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Transforming a Family Business

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Family run businesses are a significant segment of any nation's industrial structure. In India 95% of business are family run, and 30% of BSE listed companies are family owned. Anecdotal data indicate just about 20% family businesses survive a first generation transfer and 95% of them become defunct within two decade of demise of founder. Companies changing hands can employ 2-3 million people in next five years and can account for 10-15% of the GDP. However, many entrepreneurial families do not have a clear demarcation between personal and business assets and have lost even their personal fortunes because of business liabilities. Unlike a corporation, family members and their extended relations may have different rights, expectations and responsibilities in the business. This sometime can lead to conflict and jeopardize the sustainability of the business.

Many family businesses suffer from:

1) limited use of capital budgeting, risk management and working capital management techniques and long term planning
2) no clear plan to sustain the profitability of their business
3) limited wealth management and long term investments portfolio,
4) lack of a corpus,
5) fraud and risk management, and
6) lack of succession planning and business continuity.

Family business can emerge stronger by on boarding professionals, adopting appropriate governance structures, productize services, create new services and organizations, and expand into newer offerings and markets. Family business transformation is complex and messy affair. Family businesses must not only untangle the tightly intertwined family from business, but also bring business focus into the family. Successful family business transformation requires thorough planning and diligent execution. Business transformation of family business can be achieved by pursuing the following.

<u>Identify core values and separate business from family</u>

The most critical step in transformation of the business is their legacy, history and values that define them. Pains, setbacks, rejection, betrayal, recoup and wins form the threads of history that define the richness and texture of each family business. These threads of history are powerful means to inspire and direct new generation owners and employees. While transforming a family business it is important to realise that its core values, culture and history are retained and cast into the present. Founder's struggles, the value systems, extra mile commitment and loyalty of non-family members, how minor crisis were handled, etc. form key ingredients of what the business stands for. A successful business transformation must start with revisiting these moments, retelling the stories to inspire and provide identity, and also bring non-committed resources to the change program. Corporate videos, cafeteria cut-outs, newsletter, CSR activities and awards can all be mediums to recap and reposition the values.

Family business can thrive when they can successfully demarcate "family" from business. Family business operational conflicts can be easily resolved when there is an understanding of roles and responsibilities. A good starting point is to align the family business relationship with business goals and detail a plan with a clear description of the roles, expectations and performance. Plan can be effective if the family chain of command is clear. Create a hierarchy of the roles and ownership. As far as possible define the command chain of command preserving the social order and the skills required for the function. Clear chain of command makes life easy for nonfamily members to navigate their activities and careers within the family business.

Clear chain of command makes life easy for clients too, they know whom to contact for what. Along with chain of command, to sustain a family business, transparent compensation rules must be set in. Use industry benchmarks for fixed and variable compensation of various family members involved in business. Family businesses must also devise methods and platforms for younger generation to express their needs and concerns. Senior family members must prepare themselves to patiently hear without judgement and consider fairly other opinions and concerns. Finally, family business leaders must clearly separate family time and business time. Mechanisms and process are required to prevent conflicts, thwart small problems mushrooming into major business and family drama.

The adage family that eats its meals together stays together is apt for success of family business too. Create rituals and process for multi-generational bonding. Invest in documenting and advocacy of the family culture that is built by the personalities and interests of each generation. Sustainable family businesses enshrine and celebrate their pride, security, and business continuity by preserving and extending the charisma of culture. The idea is similar to a Bricolage, allowing each generation to add and extend the enterprises and cash-in the relational assets built across generations. Some of them devised simple mechanisms for breakouts or cashing out by next generations and designed appropriate methods to preserve multigenerational legacy and continuity.

<u>Evaluate your current business model and operations across businesses</u>

Business transformation up starts with evaluation current revenue streams, how business is run, how it is managed and monitored. What are the various management styles amongst family members and the business units headed by them? How is the strategy setting, monitoring and review process? Is your sales organization efficiently managing acquisition of new accounts and harvesting existing accounts to reach your goals? How effective is the marketing function in building brand and loyalist for the scale of operations? How cost effective and purposeful are the campaigns in reaching the customer numbers required for the envisaged scale? Is your company accumulating all the relevant subjective knowledge in the system to benefit from knowledge management?.

Identify gaps that exist within each firm and the group. Gaps could also be in the form of missing performance management systems to professionally manage the company, or a weak sales and marketing organization that is reactive in nature. Identify the squeaky wheels and leak points with functions and across functions.

<u>Identify growth Options as a group and for each business</u>

Family business can transform by expanding products or services or by venturing out to new geographies. Transformation requires careful assessment of options and plan for manageable risks. Have a clear business plan and strategy for at least 2 to 3 years on what the group has to achieve and how individual businesses would work. This is to show the road map, the growth plan, investments required and vision for the company. It helps clarify purpose. Clarity on the type of capabilities that need to be built to reach a certain goal is important. Detailed plans in other functional areas will also help to show that much of what is being done has been thought through carefully. Plan for a short-term and long-term goals to reach scale, define specific outputs at each stage and what would be the outcome from a scale perspective. Visualize how the outcome would impact you reaching the scale and detail broad tactical actions.

Some time to transform their business family businesses may need to prune some business. Transformation may require businesses to consciously contain low EBIT offerings and if required cut the arm completely. Transformation requires concentration of efforts and energies. Large family groups have to rationalize the products across various plants and location may have to let go some of the products and concentrate on investing in few high opportunity products to scale up.

Focus on Improving profitability and optimization of cost across the group and each business

An untiring focus on top line revenues and bottom line profit is a must for family business transformation. Target efficient profit to sales ratio compared to historical results and industry averages. Eliminate non-value adding activities and expenditure that have an impact on the financial performance or revenue of the group companies. The efficient utilisation of resources and minimal wastage with good quality are key elements to create a profitable and attractive business. Determining how to cut costs without disturbing the company's ability to generate revenue and survive over the long term is a challenging issue. Companies should evaluate what is the immediate / long term impact on the value drivers due to cost savings. Unprofitable product lines, bloated sales organizations, inefficient delivery organization, inadequate marketing department are the right candidates for cost optimization. Benchmark and target both short term and long term debts. Identify revenue leakages that could occur due to misappropriation of funds by the staff, errors in documentation or recording transactions, lack of trained staff and operational issues in control systems. Streamline with appropriate controls in all the areas of the revenue cycle. Consolidating and co-relating all revenue related information and constant reconciliation could identify and minimise potential losses and associated risks. Automation of processes and industry best practises like Six Sigma, ISO and CMMI could also prove to be a method by which standardisation of activities and processes could be brought about in the organisation. Identify what areas could be shared services amongst the various companies. Identify options to share offices and licences. Addressing production-sales integration issues through lean manufacturing and supply chain improvements is an integral part of transformation.

Enhance Goodwill and brand value

A family business acquires goodwill through better customer service, innovation and common good business principles (credit policy, quality and legal framework adherence). From a quality perspective strengthen the QMS maturity of the organization. Invest n best practices, adopt and get certified on ISO and other industry standards, and eliminate non-standard business practices. Emphasize to drive these vigorously with quarterly improvement plans. Marketing outcomes like winning of sponsored awards, sponsored research, industry and government recognition increases the visibility of the group.

Business transformation requires investments tied to measurable outcomes and impact. Invest in employee branding, people development and product experience. Winning and sometimes investing in an industry or analyst enabled award helps in building the brand recall and positioning. Investments in customer experience management, quality and delivery make a huge impact during transformation. They help to life the +WOM and bring in new accounts to table. Deepen the relationships with key clients, pursue lighthouse programs to iron out the new service and product offerings, improvise them and assiduously build a platform where the clients could refer and promote the company. Nothing works like a peer referring a service provider to another.

Invest in competencies and capabilities across businesses

Key to family business transformation is working on the capacities, offerings and capabilities. Transformation may require more investments in resources and working more harder and smarter with the available resources. Transformation requires automation of repetitive tasks within a function and outsourcing of low value added activities within a function. Transformation may require hiring of expertise from market and cultivate internal talent in parallel. Incumbents may be pursued to own newer platforms to extend and stretch their capabilities.

Transformation can be achieved only when all functions work in a tandem. Create newer organizations structure to bring more focus and market alignment, create space for newer leadership to emerge to own and direct growth and importantly, de-risk the company from vagaries of markets and offerings. Create sub-divisions for increased focus and align shared services to contain cost. Key tenet of scaling up is not just bringing new talent at key roles, but the incumbent leadership progressively stepping back so that the new leaders own and manage their areas of operations. Build systems and process that promote data driven decision making, ownership of tasks and outcomes. Choose process and procedures must be chosen for their effectiveness and ease of working. Integration in terms of common parts, processes, and people offers great economies of scope advantages. Pursue integration of production or delivery process, conversion of "implicit knowledge to explicit knowledge", common parts and competencies approach to gain from alignment and improved valuation.

A key aspect of family business transformation is to build next level leadership. Many family businesses are quite successful in retaining a large pool loyal employee but fail to grow internal leaders. Look for obvious signs of quality of work, sense of ownership of team, quality of feedbacks to colleagues, penchant to DIM (do it myself), initiative for breaks with team, etc. Internal leadership program must not restrict to a certain layer of organization, but rather be pursued as a common program across the organization. Internal leaders can emerge at various levels and the program must be flexible enough to identify and sustain leaderships of various forms. Leadership at some level may be highly task oriented, structured, process oriented, while leadership at another level may be one of managing unstructured, complex and volatile environment. Identify their life goals, self-esteem, creativity, optimism, happiness, personal strengths and motivation of the individual. Identify their natural leadership styles and design appropriate intervention strategies. Internal leaders require mentors who could be from the company or outside. They act as sounding boards, motivational support and dogma sinks. Nothing works like a comprehensive view of the organization for would be leaders. Job rotation or a new geography broadens the work experience. Internal leadership program can be successful only if strong network outcomes are defined and orchestrated. Goad the identified individuals to connect with their peers in professional forums, industry events, seminars and think tanks. Encourage them to express and reach out in the social media, by curating and directing their content appropriately. Internal leadership development must have 3 quarter plans that help the individual gain practical experience of leading and managing at the newer plane. If failures or setback happens, allow the individuals to mull over and gain from the experience. While setting them to win is important, the win must be cherished as self-gained. Internal leadership program thrive if platforms and process to self-review without the stigma of failures or low outcomes are encouraged. Create a informal self-review mechanisms where the individual can elicit the feedback, discuss and digest and push the agenda of improvement by themselves.

<u>Improve Governance at group level ad in each business</u>

Governance plays important roles in family businesses transformation. It safeguards the interests of all stakeholders and improves transparency. Governance in a family business is more complicated. It can be informal governance where a matriarch/patriarch keeps the threads aligned. Some families practice monthly accounts and quarterly board meeting. As family business move from founder to next generation to siblings or cousin consortia, they can employ following approaches to improve governance, viz., 1) creation of a family council, 2) induction of independent directors, and 3) separation of business and family.

Family council or a family office is a personal operating setup that can act as a single decision making body with various matters on behalf of the family. It is a legal vehicle, often employs in-house staff, to provide asset management, wealth protection, succession planning and tax mitigation. Family council provides centralized focus and control over family finances, legal, tax and administration issues including risk management. From a legal perspective, family office can be a LLC, Branch office, HUF, private trust or Foundation. The primary difference between the family office and traditional wealth management and financial services is that the idea of one trusted fiduciary acting on your behalf to manage many different professionals providing their services to the family; for example, trust management, legal advice, tax planning, estate planning, and investment management. Family office can have representation from multiple generations to ensure fair coverage and responsibilities. Family offices define the processes that define "family affairs" and "governance affairs". Family office clearly laid out roles for effective communication, reporting, fora and rules governing meetings, accountability, dispute resolution and administrative institution. Like a company, family office must have a memorandum of association (MOA) that define the very purpose of family office and procedures similar to articles of association. The MOA can act as a family constitution detailing the vision, values, relationship of the family with businesses. It could also detail number of board representation, voting rights, nomination, decision rights, for a and meeting rules, accountability of trustees, removal of members, dispute resolution mechanisms, financial and proprietary audits must all explicitly documented for effective functioning of a family office.

While "family office" does provide an institutional mechanism to manage risks and wealth, family business must also invest in:

1. regular family meetings that address the needs and aspirations of each generation
2. empower and support both intrapreneurship and entrepreneurship platforms for next generation
3. encourage transitions, and
4. appropriate information sharing within the family, and the executives
5. conduct an annual family office meeting with all family members (children is a choice) similar to an annual business plan meeting on the status and directions of the businesses.

Law in many countries require at least one or two independent directors to offer advice that is professional, unbiased, consistent and appealing to their way of doing business. Independent directors can be initially for 5 years and at most extended to 10 years in some countries. Independent directors propel adoption of appropriate governance practices. Independent director can be either "active" or "passive". Active independent directors not only involve in strategy making and but also participate in deeper reviews on implementation process.

<u>Plan and execute succession</u>

Success of succession depends on the planning and execution. Incumbent management has great wealth of experience and management insights. These have to be transferred and inculcated to the successor. Succession must be done in a very open and transparent manner. While succession plan is rolling, ensure the business is not hurt by the associated changes that may emerge because of the transition. Family elders play a significant role in establishing the business parameters, discussed and communicated the same across multiple interest groups to buy the succession plan well in advance. Once a future leader is identified, successful family businesses start mentoring the person through on-the job exposure and empower him to learn and implement changes. Insights from successful entry and succession of wards into family business show there are some common principles that can be easily adopted. While planning, entry at right level and mentoring are important, setting up wards with the right gamification principles ensures success. Succession plan must detail how family members can enter the business. Do they need prior nonfamily business experience, or international exposure is areas that need to be clearly articulated and documented. Most conflicts happen when a younger generation joins the board and starts involving in running of family business.

Succession plan must detail how the first 3 quarter of induction and transition happen. Do not burden the successor with constant reminder on results, instead focus on outcomes. Obsession with results can induce an undue pressure on the successor and induce her/him to focus on short term gains. Remember succession is an opportunity to rewire your business, and let somebody who is going to own and run the business in future unearths suboptimal approaches, bring fresh perspective and drive down the cobwebs. Undue praise, which happens every day for no significant output, takes the charm out of appreciation. Overusing praise may make the successor believe less of you and less motivated. Encourage them to take risk and experience failures.. Allow successors to fold up their sleeves, trip, and fall and rise up to live with the experience. Encourage them to go to the bottom of events, what happened, why it failed, what they could learn and how they would do it next time. Many business families also bring external professionals to mentor their wards to give them the advantage of 3rd party neutral insights.

Not all progeny would be interested in working for family business. Identify who is interested and committed irrespective of gender and on tradition of first born. Create space for the elder siblings to graciously side-step and allow younger, more focused leadership to emerge. Family elders must establish the business parameters, discuss and communicate the same across multiple interest groups to buy the succession plan well in advance. Once a future leader is identified, family businesses must start mentoring the person through on-the job exposure and empower her to learn and implement changes. Involve the next generation early into business and steer dinner time discussions to acclimatize the contours. The second principle is to bring them at appropriate level, preferably closer to market. Third principle is to identify respected non-family mentors who would take the new ward under their umbrage and fill in "implicit knowledge". Fourth, but the most important one followed by most successful companies is to help the heir position as a winner by setting them to win, especially by focusing on related non-core business. Do not burden the successor with constant reminder on results, instead focus on outcomes. Obsession with results can induce an undue pressure on the successor and induce her/him to focus on short term gains. Remember succession is an opportunity to rewire your business, and let somebody who is going to own and run the business in future unearth suboptimal approaches, bring fresh perspective and drive down the cobwebs. Limit praise and encourage them to take risk and experience failures

Plan and infuse professionals

Successful family business realise the value of bringing in professionals. While family business typically focus on "optimization" especially on resources front, professionals are key to bring efficiency focus. Induction of professionals into family business moves the bar from optimization to effectiveness. Unlike family members who would like to optimize resources across multiple areas, professionals drive specialization and efficiency in running of the business. They bring systems and process that can hasten the process of globalization of family business. They can also bring transparency, drive and divergence to the business and can propel new directions. Hire professionals not only for their experience but also their attitude. Professionals who have worked in large companies with too structured processes may find navigating family business tough. Hire professionals who can only lead, but mentor and guide incumbent resources. On board professionals with a long term orientation so as to benefit from continuity of changes. Involve multiple generations in identification and selection of outside professionals. Actively encourage dual reporting (to two different generational leaders) for the outside professional to ward away any personal leanings and quicker induction. Hire professionals with proven expertise on business development, international networks, export experience and team building.

Measures: outcome and impact

Business transformation can fail if the objectives, activities and outcomes are not tightly integrated. Align individual's role and responsibilities, ownership and accountability with the intended change or outcomes. Implement a simple measurement system that integrates strategy, resources, process, people and results. Family business can adopt balanced score card or results based management approaches that improve decision making, transparency of the case and effect, and accountability at various levels. Mid-period review using output and outcome measures are useful indicators of what is working and what is not working. The company can quickly calibrate alignment between activities, resources and outputs to see the returns are on expected line. In the initial days of transformation, have a daily and weekly review and as the tide turns better move to fortnightly reviews. Communicate the positive results to motivate the employees and team to pull up and deliver faster. Recognize employee making a difference and let them know their contributions have not gone noticed. Offer incentives to encourage employees. Make target achievements public. A well aligned team rightly oiled always accomplish more.

An important aspect of family business transformation is implementing right reporting systems. Family business need performance measurement system that help in addressing how various units are delivering to mission, whether they are getting the maximum impact they from their expenditures and how effectively they are utilizing their budgets. Results based management is a strategic management tool that can be effectively used by family business embarking upon professionalization program. Tools like Balanced score card (BSC) or Results based management (RBM) integrates people, process, resources and measurements to administer the programmes and improve transparency and accountability. RBM clearly defines the activities to be performed at each stage to achieve the desired results. These activities are further segregated into allocation to different groups. Each group is reviewed based on the activities and the outcomes and outputs are consolidated at the programme level to report the impact or the final result in comparison to the objective set.

Conclusion

Family business transformation is the most challenging tasks as it deals amongst other things, legacy, history, pride, values, governance, intergenerational aspirations, and the changing economic conditions. Transformation of a family business involves crafting a carefully thought out plan with clear goals and timelines, and implementing it with least disruption. Family businesses can sustain continuity and market relevance by working on not just products and services, but also the family business as a whole. The key to family business sustenance is by transform them to build in certain capabilities that will make it stronger in terms of management, process, systems and culture. Family business transformation like any change initiative is challenging, but surmountable. Many a times the drawing board may need to be revisited to recoup resources and replay strategy. Some changes can be smooth, while some continue to be overwhelming. It is a journey worth taking …….

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