FAM FIRM

OWNERSHIP STRUCTURES IN BUSINESS FAMILIES NEED CLEARLY ARTICULATED GOALS TO KEEP FEUD AT BAY

Kavil Ramachandran
Thomas Schmidheiny Chair Professor of Family Business and Wealth Management at the Indian School of Business, Hyderabad

BY invitation

Business families tend to grapple with ownership structures. 'Who-owns-how-much-and-why' is most often not discussed. Since family leaders continue to build businesses, and thus wealth, the assumption is that it is for everybody (in the family). Built on the fragile remnants of the joint family system, members hesitate to clarify the legal holding pattern. This can be dangerous as is evidenced by the multitude of family break-ups witnessed across the country. Most families do not realise that ownership-related challenges could be addressed smoothly with some careful thinking.

Basically, concerns about 'how much I own' arise out of two needs. The first one is about meeting the need to have wealth for the present and future. The second one relates to employment and status-related need. Here, the basic assumption is that managing or at least having significant responsibilities and socially recognized titles in business depends on one's ownership control, direct or indirect.

As business operations and success in the marketplace are more important than clarifying the internal structuring of ownership, new companies get formed as separate entities, often for regulatory reasons. As the family leaders allocate shares to other family members, including the next generation without bothering about possible long-term inequity, business ownership structures become a cause for concern for some family members. This is also because business performance does not remain equal for all business units at all times. The challenge really occurs when children and cousins are involved. Even in families with a single child, there can be major ownership-related concerns between parent(s) and the child, either for want of cordial relationship or for gender-related reasons. Complexity gets compounded when one is concerned about a son-in-law getting possible ownership through the marriage of the daughter.

Most of the ownership-related concerns arise due to lack of a clearly articulated goal of owning businesses. Family business leaders should be clear whether the business is only to create for self and / or the family, or to build it as an institution for perpetuity. It can be a combination of both. So long as the business is a means for the family's current wealth, individual interests and concerns will play a dominant role. If instead, the owners are there to perpetuate the family wealth, individual holding pattern does not matter. In most cases, such trusteeship assumptions are not explicitly articulated. Two of the most respected and successful Indian business families that have successfully transcended 4-5 generations have upheld the trusteeship value of ownership. They have accordingly redistributed their holding among cousins equitably in different generations. This process is made simpler if families use the holding company model as the vehicle to hold all the shares of the different branches of the family. Most family businesses that have lasted multiple generations tend to adopt this model. The Merck family that controls more than 70 per cent of MG Merck, Germany, has found this as the best ownership model in their journey through eleven generations.

Families that see the role of business more as a major vehicle to contribute to society tend to create one or more public trust (or a not-for-profit company under Section 25 of the Companies Act) to hold shares in the business. Multiple trusts under the Tata umbrella reflect this goal. There are several overseas examples of this model, such as that of the Hilti Corporation of Austria.

However, on the contrary, families will continue to have ownership-related struggles as long as their business is treated as a means to make money.

There have been recent instances in India of families adopting a 'Perforation Model' essentially for want of clear mechanisms for addressing possible differences in operational strategies. They do not show signs of maturity that enable creation of institutions out of business organizations while simultaneously creating personal and social wealth. Under the perforation model, individual family members hold most of the family's holding in the company that they manage, leaving a small portion for other family members. The net result: At any point in time, those who cannot withstand questions of strategy or performance, can buy back the remaining shares and walk out. Essentially, this is a repeat of the entrepreneurial stage in respect of ownership and management. Unfortunately, lasting empires are rarely built from such princely initiatives. Lack of trusteeship feeling and centralised holding may lead to challenges of addressing effects of cross-holding, particularly when different family members manage businesses owned by other family members.

Again, stability in ownership structure depends on clarity about the time horizon of the existence of business. Families with a short-term horizon would look at business as a means to create a decent amount of wealth for the family. They tend to follow an amoebic model of ownership break up in almost every generation.

Finally, families should be clear about questions of exit that some family members may have at some point in time. As part of governance, they should decide whether family members can sell their stake in the business, and if so, how. Most sustaining families put severely restrictive exit clauses, such as: sale only to other family members, that too, sometimes at a 10-20 per cent discount. This would discourage unpleasant instances of some family members deciding to unilaterally exit for selfish reasons.

Family businesses gain from developing clear long-term purpose of existence. This is true while addressing the challenges emerging out of ownership structures too.