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Succession Planning
Growing and Lasting Family Businesses

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Family businesses are businesses which are run by members of the family and are passed on by one generation to another. The current generation is not just the owner, but also plays the role of a custodian, guarding and nurturing the business to hand it over to the next generation.

Family Businesses are thus simply put, a combination of two ecosystems; first is the family and second is the business. The key characteristic of a family business is the inherent contradictory nature of its two constituents, i.e. on one hand the business thrives on leadership and competition whereas on the other hand, the prime concern of the family is their welfare and meeting social objectives.

Family business owners aspire to achieve a future for their business and a family legacy that will last forever.

However, if facts are to be believed, only 3% of family businesses survive beyond the third generation[1].

In the context of Indian Inc., more than two third of all businesses are family run businesses[2] that have expanded to multiple territories in the era of globalization. There are examples galore however of where lack of succession planning had a fatal impact on the business as well as on the family.

Succession Planning becomes imperative when it comes to family businesses and is one of the most critical issues faced by them. Succession planning is not only important for preserving and passing on the existing family wealth to the next generation, but also a critical area in the context of GDP contribution, given that these businesses are the backbone of the Indian economy.

Historically, succession planning has always taken a backseat in family discussions given the sensitivity of the subject and the consequential hard talks and this has thus typically lead to this issue being put on the backburner.

The lack of or poor succession planning has resulted in family conflicts, boardroom feuds and expensive court cases and consequently, spelled doom for the business. Inter-generational issues amongst the patriarch and the successor family can lead to the failure of family businesses. We have often read in the news (and very recently as well) and have observed that struggle lies in the fact that founding generations tend to uphold their visionary qualities, family values for the growth of the business while the later generations struggle with a desire for independence and sometimes internal conflicts.

The perspective of the family and the business can be better understood with the following soft factors:

Basis	Family	Business
Identity	Person oriented	Function oriented
Language	Oral	Written
Behavior	Emotional	Rationale
Risk appetite	Low	High
Attitude to change	Typically, conservative	Opportunistic
Evaluation of organization members	Independent of performance	Dependent on performance
Value of the system	Value in itself	Value through revenue
Relationship principle	Feelings and kinship	Contract
Life cycle	Limited	Unlimited in theory

Source: EY Family Governance workshop

[1] Ward J., Keeping the family business healthy, San Francisco, CA: Jossey-Bass, 1987
[2] Report on Family business by Indian School of Business (ISB)

The typical differences in the perspective of two generations are set out below:

Outgoing generation	Incoming generation
Preservation oriented	Considers opportunities for the business; change oriented
Ample experience in the business	Relatively little experience in the business
Lose control and responsibility	Gains control and assumes responsibility
Strong emotional ties to the business	Weak emotional ties to the business
Evaluate value in terms of past personal achievements and efforts	Evaluate value in terms of future financial opportunities and risks

Source: Center for Family Business of the University of St. Gallen.

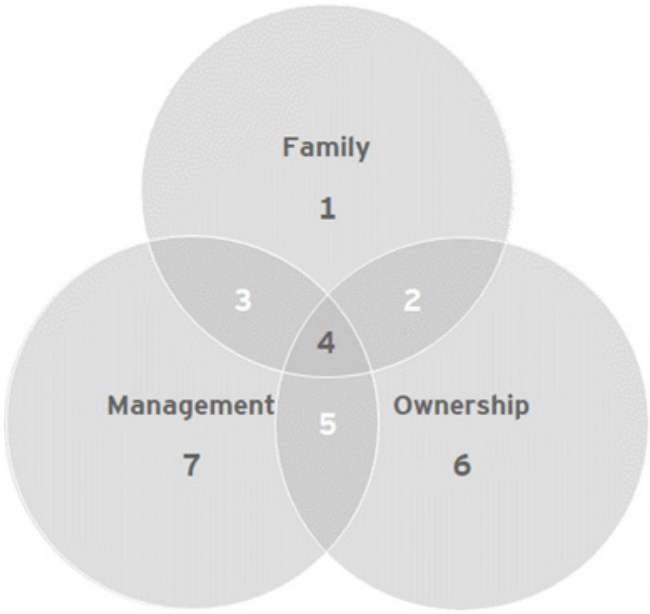
Frequently overlooked in the entire succession plan, is the importance to train, educate and instil appropriate work ethos in the younger generation.

Dimensions in terms of succession of ownership and management play an important role in laying down the roadmap to a robust succession plan. The various dimensions of succession of ownership and management are depicted below:

		Management		
		Family internal	Family + Non Family members	Non Family members
Ownership	Family internal	Family succession	Management by family and professionals	Ownership succession with professional management
	Family + Non Family members	Private equity partner / investor	Ownership and management with family and professionals	Financial investment
	Non Family members	Family involvement in management after succession		Sale of business to outsider / co-owner

Source: Center for Family Business of the University of St. Gallen.

Understanding the role of each family member in the overall scheme of succession planning is equally pertinent. Family members may occupy different roles as per the below Venn diagram:



1. Family members not involved in the management and also not holding ownership e.g. minor children and spouses etc.
2. Family members not involved in the management but holding ownership e.g. members who are pursuing other professions apart from the family business / spouses etc.
3. Family members involved in the management but not holding ownership e.g. members who are future successors etc.
4. Family members involved in the management and also holding ownership e.g. patriarch etc.
5. Non family members involved in the management and also holding ownership e.g. Strategic investor
6. Non family members not involved in the management but holding ownership e.g. Public shareholders etc.
7. Non family members involved in the management but not holding ownership e.g. employees etc.

Source: EY Family Governance workshop

Succession planning is thus not a one-time event but rather a continuous and an evolving process. It is an art and not a science. There is no playbook to be followed by families while making their succession plans. Family values, business objectives, vision and mission play a vital role in determining the succession plan.

There are various instruments/tools which are used by the families for developing the overall framework of this plan e.g. Trust, Will, Family Charter, etc.

Succession planning through fiduciary structures, i.e. trust structures, has gained importance in the recent times due to the varying degrees of advantages offered by it.

The concept of a trust has been prevalent in India since the 20th century. Trust structures were primarily set up as a tool to plan estate duty / inheritance tax, leviable on the estate of the deceased individual (the rate was as high as 85%). The subsequent abolishment of estate duty / inheritance tax in the year 1985 resulted in trust structures falling out of favour. However, there has been a gradual shift in the landscape wherein the wealthy Indian families have again started preferring more formal, sophisticated trust arrangements to achieve their succession goals especially amidst talks of probable re-introduction of the erstwhile estate duty in some form.

A Trust as per the Indian Trust Act, 1882 is "an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him for the benefit of another, or of another and the owner."

In layman terms, a Trust is a fiscally transparent entity where property of the Trust is vested /placed by the settlor / author of the trust under the control of a person or persons (Trustee) for the benefit of specified individuals or organizations (Beneficiary).

Key benefits offered by the Trust structures include giving the succeeding generation the benefits of family wealth without sacrificing control over key assets, catering to the specific demands of the family such as providing for their recurring lifestyle and maintenance expenses, a better legal framework, charity / philanthropy desires of the families etc.

Additionally, in view of the ongoing pandemic situation caused by Covid-19, High Net Worth Individuals (HNIs) have realised the importance of making a Will to ensure hassle free succession in these uncertain and unprecedented times. Will writing is the legal intention of an individual (Testator) with respect to their properties which they wish to bequeath or devolve, after their lifetime.

Setting up a Trust	Making a Will
Setting up of trust involves transfer of property	No transfer of property involved
Legal ownership transferred to trustees	No transfer of ownership to any person till testator's death
Role of settlor, trustee and beneficiary can be played by identified person	Properties passed on through Will which is effective only after death of testator
Trust can be revoked only if there is a power contained in trust deed	Will can always be revoked during lifetime of testator
Vesting of assets in trust while the settlor is alive	Vesting of assets may be litigation prone – need to obtain probate
Trust is more expensive	Inexpensive
Once executed cannot be altered unless Trust Deed provides otherwise	Can be changed as per the discretion of the testator at any point of time
Property left through a trust does not go through probate	Property left trough Will goes through probate
Privacy after death	Will is comparatively a public document upon death of the testator
Stamp duty on transfer of property to trust	No stamp duty exposure on receiving the property through Will

Source: Center for Family Business of the University of St. Gallen.

Further, in context of large extended families, a Family Charter also known as Family Constitution becomes important and noteworthy. Family Charter is a formal written document codifying various aspects of the family side as well as the business side. It is a key document used for governing the family in terms of their actions and relations while dealing with situations in their day to day functioning.

The key ingredients of a Family Charter include a preamble detailing the family background, values, ethos, decision making mechanism, economic interest, funding of new business ventures, conflict resolution strategies, fixed allowance to non-working members, exit opportunities to dissenting members etc. Given the ever-changing landscape and continuous evolvements, both from perspective of business as well as family, it may become pertinent to re-visit certain aspects at an appropriate time.

Succession planning sets out to balance the interest of a business with the family members and subsequently passing the baton to successive generations. A robust succession plan with adequate flexibility and with effective channels of communication and transparency should be high on the priority agenda of any family businesses. In the current disruptive scenario, the effort to sustain a family business is an ongoing continuous process and needs active revalidation from time to time. ■