business board must have provisions for legal recourses.

Family ownership control refers to the legal structures and mechanisms that are adopted to protect the business and family from opportunism and guile. This includes separation of the CEO and chairperson role for the business units, choose or select to positions for business units owned by family, rotation or stability amongst family members on FBC, inheritance of shares of companies whenever a separation or marriages affects the business, issuance of dual-class stocks to control family ownership and ward off any potential hostile takeover. This can cover distributions amongst owners, mediation options, and restrictions on transfer of shares because of divorce or death, buy-sell provisions, dissolution of companies, spousal consents, and automatic buy-out mechanisms to protect ownership interests among others.

Family Communications includes formal communications through FBC or respective business groups on business and other areas, code of conduct in formal meetings, communication protocols for sharing and receiving feedbacks through formal mechanisms only, communication codes

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for FBC or any of its members seeking information from a business unit, FBC Media policies among others.

Family rituals and preserving identity refer to the assets and allocations family businesses make to preserve their identity (cultural or religious grants and activities). Family Business builds and reinforces the culture to balance personalities and self-interests across generations using rituals, traditions and routines. Rituals such as all annual family meet, back to root celebrations, founder's oath ceremony, among others have a symbolic meaning to the family and show cultural, religious and ethnic practices of the family. Traditions and routines are choice-based events such as village fest or cultural meet or dinner meet to encourage informal getting together and discussions about the business and family. This will however, have to be financed by the Family Business Board through the royalties they earn or the interest from the corpus and not by the company.

Corporate governance of family business units include a number of family and independent directors on board, occupation and professional expertise of independents, advisory board composition (insiders vs professionals), women directors, separation of chair (FBC chairperson or nominee) and CEO (professional), formal audit, remuneration and risk committees, performance review of boards (inclusion of FBC or nominees or self-managed) and adoption of robust GRC tools to track and report ESG.

Family member assessment and assimilation includes formal structures and process through FBC or other informal mechanisms reporting to FBC to support each family member to see their fitment with business, periodic assessment of family members in business, remuneration benchmarks, family member replacement policies from business units, family member career management policies in non-business areas

Succession Management refers to who the next successor is, their method of appointment or election and induction, mode of succession on cases of adopted children, no children or heir, and step-children, Succession on emergency, marriage, pre-nuptial or divorce implications on the succession, Restrictions and Inclusion of gender, first-born bias, in-laws into business, Method of transfer of ownership, succession mechanisms (intrapreneurship, education, learn from shop-floor), involvement of insiders and non-family professionals in identification, grooming, evaluation and continual mentoring of successors, succession tenure, number of attempts and exit options.

Family wealth management includes creation of corpus, family office set-up, involvement of family in Family Office or professional managements, profit sharing or royalties to family trust, management of corpus, percentage to be reinvested into existing business, allocation areas and risk preferences, buy-backs, M&A, reporting and review of wealth growth.

Philanthropy and CSR include the family business commitment to social causes, focus areas for investment and continued support. Mechanisms to involve family members, options to create Section 8 or Section 25 Companies or foundations headed by family members and its relationship and governance by FBC, alignment of causes to vision and values, reporting and review of CSR.

APPLICATIONS OF THE FAMILY BUSINESS CODE

The proposed family business code addresses unique requirements of different constituents. For family business owners, the code works as a checklist to self-rate how many of these dimensions are in use, which have been considered, which have been considered but not implemented yet and which are in force and yielding results. This assessment serves as a starting point for their board to realize the best practices and the gaps. It would serve as a roadmap for the family business owners to invest and direct "governance structures, process and practices" required to support growth and expansions with requisite controls.

Family businesses and GRC consultants can use the family business code to assess the current stage of governance maturity and adopt a governance maturity model to drive improvements. External agencies like analysts, bankers and investors can use the code to evaluate an unlisted/ listed family business and create maturity models. **Stage 1** family businesses may have a weak alignment of company's vision mission and goals with limited governance structures and mechanisms to manage business and family interests. **At stage 2**, while business and family goals have broad governance structures, conflict resolution mechanisms may be weak. Business units have no formal structures to facilitate feedback and communication; there is an irregular performance evaluation and little support to family members on career management; they make succession plans with an emphasis on male heir & first-born restrictions along with irregular philanthropic duties.

At stage 3, the family business is more matured, it brings in professionalization of business with a clear definition of company goals, presence of governance structures like family council, Family Assembly, cousins consortia or other forms to manage business and family interests. Formal conflict resolution mechanism along with clear legal structures and mechanisms exist to protect the business and family. Family assembly or other structures are required to conduct and facilitate formal communication within respective business groups in business and other areas. Formal structures to assess family members in business, remuneration benchmarks and family member replacement policies from business units are available. Succession plans with gender bias but no restrictions on the first born. Family office and a formal Wealth Management committee exist.

At Stage 4 the family business governance is optimal, governance structures manage business and family interests including equal representation amongst all family branches or otherwise, women representation on FBC, Succession rights of wife and daughters. Conflict resolution with inclusion of internal and external mediators, well-defined legal structures and mechanisms to protect the business and family may be in force. Effective family communications are in place with code of conduct in formal meetings, communication protocols for sharing and receiving feedbacks through formal mechanisms. Mechanisms to reinforce the culture, balance personalities and self-interests across generations using rituals, traditions and routines among other forms shall exist. Succession planning and execution with focus on merit not on gender or firstborn shall be in force. Formal and clear public engagement, political donations and philanthropy policies are in force.

CONCLUSION

Family businesses are unique, leading towards differing requirements on the governance. The code proposed needs more empirical validation. However, the family business code suggested here serves as a tool for family businesses to evaluate where they are and what investments they require to stay profitable and survive across generations.

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