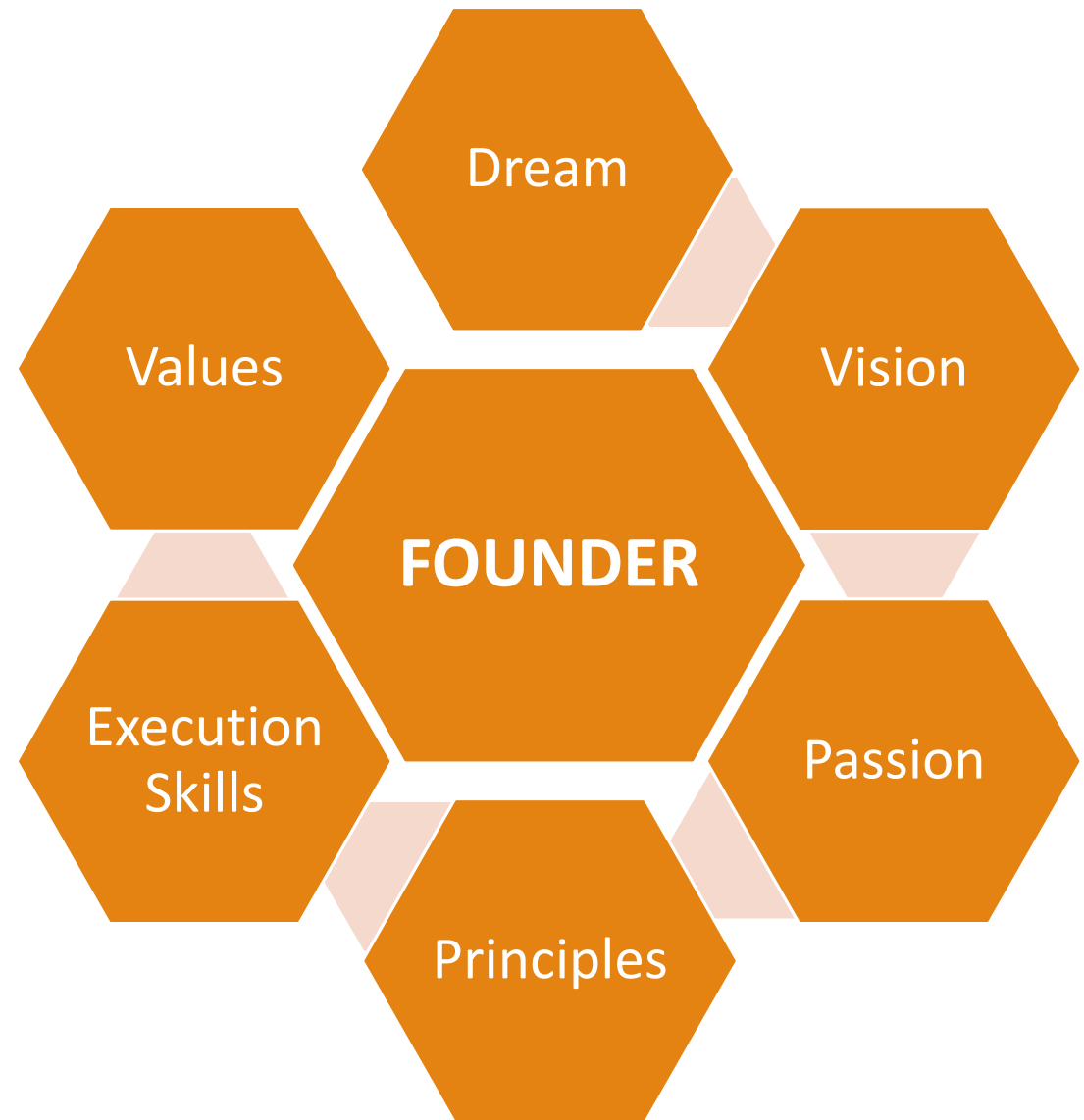


SUCCESSION OF FAMILY OWNED BUSINESSES IN INDIA

Each business is unique and special

Global family businesses are a backbone of any economy

BUSINESS
Legal & Lawful



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Global scale: around 35% of Fortune 500 companies are family-owned businesses. The pivotal role played by family-owned businesses in building strong and resilient economies can never be downplayed.

Contribution of family owned businesses in the growth of Indian economy:

In India, more than 65% of the contribution to Gross Domestic Product (GDP) in the organized sector is accounted for by family-owned enterprises.

From globally reputed, big ticket business houses like the Tatas, Birlas, Adanis and Jindals to SME and MSME units, a majority of businesses in India have been run by families for generations.

Indian family-owned companies have delivered an average 13.9 per cent annual return since 2006 compared with 6 per cent returns generated by their non-family-owned peers; and

As many as 12 of Indian businesses made it to the list of 50 most profitable family-owned businesses in Asia, excluding Japan. They include Emami, Bajaj, Godrej Consumer Products, Eicher, Symphony, HCL Technologies, Marico, Hero MotoCorp and TCS.

Origin

- Family business in India - since long;
- India - a rich and glorious history of family-owned business; and
- The origin is traced back to the bazaar system in the ancient times.

History of family owned businesses:

- Initially - trading and money lending involving the hustle and bustle of the bazaar;
- - small-size businesses requiring small investments managed by themselves only;
- Confined to certain communities, notably the Jains and Marwaris especially in the northern India;
- Once they entered into manufacturing sector - need for more and heavy investments not manageable by themselves;
- Lack of Trust factor: Fear of external participation; and
- Family businesses inducted their family members or relatives or friends ensuring majority control and management.

Life cycle of Family owned businesses

- Usually starts with one person and after initial success family members join in;
- Businesses continues from one generation to the other;
- The success of family businesses enabled the family members to study abroad and bring in new ideas;
- Every coin has two sides – old business vs new opportunities - question existing business ethos and manner of doing business;
- Usually the senior management comprises of family members, as sometimes it's difficult to accept the change and repose confidence amongst the professionals;
- Businesses which evolve, accept changes and adapt with the changing environment are able to succeed and move forward; and
- Businesses which are marred by conflicts, lack of adaptability and family ethos goes towards disintegration.

Key Drivers for the success of family business

- ✓ Acceptance and adherence to family system and values;
- ✓ Rigorous training and adaption to new technological skills and advanced management techniques;
- ✓ Reliance on professionals and hiring of management team;
- ✓ Professionalize your structure. Get the interest of management team aligned with the growth of the organization;
- ✓ Develop a strategic plan;
- ✓ Increase the capital base;
- ✓ Consolidate your business. Identify core and non-core business and take calls on consolidation or diversification based on need of hour;
- ✓ Believe in innovation. Disruption is the mother of evolution; and
- ✓ Empower the next generation.

Succession Planning in family owned businesses

Some Key Questions

- ◆ how to manage business without family patriarch;
- ◆ manner of transfer of control and ownership; and
- ◆ roles to be discharged by various family members.

When should the process be started?

- sooner the better;
- Family members should be made privy to succession exercise;
- Be honest to confront and admit your family's strengths and weaknesses;
- Like all fingers are not equal, similarly all family members can't get equal shares; and
- Take professional help for implementation.
- Transparency and sharing of key information with all is critical.

When will succession planning work and become successful

- If the process - factors in the legacy and the family ethos ;
 - takes care of needs of family and members adapt to changing environment;
 - develops the next generation as the leaders to take over baton from the family patriarch; and
- Acceptance that ownership is different from management. Management is more important than ownership;
- If the family members understand that united, we stand and divided we fall;

Important:

- Due care to the feelings and thought process of family members not engaged in the business;
- While they may have economic benefit in business, they may not be allowed to participate in discussions related to business;
- Role, authority and obligations of each member participating in business should be well defined. One must ensure that members should not step on toes of other and especially non-family professionals;
- Non-family professionals must be heard and respected as contrarian views are important and they bring in important perspective for consideration;
- Family members must accept and adept to changes; and
- One must not mix emotions with business. This is difficult but sincere efforts must be made to achieve it.

Succession Planning- Essential Steps

- Writing of family constitution;
- Formation of family council; and
- Engagement of external advisors to family council.

Family Constitution

- Constitutional document as to how family will be run;
- It enumerates, family ethos, vision, policy statement, manner and conduct expected of members, roles to be assigned for businesses etc.;
- clarity with regard to status of married/widowed/separated daughters;
- All working and non-working members are bound by it;
- Will enumerate and how the family members' requirements and interest be taken care of;
- Expenses on marriages, education, leisure travel, cars, renovation, buying and selling of real estate, monthly privy purses and manner of payment will be dealt with in the constitution;

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- Difference between family assets and personal asset of a member;
- Status of jewelry and family heirlooms, art and artifacts;
- Expulsion of members due to misconduct, breach of family values and breach of written constitution;
- How and in what manner shares of entities owning family businesses could be purchased or transferred inter-se amongst family members or outsiders;
- Aspect of non-compete with family businesses;
- Exit process and strategy for members who are either expelled or asked to leave; and
- Dispute resolution through mediation and arbitration.

Family Council

- Melting pot of different branches of the family where ideas are exchanged and implemented.
- A smaller group which deals with day to day to business and family matters;
- who could be a member-process of admission and removal;
- membership-all or elected members. Whether membership by birth/due to marriage/adoption;
- role of chairman, rights and responsibilities;
- role of each of members, rights and responsibilities;
- how the meetings will be conducted;
- matters to be discussed;
- how decisions to be taken-manner of voting-unanimous or majority vote;
- how decisions to be taken at the holding company and operating companies by the nominees of family; appointment of nominee; and
- how expansion, diversification, consolidation or disinvestment of businesses will be done.

Important

- The critical provisions of the family constitution should be captured in the constitutional documents of the holding and operating entities;
- In case the business entity is a listed entity, efforts be made to set up code of conduct for board of directors which should be adopted and accepted by shareholders and board. The code of conduct of board of directors will include key aspect of governance in consonance of family constitution; and
- Off sites of family council. Important to tackle critical issues in more relaxed and informal environment.

Process Involved includes:

Structures – Trust - Types / Will / Appropriate clause in the Memorandum and Articles of association / LLP docs / partnership / Holding company / SPVs etc- Need to ensure structures support minimum tax / minimum transfer duties / estate duty angle. Everything to be properly tied up and to be in sync with family constitution.

Compliances: Structures need to be in compliance of corporate laws / FEMA / SEBI / Listing Requirements/

Documentation pursuant to structures need to be in sink with the structures completely – they should be tied up with the Umbrella document – Family Constitution

Desired objectives can be achieved only if all is the above is done properly – this can lead to peace, harmony, continuity, no conflict situation ensuring sustainable growth and preservation of wealth

SC: Vimal Shah & Ors vs Jayesh Shah & Ors

Disputes between trustees and beneficiaries or between trustees or between beneficiaries under a Trust Deed cannot be referred to arbitration unless all respective parties agree and sign.

SC: Recent Judgment on Daughter's right as a coparcener

SC has put an end to all conflicts in relation to amendment of S. 6 of Hindu Succession Act, 1956 arising out of the Hindu Succession (Amendment) Act, 2005. The conflicts revolved around (i) whether the rights given to women are prospective or retrospective i.e deemed to be there since 17th of June, 1956 when Act of 1956 was passed (ii) whether daughter became a coparcener or not if father was not alive when Act of 2005 came (iii) whether the rights under the 2005 amendment were available to daughters born before or after the amendment (iv) whether redistribution of shares could be done in those matters where preliminary decree of partition is passed and so on and so forth. **The only exception is where the HUF assets have been partitioned on or before the cut-off date of December 20, 2004.**

Relevant SEBI order

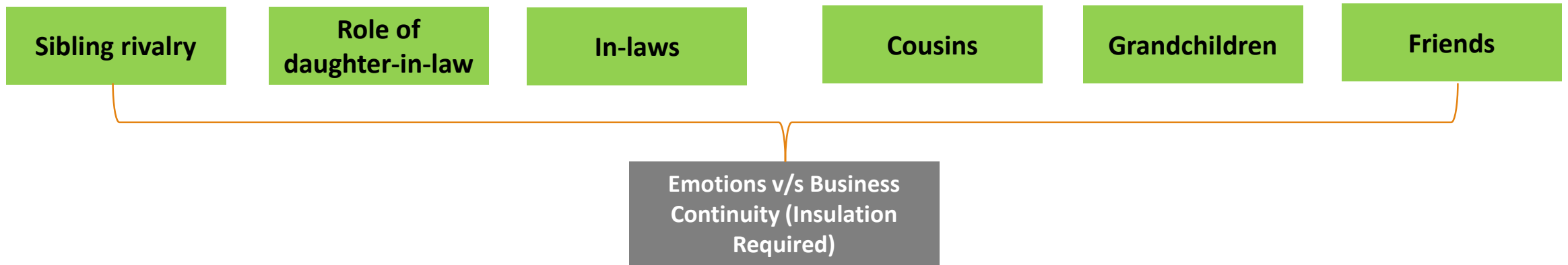
FAMILY CONSTITUTION

More and more families are coming forward to adopt a family constitution and to adopt succession planning as a tool to continue business and preserve wealth

Some of the known families who have adopted family constitution include:

- ◆ GMR
- ◆ DABUR GROUP
- ◆ MURUGAPPA GROUP
- ◆ APPOLO HOSPITAL
- ◆ GODREJ

Indian Families



Introspection needed

- Why are we together?
- Is business running well?
- Is the structure alright?
- Basis of business decision?
- Owners or Professional management?
- Resistance to change?

Succession Planning

The concept of business succession planning is gaining ground as there is a need to protect and preserve their wealth from future uncertainties & inheritance tax



Accordingly, a family trust structure may be setup which will hold the entire stake of group companies, with family members [including lineal descendants] as its beneficiaries – the key benefits of trust structure are as under:



- Enables separation of control and management from economic ownership
- Shield against any future estate duty/ inheritance tax risks
- Helps in ring fencing family wealth
- Defines rights and obligations of each family member in the family business
- Provides mechanism for effectively managing family disputes, if any

Estate tax was levied in India till 1985

It is already a reality of developed nations like USA & UK (with tax rates upto 40%)

Strong possibility that it might be introduced in India soon

Specimen – Trust Framework

