FAMILY BUSINESS IN INDIA (Challenges & Role of External Leadership)

Dr. Neelam Goel
Department of Commerce
Shyama Prasad Mukherjee College
University of Delhi, Delhi.

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ABSTRACT *The article tends to explore the course of family business in India for three generations and beyond. The family businesses have been facing certain challenges over the years and the role of leadership has changed from internal leadership to integration of external leaders in the family business. The article begins with the brief about the history and nature of family business in India and followed by the challenges and integration of external leaders in business. The article will also explore why family-owned businesses choose to make the transition to professionally run, and how having appropriate motives impacts the success of the transition. We will also examine what makes for successful and unsuccessful practices, analyse the inherent challenges and make suggestions for best practices.*

Introduction

Family as a social institution is one of the oldest surviving (Goode, 1982), but only in recent years family business, an important arm of it started receiving academic attention. After a detailed review of the existing literature, Zahra and Sharma (2004) concluded that family business research has a long way to go from the present fragmented and descriptive state. There are conceptual differences between family and business (Ward 1987, 2004), though opinions on treating them as conflicting systems vary. Family businesses are found to split up like amoeba as they grow, and very few of them survive beyond three generations, supporting the age old saying, "shirt sleeve to shirt sleeve in three generations" (Carlock and Ward 2001, McCulloch 2004).

Most discussions in this area are based on research in advanced countries. In most developing countries, including India, it still remains a black box; academics and industry observers were puzzled to witness the recent break up in the second generation of the Ambani family, the largest private sector group worth over US $ 20 billion. Even anecdotal evidence is limited to a few biographical sketches (Tripathi, 2004; Piramal, 1998) and consultant impressions (Dutta 1997; Sampath 2001). Sharma and Manikutty's (2005) study of diversified family groups is one of the few notable research pieces from India in this area. In essence, not much is known either about the survival rate or the factors contributing to the successful survival of family businesses in India.

Family businesses constitute most businesses in India, as anywhere else. Economic liberalisation and rapid expansion in the industrial base in recent years have not only created growth opportunities for many but also have tested their resource capabilities to respond to them; some have chosen to follow the role of a custodian of their existing wealth and followed the preservation route, while some others have followed more of an entrepreneurial route of exploiting opportunities with or without relevant resources, with mixed results. One of the key resources for all of them is their family, and their prime concern is wealth and welfare of their family. A major dilemma many of them have faced particularly in the last decade since economic liberalization began is to choose between combinations of risks and returns of business growth and conservation of wealth of the family. This, of course, is intertwined with the missions of their businesses and families. They are fascinating because of the mutual dependence of two ecosystems (family and business) that have inherently conflicting characteristics. Some of the key dimensions that determine the cohesiveness of both the family and business are: succession planning, remuneration and rewards planning, recruitment and rewards for non-family professionals, retirement and estate planning, induction and grooming, ownership structure,

preserving wealth, resolving conflicts, business vision, strategy and governance, family vision, strategy and governance.

For years, companies in India have been transitioning from family ownership to more professionally run operations. There are three primary reasons for this phenomenon:

1. The increased complexity of operations in today's frenetic business environment. Whether companies are expanding internationally or simply increasing the scale of their operations, there is a growing need for external professionals (i.e., someone from outside the family).
2. As promoters step down, the firms demand appropriate leadership as well as talent to help them succeed in the long term. While family members can help in this transition, history has shown that firms considering external executives are more likely to thrive.
3. Regardless of the industry, fields are becoming increasingly competitive. To stay viable, it's crucial that companies have diverse perspectives within management to objectively assess the organization's strengths, weaknesses and risks and help them plot a positive course of action. For myriad reasons, some companies have been unsuccessful in completing this transition from being solely family run to hiring external professionals for leadership roles. Challenges vex the entire process, and there's not one successful model for making the transition to professional leadership, so each case will be unique.

The article tends to examine in brief the course of family business in India, their transition phases followed by the challenges and the need of integration of external leadership for success in future. We are focusing on mid-sized companies for three reasons:

1. Medium-scale companies grow rapidly, which provides a strong incentive for bringing an external professional aboard.
2. These companies are more likely to bring an outsider because they are younger and their culture is more open to attracting diverse leadership and inspiring change.
3. Professional leaders, who would not be hesitant to pursue a CEO position with a traditional company that has an established market and a history of successfully onboarding external leaders, may be more hesitant to join a less-proven young and medium-sized company.

Relevance of success in Family Business

For historical, evolutionary reasons, most countries have family businesses constituting the largest category in terms of ownership; estimates do vary, but is above 75 percent in all cases (Duman 1992, Paisner 1999; Watts and Tucker 2004). About a third of the companies listed in Fortune 500 are family businesses (Lee 2004). Since they normally do not have short term orientation but are interested in growing the family wealth with necessary precautions and have a different set of strategic goals compared to non-family owned private companies (Ward, 1987; Sharma, Chrisman and Chua, 1997), their long term contribution to economy is significant. This is true with the Indian economy too. However, long term sustenance of family business depends on its smooth survival across generations as shown in Figure 1. Families that successfully survive three or four generations have a complex web of structures, agreements, councils and forms of accountability to manage their wealth (Jaffe and Lane 2004). This seems to be much more evident in the west compared to emerging economies such as India. Reflecting the complexity of the process involved, succession planning has been an area of keen interest for researchers. This could be for a variety of reasons. One, organizational transition from an entrepreneurial stage to a system driven, professionally managed firm is not easy (Churchill, 1983), and involves evolutions, revolutions and crisis (Greiner, 1998). Two, there is often a simultaneous process of transformation taking place in the family and business with the size of activities of both growing (Kepner 1991; Morris et al 1997; Sharma, Chrisman and Chua 2003).

Company's point of view

WHY MAKE THE TRANSITION?

If a company wants to go professional simply because "everyone else is doing it," the transition will likely fail since it lacks a real motivation. That will result in less effort from the family to accept and empower the executive, creating a great deal of tension. ***The company should have clear motives for bringing in external executives.***

Following could be the prospective reasons for a shift towards external leadership in the family businesses:

1. **Industry promotes innovation** If an industry is innovating at a rapid pace, it's crucial that a company be able to stay with the latest trends. Family-run businesses can become insular and entrenched in their ways, so an external executive can help ensure that a company stays current.
2. **Industry is rapidly changing** Often, family-run businesses lack a willingness to cultivate management innovation. But if the industry is changing, the company likely sees the need for the change that external management brings to the organization.
3. **Competitor is gaining traction** This is a particularly important factor for newer industries or industries that have changed drastically due to technological transformation, such as: banking, consulting, software, food, mobile and retail.
4. **Globalization** Families often seek external guidance when they set out to globalize operations, as the international mindset requires the ability to think across boundaries, disciplines and cultures. Companies must invest in education, experience and evolved HR models, as well as hire people who can help the company create networks and become more flexible and inclusive.
5. **Increased complexity of operations** Family businesses are often compared to start-ups, since they typically are founded by close friends and have loose hierarchies and decision-making practices. Both value loyalty and the ability to take on multiple/diverse responsibilities, and one of the biggest problems is scaling up too quickly. "Every time a company triples in size, everything breaks," as Rakuten founder Hiroshi Mikitani put it.
6. **Attracting talent** Retaining talent can be a serious challenge, because family-run businesses tend to be fairly insular, which can limit opportunities for external hires.
   Capable leaders often move on if they don't feel there are enough opportunities, and this migration can hurt a company's ability to keep the most promising leaders for the future.
7. **Succession issues** Succession within a family-run business can be a nettlesome issue. Bringing in an external professional ensures there are options for succession down the road.
8. **Lack of adequate leaders** If a family doesn't have the appropriate talent to manage the company (perhaps for lack of global experience), seeking external leadership can be a smart move.

Furthermore, a company needs to decentralize activities after it grows. Most family-run businesses have a flexible hierarchy and the manager makes most of the decisions based on the family's beliefs, whereas external managers are strong enough to manage with authority.

The challenges which could be a block in the success of Family Businesses:

The Number Game! (Choosing the right proportion of external and internal leadership for the organisation)

During this phase, the family will have to decide how much power to relinquish and how involved family members should be in the organization. Hiring the right executive is another challenge, which can resemble obstacles faced by non-family businesses. Coming to an agreement can lead to tension among family members, so it's best to achieve consensus in these matters. For example, since most conflicts between family and executive stem from incompatibility, it's essential to perform a cultural evaluation of the firm. One step in that process will be defining the criteria and

skills required by the new executive. In addition, the board and the promoter should express their expectations and goals for long-term success and draft a formal timetable, as opposed to simply hiring the professional immediately.

Revisit the Goals!

In this phase, some aspects of the company's culture will be questioned. While candidates are interviewed, the family must reassess the firm's basic philosophy, values and goals to ensure the new environment is prepared to accept external management. During the process of choosing the executive, the family must guarantee transparency. This will not only benefit employees, who will be highly affected by this transition, but also the incoming professional by ensuring legitimacy. Finally, some members of the family are likely be apprehensive about losing power. This is why it's crucial to delineate the boundary between family and business/management and ownership.

The Transition Phase!

During the transition, the family must work with the executive to explain new basic work expectations to customers, vendors and other business connections. This rite of passage will set a tangible reminder of the executive's authority.

The Future Outlook

After this handover is concluded, it's crucial that the company set reasonable expectations for company performance and the pace of change. The family of a troubled company might expect overly positive results and even let the executive go if they're not met, only to start the process again. In the future, the family may want to consider the board composition to add needed market and business expertise.

The Right Mix of Internal and External Leadership – Steps towards Success

The first step in this process should not be introducing an executive as a direct report to the promoter. The new executive should start two or more levels down, since conflicts are more likely when the interaction between executive and family is high. The promoter's direct reports have a lot of interaction with the family and promoter, so the best move for the organization is to get familiar with external executives at the manager level. This placement softens the initial shock and creates the right context to bringing in an external leader.

One of the primary goals of bringing external management is to align the organization, so the promoter needs to be open to relinquishing control and letting the external professionals make the decisions. The family agreed to let managers to take control, so they should ensure they are living up to this agreement. They can help by empowering managers to select the course of their business, and helping guide the business into becoming an independent company. In Mahindra & Mahindra, for instance, the family is the owner but not the manager. Board members can make independent decisions, as opposed to being only a "paper" position. Both the company and the family value this separation. This example shows that having a distinctive boundary between ownership and management, as well as rigorously following processes, are complementary qualities. These practices are crucial, as they illustrate a commitment to helping the company evolve and grow. They also demonstrate the family has a professional mindset and understands that being externally driven will deliver better results. **"There are formal structures available, and it is important that they be applied," Godrej said. "There are good parts of family businesses processes and non-family models. The ideal is to mix the best parts and adopt them."**

The firm's level of commitment to this separation is essential when considering external talent, since having independent leadership is one of the primary features sought by individuals

considering working in a family-owned business. These issues reinforce the importance of strictly following processes when choosing a successor. The company must know exactly where in the organization they need the executive, and the family needs to make it clear what they need the new professional to do so the executive can feel free to make decisions. The best approach is to create this environment, identify the needs, delineate them clearly — and only then begin the process of hiring an outsider.

The company also needs to clearly communicate its vision. Earlier, we established that the family must have a strong reason to bringing in an external executive, which is why having rigorous procedures for such transition is crucial: after communication has been established, the promoter should allow the new leader to take the vision forward. Likewise, another way of making sure the executive is independent is to encourage the leadership to challenge the promoter's opinion. The professional has higher degree of experience and can likely interpret the events with more clarity than the family.

However, this works only if the executive was properly taught the culture of the firm and the promoter believes in the professional's judgment. Otherwise, negative tension will emerge and hamper progress. This is why it's important to ensure the board and the family are aligned on the hiring decision, and that process should be completely transparent. An increasingly popular way to separate ownership and management is to draft a family constitution. The idea is to ensure that the business remains viable, even in case of a familial dispute. Family constitutions are often implemented mostly by second- or third-generation family members, but even members from the first generation are using this idea. The goal is to resemble larger conglomerates since they typically represent a model of efficiency, steady growth and long-term endurance.

A family constitution includes, but is not limited to, ways of allowing family members to start their own businesses while maintaining the ownership and procedures that prevent the group from further splits during future successions. A constitution aims to control three circles: family, management and ownership.

The family must also address the issue of talent retention to ensure accomplished executives feel optimistic about their futures with the company. "About 40 years ago, our organization observed that many capable leaders were leaving the company," Godrej said. "They just weren't reaching top positions, which meant that, in the middle of their careers, very good performers would look for outside options. We have now clarified that is not the case, so we have seen top-level leaders reach executive positions. However, we have publicly stated that the chairman position would be reserved for family professionals."

Finally, the company needs to be aware that attracting top talent can be expensive. There's a saying, "You get what you pay for." Given that, companies should try to understand the talent market and prevailing compensation expectations so that they are prepared when the time comes to make decisions about the appropriate investment.

THE EXECUTIVE'S POINT OF VIEW

WHY JOIN A FAMILY BUSINESS?

External executives are often attracted to family businesses because of their informality. For example, changes in culture or processes are easier to make in an environment where information can be easily passed to everyone in the company.

Also, the executive's influence extends further than in the traditional non-family firm, and closer connections with employees ensure a stronger impact. This means external executives can see the

workers' capabilities, and therefore devise a firm-specific strategy. Conventional wisdom holds that progress is faster in this environment, due to less bureaucracy — not unlike a start-up.

Though there is a strong feeling that the culture and the promoter are interdependent, executives often find that this characteristic doesn't affect a company's ability to innovate. Just as in non-family businesses, whether the company accepts change or not is part of the culture.

THE PRE-SELECTION PROCESS

Before even getting the offer, it is imperative that executives confirm they are being hired to promote change or lead the company in a new direction, as opposed to being hired solely to be compliant. That means confirming the role will have actual decision-making power and the independence to develop a strategy.

The second step should be assessing the cultural fit and ensuring alignment with the promoter's idea of the business model. To evaluate the chemistry fit, the executive should spend time with the promoter or family to understand their point of view, making sure everyone is on the same wavelength.

It's also important to ensure there is a good level of communication, the decision-making process is well articulated and the family understands its influence over the business, since all will directly affect management.

AFTER THE OFFER

After the executive accepts the hiring offer, it's crucial to establish credibility with the promoter. The primary reason is because executives won't be able to make progress without successfully convincing the promoter to trust their judgment. That creates a level of personal trust and proves loyalty —in the end, it's as much professional dependence as it is personal.

Obviously, the professional should present data and financial metrics to make the case for important strategic and operational decisions, as one would with other companies. But initially, executives should be mindful that the family wants to feel confident that decisions about the business will be good for the promoter, the family and the company.

Similarly, executives should understand this dynamic and the possibility that there may be times when the interests of the company diverge from the interests of the family. Executives must put the company's interests first, and must be willing to step up and make a case for their decision, even when the family may disagree. In these cases, the executive should discuss the different views with the chairman in private. Ultimately, the decision will come from the family; however, the family should respect the executive's initiative.

Leadership in a family business also tends to come off-the-clock requirements. Usually — and especially with older promoters — executives will be expected to attend some family functions. So, the professional will likely have to be integrated into the family's personal life. Executives should view their participation — and often their spouses' — in these activities as part of the job.

Finally, being open-minded is particularly important when joining a family business, where the culture often descends from the founder's vision for the company. Observing the accepted behaviours will go great lengths, since being familiar with the culture will help create a no-gaffe start and give a glimpse into how the family thinks and operates. It will also gain the trust of the employees, who may be wary of new leadership.

Following could be likely challenges for external executives:

The main challenges facing new executives are fighting micromanagement from the promoter, the lack of hierarchy and difficulty learning the company's informal network. The relationship between promoter and executive can only be positive if both are open to each other's advice.

Executives can only lead if the family lets them be independent. Once again, these issues illustrate the importance of a strong chemistry with the promoter. The most important work the executive must do before accepting the offer is having clear and candid conversations with the promoter.

How can external leaders be a source of success in family business?

Professionals are brought to companies because the family believes they are best suited to guide the business in a new journey. Therefore, newly hired executives should quickly offer their strategy for future growth. However, contrary to popular belief, tension between the promoter and the executive rarely is the result of disagreements about strategic or operational decisions. Rather, conflict occurs when there is little personal alignment between promoter and executive — i.e., when the styles are different.

Often, the family hires an external professional because it is seeking different opinions, or the business needs a new strategy. Therefore, family members expect a certain amount of tension, at least initially. To overcome this tension, we advise the executive to provide feedback upfront, rather than silently disagreeing. Outbursts, which are bound to happen, will only be tolerated after credibility and trust have been built. However, if the family feels the executive does not have the best interest of the company at heart or they are not aligned with the firm's culture, then the family and the board will not accept the executive's ideas/strategy/advice.

Another key point to remember is that inspiring change is a slow process. First of all, the executive should listen to the family and employees — they're likely not averse to change. But the promoter can be inexplicably connected with the company, and pushing for change can transform the environment into a highly emotional setting. So, it is crucial that the executive finds a way to allow all parties to let the emotions out, instead of repressing them.

Moreover, challenging status quo is more than merely inspiring change. Family businesses are focused on the long term and creation of value, not simply revenue and bonuses. This mindset tends to work in parallel with making sure the company is up to date, technologically. Change in any industry nowadays happens fast. To keep up, the leader must ensure that processes can be quickly adapted and integrate within themselves the space for change and innovation. Keys include effective communication, believing in the greater good of the company, holding functional meetings and using relevant metrics to assess performance.

CONCLUSION

The decision to bring aboard an external professional is not easy for family-run businesses. There can be a high degree of distrust, as some members of the family worry about losing control of something that has been internally controlled for years. The culture fit can be hard to mesh, at least initially. And there can be unreasonable expectations heaped upon the new executive. But these obstacles, while arduous, are not insurmountable. And the results can be quite positive for the business, resulting in an external executive who brings a smart perspective on operations, wide-reaching personal connections and valuable global experience.

Taking a position with a family-run business can be a daunting challenge for an external professional. The culture can be hard to grasp, and there can be a high degree of distrust when the new executive first starts. The new hire should remain resolute and be patient, though — success won't happen overnight. By trying to adjust to the accepted culture and bringing experience and connections to the family setting, a new professional can thrive within even the most entrenched family-run business.

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