

# CORPORATE GOVERNANCE IN FAMILY BUSINESS

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# FAMILY BUSINESS

- A company in which a family or a business group has controlling interest and the family or the group is free to appoint its members as managers
- In India family business dominates the corporate sector
- 75% of employment; 65% of GDP; 71% of market capitalisation [year 2001 data]

# FAMILY CAPITALISM

- Family capitalism precedes shareholder capitalism.
- India is no different.
- Concentrated ownership exists at any point in time because of institutional voids, the absence of specialized intermediaries in capital markets.
- Pyramid structure helps to tap equity financing while retaining family control.

# FAMILY CAPITALISM

- Groups and the concentrated ownership that they represent, whether in history or in contemporary emerging markets, are robust form of business organizations.
- They potentially last centuries changing their footprint and functional form, and weathering severe shocks.

# FAMILY CAPITALISM

If family business is not engaged in rent-seeking behavior or entry-detering behavior, it is not inimical to competition

# FAMILY CAPITALISM

- During the period of severe government intervention, some families exploited the system, and some reinvented itself.
- It is too early to sound the requiem for family management. Adjusting itself to the changing times, it has demonstrated a remarkable resilience.

# THE E T CORPORATE GOVERNANCE SURVEY [2004]

- Among top 20 companies, 10 companies belong to business groups.
- Among top 20 companies in terms of governance structure, 10 companies belong to business groups.
- Among top 20 companies in terms of value creation, 11 companies belong to business groups.

# THE E T CORPORATE GOVERNANCE SURVEY [2004]

The Economic Times used the following parameters to evaluate companies:

- Accounting quality
- Value creation
- Fair policies and actions
- Communication
- Effective governing board
- Reliability

# FAMILY BUSINESS

- 3% of family business survives third generation [CII study]
- Out of 100 first generation business, 38 survive in to the second generation; and 12 survive in to the third generation

# DISTINCTIVE FEATURES OF FAMILY BUSINESS

- Owners define the value of the company.
- The value of the company reflects the family value.
- Businesses group and not the individual joint stock company is the unit of decision.

# DISTINCTIVE FEATURES OF FAMILY BUSINESS

- Relationships in a family business build on trust between owners and managers and between owners and the board of directors.
- Owners prefer to appoint kin in top positions if talent is available internally.
- Owners appoint directors from friends and philosophers.

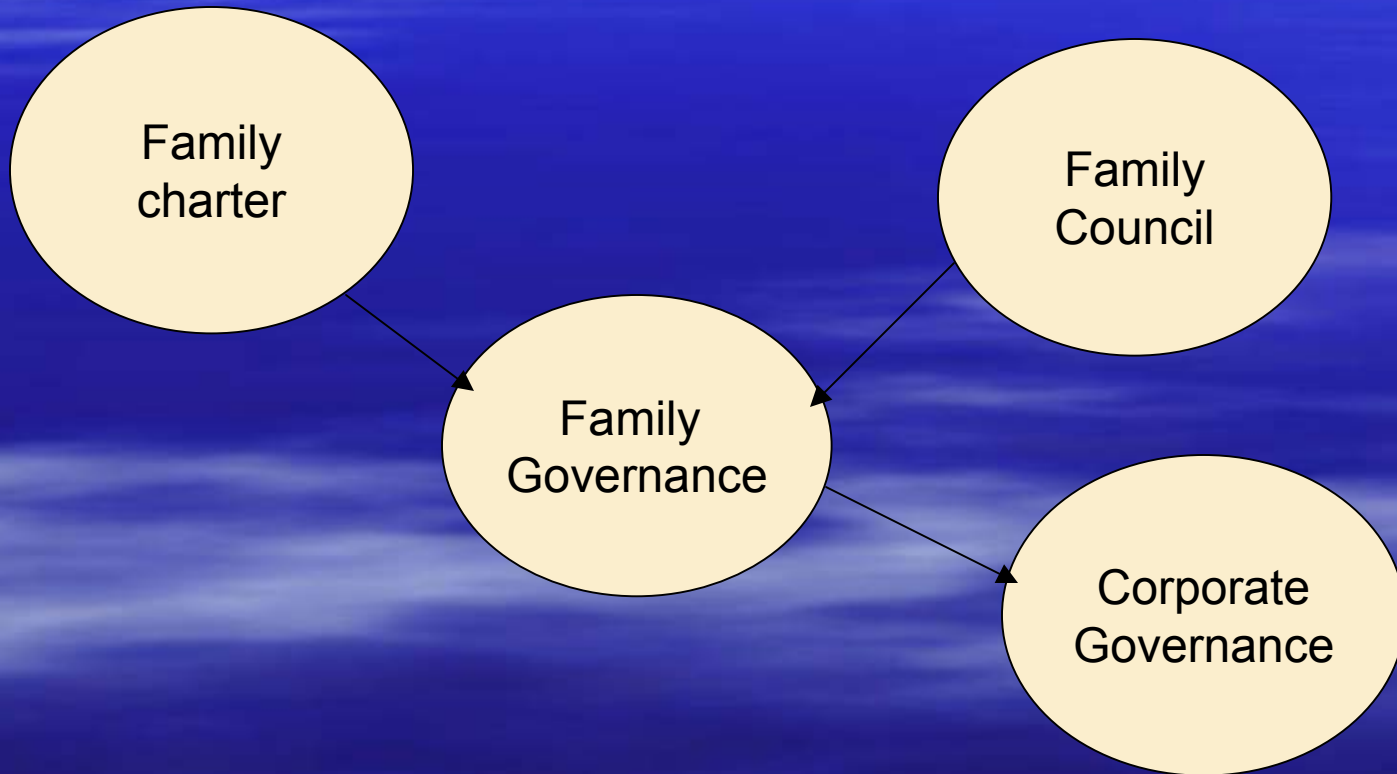
# DISTINCTIVE FEATURES OF FAMILY BUSINESS

- Often, family's unity and commitment get priority over the core business objective, that is, 'maximizing the value of the firm'.
- Entrenchment of management is more common in family business

# FAMILY BUSINESS

- Size matters: Decay takes long time or business is resilient enough to take challenges
- Reasons for decay:
  - Family split (sibling rivalry)
  - Internal management problems
  - Absence of succession plan
  - Inability to face challenges posed by younger companies

# Corporate Governance



# 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 bond among the family members and employees and to articulate the role of each family member.

# 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 disputes

# Key Success Factors

- Family's reputation inspires investors to invest in the business
- Commitment to family values and beliefs
- Emotional attachment to business
- Benevolent dictatorship
- Professional management: Only competent family members are inducted in the business; Professionals are inducted to fill in the gap in skills, knowledge and experience

# Weaknesses in 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
- Absence of succession plan
- Induction of younger members without consideration of competence

# Directors

- The lead independent director acts as the friend, philosopher and guide
- The members of the board should be sensitive to the family aspirations, in particular the aspirations of the new generation.
- A new generation individual at its 30s is full of energy and desire to experiment with new ideas. The board should play the role of philosopher and guide and also provide checks and balances.

# Directors

- Directors often act in the interest of the family rather than as trustees for dispersed shareholders. This is inappropriate
- The board should ensure that shareholders' wealth is not exposed to unwarranted risks. However, it should not undermine the entrepreneurial spirit of the new generation.

# Corporate governance

- Corporate governance is as good as the head of the family desires
- A family that are successful in managing business make itself accountable to an independent board

# Conclusion

- It is a global phenomena that family business resist changes in institutions that helped it to build the empire.
- India should provide a different hypothesis.
- Indian family business provide evidence that they can co-exist with new generation entrepreneurs and transnational companies