

# **Building a Lasting Family Business**

## ***Role of Family Constitution***

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**Kavil Ramachandran**

**Professor and Executive Director**

**Thomas Schmidheiny Centre for Family Enterprise**

**Indian School of Business**

# Share of Family Firms in Europe

Country	% of Firms
Austria	80
Belgium	70
Finland	86
France	75
Germany	95
Italy	93
Netherlands	69
Spain	75
Sweden	80
Switzerland	88
United Kingdom	69

*Source : Floren, Uhlaner and Nerent – Braun (2010)*

# Family Business - Definition

- **Promoter family has significant ownership control**
- **At least one member involved in operations or governance**

## Unique Challenges – Managing Different DNAs

<b>Family</b>	<b>Business</b>
Relationships natural	Planned relationship
Cannot fire	Can fire / dismiss
Entitlement by birth	Meritocracy
Informal	Formal
Tradition bound	Organized ; Objectivity Change is natural
Values	Structure / Systems
SOCIALISM (compassion)	CAPITALISM (competition)

***Most family businesses do not survive 3 – 4 generations!***

# Lack of Rules Lead to Chaos

**Dilemmas**



**Deviation**



**Differences**



**Disputes**



**Destruction**

# Relevance of Family Governance Mechanisms

- The way family is managed, taking care of interests of all stakeholders in a fair manner
- Well governed families have vision and values alignment
- Have policies, processes and mechanisms for clarity
- Policies cover : Inheritance, Involvement in Management, Rewards, Leadership Succession and Retirement, Entrepreneurship.....
- Processes : How decision taken, implemented, controlled, corrected, situations with no policies .....
- Decision making structures

*All well-known multi-generational families have good governance (GMR, Dr Reddy's, Dabur, Murugappa, Merck, Hilti....)*

# Family Constitution

- Constitution outlines goals, roles, rights, duties of family members
- Develop clear policies and processes to accomplish family's purpose of being together
- Discuss multiple scenarios and their implications ( like preparing a strategic plan)
- Identify structures to formulate and implement strategy
- It is the outcome of detailed discussion among all family members

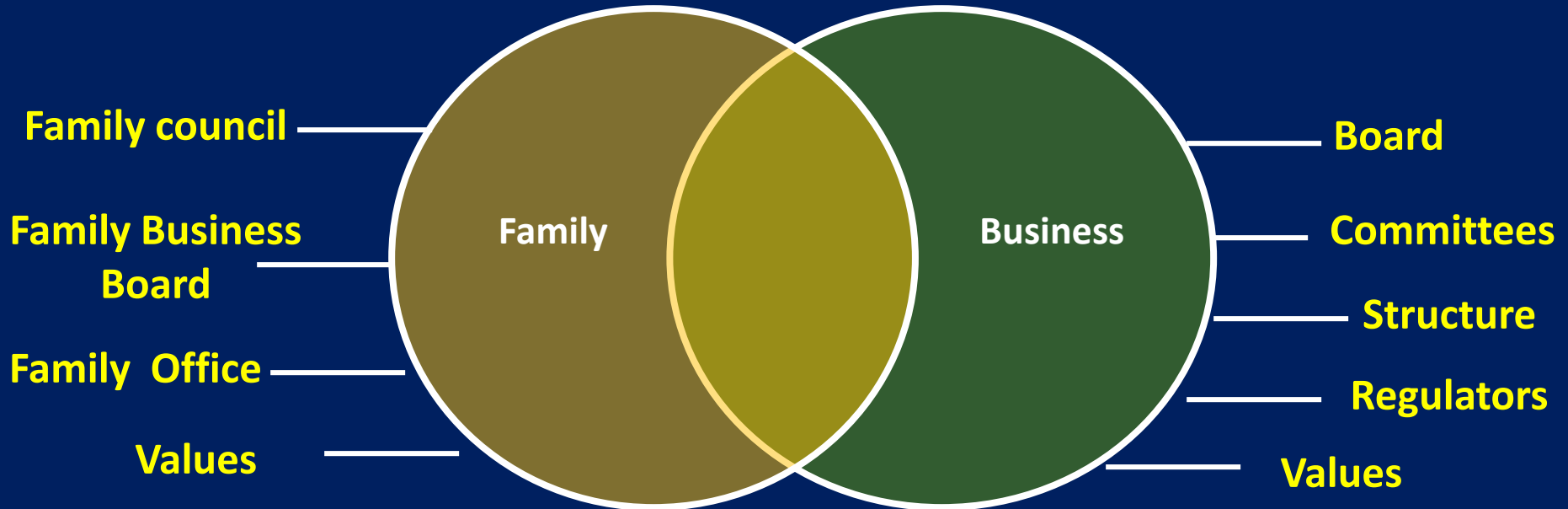
***Never outsource the task of preparing constitution; take help but the Constitution should be FOR the Family, BY the Family and OF the Family***

# Family Governance Structures

- **Family Council**
- **Family Business Board**
- **Non-Business Family Forum**
- **Family meetings**



# Structural-Systemic Support to FB



# Suggested Chapters of Family Constitution

- **Preface**
- **Introduction and Family History**
- **Definitions**
- **Family Vision and Values**
- **Rights, Obligations and Code of Conduct**
- **Family's Business Vision and Values**
- **Business Strategy**
- **Family Council and Family Assembly**
- **Family Business Board**
- **Non Business Family Forum**

- **Ownership, Share Holders Agreement and Dividend Policy**
- **Family Employment**
  - Retirement
  - Succession
  - Induction
  - Rewards
- **Role of non-working family members**
- **Role of Next Generation**
- **Family Entrepreneurship**
- **Family Wealth Management and Family Office**
- **Personal Financial Security**
- **Family Fund**
- **Family Philanthropy**
- **Managing Differences**
- **Appendix (Share Holders Agreement)**

# Process of Writing Constitution – Key Steps

- Create awareness and educate
- Diagnostic Questionnaire (Criticality Vs Satisfaction level)
- Workshop on feedback and way forward
- Prioritize areas to cover in terms of policies
- Identify & solve immediate & major irritants by creating policies
- Develop tentative solutions & start implementing policies/processes
- Address challenges affecting multiple areas
- Gradually build confidence and togetherness feeling to find solutions or create policies
- Be a mentor, soul keeper, shoulder to weep, mediator and retain family's trust and confidence
- Draft key policies and processes
- Discuss and finalize and implement
- Chair sessions if required
- Final agreement in clear language
- Share Holders Agreement is the only legal part of a constitution

# Further on Creating a Constitution

- Length of the constitution does not matter
- Preserve notes of the discussion
- Keep visual history for posterity
- Educate nextgen through discussion, clarification and elaboration
- Rededicate to the spirit of the constitution
- Provide “adequate” flexibility for amendments
- Too much of rigidity leads to cracks and breaks!
- Keep 6-24 months horizon to write the constitution
- Arrive at consensus through iterative discussion, consultation and education; avoid voting if possible
- Prepare it when life is simple and relationship is smooth

# Illustrative Questions to Generate Discussion

## Family Vision and Values

- **What is the purpose of being together? What does it mean? Which are the areas of convergence?**
- **What are your values?**
- **Are these common for all family members?**
- **Do you practice them always?**
- **Is it important to practice them?**
- **What are the challenges in practicing them?**

# Key Family Values (Illustrative)

- Trust
- Transparency
- Honesty
- Integrity
- Entrepreneurship
- Caring / Compassion
- Flexibility
- Forward looking
- Openness
- Professionalism
- Humility
- Stewardship

*These are generated through discussion and validated for their practice*

# Ownership

- Responsibility and not entitlement
- Trustee and not owner
- Passion and not burden
- Entrepreneurship and not maintenance
- Preserve heritage and not destroy



# Ownership

- Are you clear about the ownership structure of the business and shares of each member?
- Are you satisfied with it?
- Do you have any concerns or suggestions?
- What is the structure followed today and what are the tax etc., implication of going for a new structure such as holding company or LLP
- Do you think all members of the same generation should hold the same percentage of shares? Why?
- Who all should be eligible to inherit shares?
- How about sons, daughters, daughters-in-law and sons-in-law?
- What conditions do you wish to put to ensure that shares do not go out of the family?
- What happens if a family member writes a will that is in conflict with the provisions of the shareholders agreement.
- Should family members be allowed to sell their shares? To whom? When? Why?
- What should be the preconditions for it? How do you address the challenge if the company is privately held?
- What should be the basis on which dividend declared?
- Is there a prenuptial agreement? Terms?

# Share Holders Agreement

- **Definitions and Interpretation**
- **Objectives**
- **Covenants and Undertakings**
- **Co-operation**
- **Participation as the Shareholders of the company**
- **Objects of the company**
- **Share Capital**
- **Transfers and Transmission of shares (conditions and restrictions)**
- **Tag along and Drag along rights / obligations**
- **Board of Directors**
- **Powers of the board**
- **Dividend Policy**
- **MOA and AoA**
- **Competing business**
- **Arbitration**
- **Term (duration) and Termination**

# Rewards

- How do you decide rewards for family members involved in different activities, in business or otherwise, full time or part time?
- How do you reward contributions according to the number of years and quality of contribution?
- Is this feasible? Is this required?
- What about a gratuity based on contribution?
- Should family members involved in business and other activities be evaluated for their performance?
- What are the practical challenges?
- How can those be addressed? Fully or partially?

# Business Involvement

- Should each family member be given independent operational responsibility for an entire business?
- How do you avoid silo effect and water tight compartmentalization?
- Should the responsibilities be assigned based on different functions such as finance and marketing?
- Would you like to rotate family members across businesses? Why?
- Should the person handling any one business be holding significant majority of its shares?
- What are the positive and negative implications of it?
- Should that person be free to sell part or full of his / her shares? Why? To Whom? Under what conditions?

## Wealth Management

- How should the family decide management of its collective wealth?
- Do you have clear criteria about wealth management?
- What are the features (+ve / -ve)?
- How can the practices be improved?
- Do you have a clearly earmarked fund to meet specific family expenses / investments such as retirement benefits, family holiday and philanthropy?
- If yes, how is it functioning? If not, do you find the need to have something like it? How much? Will it be created out of dividend income?

## Business Strategy

- How are decisions on business growth, new ventures and divestments taken?
- Do you have detailed and objective discussion based on specific goals and criteria on such matters?
- How satisfied are you with the current process?
- Can the process be improved?

## Family Council and Business Advisory Board

- **Family Council (FC) being the general assembly of the family, who all should be its members? What should be the minimum age? Do daughters and sons-in law be members? What will be its mandate? How will you preserve confidentiality of some information?**
- **Who all should be members of the Family Business Board that formulates and oversees family's business interests? What else should be its mandate?**

## Family Philanthropy

- **What is the family's social responsibility? How is it accomplished? How are the family members involved? To what extent are you satisfied with it?**

## Managing Differences

- **What are the grounds for differences? How do you prevent differences in opinion becoming ego clashes and destructive thinking? What should be the policy and process for managing differences?**

# Process of Writing Constitution – Key Steps

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# Way Forward - Proposal

- Customizing the Diagnostic Questionnaire
- Individual meetings @ one hour each to
  - Reflect over questionnaire
  - Personal preferences, goals and challenges
- Workshop on summary findings and preparation of a schedule for developing policies / address existing concerns/challenges (Half Day)
- 3 – 4 One Day workshops to discuss policy and process options and some best practices (2 – 3 months)
- Drafting a Share Holders Agreement (if not existing) or revisit an existing SHA (One Day) with the help of a lawyer
- Draft the constitution (One Week by Ram)
- Detailed discussion and finalization of constitution (1 – 2 days)
- Start implementing the constitutional provisions and check their robustness (3 months)
- FINAL version of constitution – read and signed (one day)



**Thank you**

# Ownership Structures

- **Partners /Private / Public / Trust**
- **Concentrated – Dispersed**
- **Holding co – Stand alone cos**

# Ownership and Involvement

	<b>Operating Owners</b>	<b>Governing Owners</b>	<b>Active Owners</b>	<b>Investing Owners</b>
<b>Ownership</b>	Significant	Significant	Significant	Scattered, small
<b>Strategy</b>	Lead	Active partner	Understand and guide	Accepts
<b>Culture</b>	Lead	Lead	Contribute and guard	Understand
<b>Governance</b>	Lead	Lead	Lead	Understand
<b>Involvement in operations</b>	Lead	Oversight	Never; some oversight	Never

- **What should be the nature of responsibilities of family members involved in business? What should be the policies for induction of new members and retirement of the existing? How satisfied are you with these policies (including qualification, experience and remuneration)?**
- **Do you think that you have a very professionalized business? What are the positive and negative aspects of it as practiced by your family business? Do you think family members should be mainly involved in new venture creation and overall business strategy and less in operations? How is it working now?**
- **What are the key challenges for people who retire? How should these be addressed? How do you address the concerns of those who retire?**
- **Should there be a separate clear definition of the role of women or in-laws in business?**

# Family Governance - Illustrations

- **Murguappa** — **Entry and Retirement**
- **Sudarshan** — **Salary vs Dividend**
- **GMR** — **Rotation of Roles**
- **Merck** — **No Family Employment ;  
Exit very difficult**

## Being Together

- **Benefits** : **Happiness, scale advantages**
- **Challenges** : **Limited freedom**

# Common Features of Long Lasting Family Businesses

- “The most important prerequisite for prosperity across generations is clarifying and sharing the family philosophy”

*Ichiro Takanashi*

*30<sup>th</sup> generation, Marujin Group, Japan*

- “The values are the unity of the members and the branches, however many there will be in the future, the consideration and management of every vision and particular interest, and finally the recognition of the values of the competence inside the family business.”

*Dino Frescobaldi*

*30<sup>th</sup> generation, Marchesi de Frescobaldi, Italy*

# Family Business Board (FBB) - Responsibilities

- Define business vision and values with FC approval, review intervals
- Formulate business strategy
- Define and ensure adherence to standards of corporate governance set
- Develop dividend policy keeping liquidity requirements of family and affordability of business
- Nominate family representatives to company boards
- Regularly update FC on family's business interests
- Evaluate proposals for new ventures, family CSR and collective wealth management
- Advice FC on family employment in family controlled businesses and enforce policy implementation including norms for rewards
- Constitute and oversee a Performance Evaluation and Compensation Committee for family members involved in business. Have 1 – 3 non-family members
- Propose policies to FC for unanticipated situations where no policy exists as per the constitution and Share Holders Agreement

- Attract and retain **high quality family and non-family** professionals
- **Encourage** entrepreneurship among family members
- **Act as the** sounding board for all ideas pertaining to the family and its wealth
- Run like a corporate board in terms of agenda, meeting, minutes and membership
- CXOs may participate selectively
- Frequency : **At least once a quarter, but preferably every month or bi-monthly**
- Location : **At least 25 percent of the meetings at an outstation**
- Chair : **Same as FC, elected or by rotation.**
- Membership : **Responsibility and not a source of power**
- Qualification : **Business Knowledge, Financial Acumen, Family Values of Stewardship, Transparency etc.,**
- Membership : **In small families FC doubles as FBB**
- Expenses : **Family Fund to cover**
- Remuneration : **Non-Executive positions have no fee**



# Family Council (FC) - Responsibilities

- Establishes policies for all major activities of the family, particularly impacting the practice of shared vision and values of the family
- Encourages members to discuss their suggestions/ideas with other family members before bringing them up for taking decisions
- Members to give FC sufficient notice for any agenda item
- Takes care of the interest of those not routinely involved in business
- Constitutes the Family Business Board
- Normally meets half yearly or as decided by the FC
- Encourage open discussion, but discourages voting
- Chair to invite outside experts to share experiences
- Inform all members about their ownership rights in the companies
- Rights, Obligations and Code of Conduct apply to FC too
- Annual meeting of FC and Family Assembly back-to-back (FC – Formal, FA – Social)
- Same person need not be the F&B leaders
- Fix dates in advance

# Code of Conduct

- Complete clarity on the essence of family values and their strict enforcement always
- Any family member involved in the affairs of the business should continue to be loyal to the family and business both in spirit and action
- Do not have any personal / private interest while handling business affairs of the family
- Any member having a possible conflict of interests due to martial relationships with another family with a written constitution or not will disclose such possibilities and maintain strict confidentiality on either side
- Decisions should be taken entirely based on the interest of the family and business and its stake holders
- Have no active private interest in business outside the responsibilities expressly provided by the family to avoid conflict of interest
- Adhere to the legal and ethical requirements of wealth management and not do anything that will affect the family's reputation

## Contd..

- **Declare personal passive investments to other family shareholders regularly**
- **All properties of significant value inherited from in-laws etc., are regularly declared to family office or key family shareholders**
- **Family members shall not acquire own company shares for self from the market, except as part of short term personal wealth management, and as per legal provisions**
- **Declare holding in family controlled businesses**
- **Family meetings are always held in a cordial atmosphere. Hence, meetings may be adjourned to allow members to take time out when discussions get heated. There should not be any personal criticism of other family members in front of others**
- **Respect others always**
- **Punctuality is important; respect others' time**

## Contd..

- Do not interfere operationally in the others' areas of business responsibilities. However, this should not lead to creation of silos
- Not to charge the company with expenses that are incurred for personal / family purposes or those not admitted as business related expenses
- Read, understand follow and uphold the family constitution in its spirit and contents
- Attend all meetings one is eligible and obliged to and seek prior permission for leave of absence if required
- Maintain confidentiality in all matters that are agreed to be so or considered to be so
- Do not be actively involved in politics while being actively involved in business

*Add rules and guidelines for social behaviors, austerity, participation in political and religious organizations*

## Violation – Non Adherence

- Any family member not adhering to the above will be counseled / reprimanded / punished by the family appropriately. Family members are collectively responsible to not only preserve and adhere to the values, but also practice the Rights, Obligations and Code of Conduct
- Matters of breach of conduct will normally be addressed first informally by senior family members before escalating to the FBB and FC, if need be. Moral pressures from the family will be preferred to any severe action. Community service including through the family's own philanthropic activities will be considered as an option by the FBB and FC
- In all cases of violation, the FBB will be free to take appropriate actions including forced disengagement with its business in any significant manner either on temporary or permanent basis
- The Family Council will be the custodian of the Code of Conduct and will monitor its practice and help bring corrective measures if required
- Aggrieved members will be free to appeal to the FC through its Chairperson for considering revision of the decision of the FBB
- The spirit behind any action of the FBB / FC will be to correct the individual and bring him back to following the provisions of the constitution