Empowering legacy:

The crucial role of family governance frameworks in Indian family businesses

November 2024

pwc

Importance of family businesses in India

Family businesses are the backbone of the Indian economy, contributing significantly to job creation, innovation and economic growth. They are **deeply rooted** in their communities, serving as vital lifelines in both rural and urban areas. Their **long-term** perspective, **trusted** relationships, **stable** leadership, commitment to **values**, receptiveness to **new** technologies, forging of new **partnerships** and **alliances**, and access to sustained **capital** are key drivers of nation-building.

Why are family businesses unable to survive beyond the third generation?

Despite their significant contributions, family businesses face several challenges as they have to balance both the emotional needs of the family members and rational needs of the business. These challenges get aggravated during inter-generational transitions and impact the longevity of the business. As per PwC, only 63% of Indian family business leaders say they have formal governance structures in place, including shareholder agreements, family constitutions and protocols, and even wills.[1]

Key issues include:

1. **Inability to adapt:** Many family businesses struggle to keep pace with the rapidly evolving business environment. This failure to adapt can lead to a decline in market position. Even once-dominant companies fail to keep pace with the fast-changing **technology landscape** and **shifting consumer needs**, leading to significant erosion of their market position.

2. **Succession planning:** Despite the fact that 9 out of 10 publicly traded companies in India are family-owned or controlled, many lack a formal family governance **framework**.[2] The absence of clear succession **plans** in ownership as well as management often leaves potential successors **underprepared and unmotivated**, which leads to a lack of clarity of role and accountability of family members. However, mature companies have started focusing on proactive succession planning through active grooming of the NextGen for leadership roles and putting up a structured governance model in place.

3. **Family conflicts:** Misaligned expectations, values and goals among family members can lead to conflicts that disrupt operations and hinder growth. In any family business, differences of opinion (on business strategy, role of the NextGen, accountability, performance of senior executives etc.) are inevitable. However, businesses that establish policies, forums (consisting of independent advisors) or objective mechanisms to address these differences, manage to thrive despite these challenges. The golden rule is to establish policy before the need arises.

4. **Communication gaps:** Poor communication among family members (amongst various working family members, between working and non-working family members) often results in a trust deficit, strategic misalignment and execution failures, thus escalating internal tensions.

5. **Entitlement mindset:** An entitlement mentality can develop among family members, where they perceive the business as existing primarily to serve their interests rather than serving the **needs of the customers.** This mindset can undermine performance, leading to complacency and a **lack of accountability**. Addressing this issue requires instilling a sense of responsibility and purpose aligned with the long-term goals of the business.

---

1. https://www.pwc.in/assets/pdfs/research-insights/creating-holistic-value-for-family-businesses-v1.pdf
2. https://www.livemint.com/weekend/a-family-feud-millennial-money-culture-and-a-controversial-coronation-11683890942300.html

Need for a family governance framework

Due to the complexity of family businesses and the need to manage the expectations of various family members, it is important to establish a structured governance framework. Such a framework will prioritise business growth, meet the aspirations of different family members ensuring harmony in family, and preserve and grow wealth, thereby reducing conflicts and improving alignment.

Core elements of a family governance framework

A well-defined governance structure ensures **transparent communication**, **clear description of roles, remuneration and responsibilities of various family members**, and the establishment of well-defined decision-making processes. A family governance framework consists of the following components:

01

Common values for the family

Family values are the **non-negotiables** that have been the core reason for the success of any business group. Although every successful family business has these values, they aren't always transcribed into concrete **working principles**. It is important to identify and preserve the founder's philosophy which formed the foundation of the business and provided the licence to operate. Commitment towards the founders' philosophy ensures that its core values remain central to its operations. Discovering this builds **pride and passion** and connect with the NextGen, employees and stakeholders. Successful family businesses codify these values into their governance framework.

02

Alignment on a purpose

A unified purpose enables a family to address the fundamental question: **Why do we exist as a family business?** This clarity of purpose strengthens the bonds between family members, fostering a voluntary commitment to stay in business for a **bigger purpose** which can only be accomplished by **working together**. It creates a shared sense of identity and direction, ensuring that decisions are taken to achieve a **common goal** rather than fulfilling individual interests. By fostering this alignment, families move beyond individual benefits to building an **enduring legacy**.

03

Formulating strategies based on the purpose statement of family

Finding a purpose helps the family to outline the **broader objective** that they want to achieve as a business. In order to foster growth, it is important for family businesses to draft a long-term strategy. A comprehensive strategy enables **alignment within the internal organisational structure** and helps in **prioritising strategic objectives** to achieve exponential growth.

04

Assigning roles and responsibilities basis the strategy

Defining the roles and responsibilities of family members will help in translating the strategic objectives into **actionable initiatives**. Clarity in roles and responsibilities is crucial for **minimising friction** and **enhancing accountability** within the organisation. By establishing clear key performance indicators (KPIs) and key result areas (KRAs), families can track individual performance and need for support while ensuring that **planned outcomes** are achieved. In the process, roles and responsibilities that family members may not be able to assume can also be identified, and external help can be sought by collaborating with employees and advisors. This realisation will change the organisational culture from control to collaboration. The leadership should also keep business success at the centre and assign responsibilities to individuals who will be instrumental in driving that success – it is important to review a position or an initiative, not a person.

05

Professionalisation of family businesses to take accountability of outcomes and move to a performance-driven business.

Professionalisation of a family business does not necessarily mean hiring outside talent – rather it focuses on changing pre-existing notions of family members in business, in order to encourage them to be more responsible and accountable. It shifts the mindset from entitlement to one of responsibility and privilege, fostering a culture where contributions are valued based on merit. To remain competitive in today's landscape, family businesses must **v** akin to non-family businesses. Establishing a governance framework nudges family businesses towards professionalisation by introducing formal structures, defining roles and responsibilities, and applying industry best practices.

Further, to achieve aspirational goals, partnerships with external stakeholders (shareholders, partners, investors, customer, environment and other stakeholders [SPICES]) becomes essential. Family businesses cannot achieve their long-term vision in isolation. Strategic collaborations with employees and stakeholders help in driving growth, building sustainable practices and fostering innovation.

06

Attracting and retaining talent to build institutional members who have an entrepreneurial mindset

Having institutional members is critical for the success of family businesses. Family businesses can attract and retain the right talent by creating a collaborative culture that fosters innovation and prioritises merit while maintaining responsibility towards outcomes. By developing a strong talent pipeline, family businesses can make their business distinctive in the market.

Family businesses can identify top talent who are eager to join because they recognise the potential for significant growth and opportunities for personal wealth creation.

07

Facilitating entry and development of the NextGen

A founder-led business is built on the culture of control with values like secrecy and privacy. However, due to the evolving nature of businesses, this culture needs to become more collaboration-centric to ease the entry of the NextGen through collectivism, mutual dependence and transparency.

Today's NextGen wants to pursue opportunities where they feel involved, and their roles are clearly defined. They want to be part of a business that has a clear purpose. Therefore, to make family businesses attractive for them, it is important to redesign the business by making it a purpose-led organisation that has well-defined values and a clearly articulated strategy. This will cultivate a sense of pride and help further the legacy. Moreover, it will help the NextGen tackle stretched targets and take responsibility of the outcomes and subject themselves to review by an independent committee.

To ensure longevity of the business, it is important to ease the upcoming generation into the business and, subsequently, leadership. Preparing family members for assuming responsibilities in the business requires a focus on acquiring new skills and competencies aligned with the evolving needs of the business.

Considering the dynamic nature of the market, family businesses should always revisit their governance frameworks regularly – especially during leadership transitions. Governance frameworks can play a crucial role in capturing the aspirations of the next generation and guide their growth through a structured strategy that encompasses the following:

- **Discover:** Identify personal and professional areas of interest.
- **Develop:** Help them develop skills to make them successful in their areas of interest through mentoring, experience sharing and classroom sessions.
- **Deploy:** Give them an opportunity to put their skills to test and provide support and feedback.

Adopting this strategy will help the newer generation to move up the ladder basis the outcome and prepare them for leadership positions, while maintaining the core values of the business.

08

Financial security for working and non-working family members and clarity on ownership succession

Succession planning is crucial for ensuring a smooth transfer of ownership in a family business. Key policies should include financial security for family members, clearly defined wealth creation goals and transparent communication of these plans within the family. Additionally, providing family members with some financial freedom is essential to maintain both individual dignity and choice.

Having a personal financial security plan empowers family members to make independent decisions. It gives them the freedom to explore their own interests and reassures them that their individuality is respected. This financial autonomy helps them avoid reliance on the senior generation or the family business. A robust governance framework must address ownership issues like:

- strategy for transferring part or whole ownership
- clear principles for the succession and continuity of the family business
- principles of family employment
- family fund policy
- policy for exit
- formal dividend policy
- policy for philanthropy
- policy for contingencies – death, dispute, disability and divorce.

09

Framework to manage conflicts

By establishing separate forums like family councils, a family business can address both family and business matters in a structured way, while avoiding overlap and conflict. A family council can focus on sensitive family issues, such as the NextGen's involvement or personal financial security, while the business council can handle business growth, strategic investments and operational challenges. These distinct forums allow family concerns to be openly discussed without hindering business operations.

A robust governance framework is key to managing conflicts in family businesses. It clearly defines how family members engage with the business and each other, reducing personal biases and emotional entanglements. This framework encourages family members to separate their 'owner's hat' from business reviews, promoting impartial decision-making. A transparent communication policy, including the disclosure of financial interests, fosters accountability and trust within the family.

Conflicts are inevitable in family businesses – so it is important to focus on how they're managed. To facilitate effective conflict resolution, the 5Cs mentioned below should be taken into account:

- **communication** (ensuring everyone's voice is heard)
- **clarity** (clearly defining the roles and responsibilities)
- **consistency**
- **changeability** (being agile)
- **culture of fairness** (just and equitable in dealing with stakeholders).

Essential components of a robust family governance framework

A robust family governance framework comprises three key components – the family council, business council and ownership council. These councils serve as the foundation upon which the governance of the family business is built, ensuring that each stakeholder's interests are addressed while promoting overall harmony and sustainable growth.

The role of the family council

The family council plays a vital role in maintaining strong family relationships and managing differences effectively. It provides a structured platform for open communication, ensuring that fair processes are in place for addressing various family matters. Key functions of the family council include:

- **establishing clear communication processes** to promote transparency and understanding among family members
- **managing conflicts and differences** through mediation and structured dialogue, fostering stronger relationships
- **facilitating the induction of new family members,** helping them integrate smoothly into family dynamics and governance
- **setting policies** on important aspects such as social media usage, code of conduct and the management of family funds to maintain cohesion and discipline across the family.

The role of the business council

The business council is instrumental in steering the family business' growth, ensuring that it remains competitive while upholding family values. Its key responsibilities include:

reviewing strategic initiatives to align the business' direction with both market trends and family objectives

developing an empowerment process for decision-making, enabling swift and effective responses to business challenges

establishing an efficient review mechanism, ensuring ongoing assessment of business performance and strategic goals

creating a continuity plan, securing the long-term sustainability of the enterprise

preparing the next-generation leaders by defining their roles and responsibilities, guiding them towards effective leadership.

The owners council: Safeguarding wealth for future generations

The owners council is focused on preserving and growing the family's wealth while ensuring responsible ownership. Its core responsibilities include:

- **establishing clear principles for succession and continuity**, ensuring smooth transitions across generations
- **defining policies for responsible ownership**, guiding family members in the stewardship of family assets
- **overseeing new ventures**, ensuring they align with the family's long-term goals
- **managing the financial security of each family member**, through well-defined family fund policies and strategic oversight
- **addressing key issues** such as deadlock resolution and exit strategies, safeguarding the family's wealth and ensuring long-term strategic alignment.

Implementing a family governance framework: Continuous journey for managing key issues

Understanding the current state of the family business is the first step towards developing an effective governance framework. This involves conducting one-on-one discussions with family members and understanding their needs, aspirations, expectations and challenges. Based on these insights, a roadmap is crafted to guide the family through the governance process, typically over a period of 8 to 12 months.

During the first phase, key elements such as family values and purpose, and the roles of the various councils are defined and institutionalised. The main effort is towards embedding the framework into the daily operations of the family business – i.e. living the family governance framework. This requires ongoing support and follow-up to ensure that the strategies and action items developed during the first phase are actively implemented and adjusted as needed. The role of trusted external advisors becomes pertinent to navigate biases and manage conflicts during this process.

Matured families invest time over the years in meticulously developing their family governance framework. This effort is the first step towards establishing a systematic, policy-driven approach to managing their family business. The resulting framework is a dynamic, living document – crafted by the family, for the family.

In conclusion, the process of family governance involves careful planning, structured implementation and continuous adaptation.

What is the right time to establish a family governance framework?

Triggers to look for in your family and business

There is no fixed or ideal time to implement a family governance framework – it isn't determined by the revenue or the number of employees you have. Rather, it depends on the unique needs of your business and the growth stage of your business. Ideally, one should consider implementing a family governance framework:

- before disagreements escalate into conflicts
- succession of ownership and management becomes a concern
- the next generation enters/takes over the business
- the business reaches a critical transition point.

Proactively establishing governance frameworks enables family businesses to address potential disparities early on, thereby mitigating future conflicts and ensuring seamless transitions. Early implementation creates clarity around roles, responsibilities and expectations, thus fostering alignment and preparing the family to navigate future challenges with greater cohesion and stability.

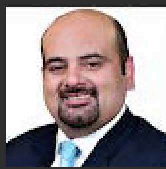
About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 151 countries with over 360,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.

Contact us

Falguni Shah
Partner and Leader, Entrepreneurial and Private Business PwC India
falguni.shah@pwc.com



Jayant Kumaar
Partner, Deals and Family Office Leader PwC India
jayant.kumaar@pwc.com

Editor

Rashi Gupta

Design

Pooja Sharma

pwc.in

Data Classification: DC0 (Public)

PS/November 2024/ 42099