ISB | Thomas Schmidheiny Centre for Family Enterprise

# Family Business Briefs

***Issue 48 / June 2018***

*Welcome!*

*I am delighted to share with you the latest issue of our newsletter, '**Family Business Briefs**.' This issue contains some thought-provoking ideas, facts and figures about family businesses that you may find noteworthy. The briefs has the following sections:*

- *Summaries of research articles with practical implications **on Governance and Succession***
- *Summary of a published family business case on **Aurobindo Pharma***
- *Inspirations from the life of **Kasturbhai Lalbhai***
- *Interesting insights on **Dr Reddy's Laboratories Limited***
- *Infographic on **Age of Family Firms in India***

*We hope that you will find these edifying and inspiring.*

***Our training programmes for Family Business Advisors, Women in Family Business and Family Business Growth and Transformation are scheduled during July / August 2018. For more details, please visit our website http://www.isb.edu/fbwm/education/training***

*As always, I encourage you to send your feedback and share suggestions about something interesting and relevant, which you may want us to include in future.*

*Best regards*

*Ram*

*Kavil Ramachandran, PhD*
*Professor & Executive Director*
*Thomas Schmidheiny Centre for Family Enterprise*
*Indian School of Business*

# ARTICLE SUMMARY

## Family Constitution and Business Performance: Moderating Factors

*- Rocio Arteaga and Susana Menéndez-Requejo*

Family Constitution is a written document comprising rules and procedures that govern family business relationships. It includes policies and guidelines for ownership and transfer, wealth management, succession planning, governance structures and other matters of critical importance. It is signed and ratified by each member of the family. Although family constitution is an important document that comes into being after a lot of discussion and negotiation among family members, it has not been adequately studied in family business research. This paper analyzes 530 Spanish family businesses and examines the effect of implementing a family constitution on firm performance. The paper also probes the factors that moderate this link.

### Family Constitution and Firm Performance

Family Constitution contributes to family firm professionalization by establishing policy-based decision-making processes. It promotes shareholders agreement, family communication and cohesion. The authors argue that by addressing these issues, family constitution reduces agency conflicts and negative effects of socioemotional wealth preservation. This improves firm performance.

### Moderating Factors

***Non-family CEO:*** Family CEOs may pursue family-centred non-financial goals which may affect firm performance. Family Constitution promotes professionalization, limits nepotism, establishes corporate governance norms and minimizes agency problems. Therefore, the authors argue that firms with non-family CEOs are likely to have better performance.

***Multiple Family Owners:*** Family constitution addresses the issue of shareholder agreement, protects minority shareholder and prevents blockholder conflicts. Hence, firms with multiple family owners are likely to perform better than firms with concentrated ownership.

***Later Generations:*** Family constitution improves family cohesion, which is much needed in firms controlled by later generations. Thus, such firms are likely to perform better.

Data analysis confirmed the positive effect of implementing family constitution on firm performance. Presence of non-family CEO, multiple family owners and later generations were found to have strengthened this relationship.

### Practical Implications

Family firms need to focus on developing and implementing a Family Constitution.

- Family Constitution not only provides a mechanism for governance but also improves firm performance.
- Implementing a family constitution sends a positive signal about the firm's governance approach, to external audiences like, financial institutions, customers, suppliers, and other stakeholders.
- Multi-generational family firms or firms with multiple family owners are likely to be especially benefitted by implementing the family constitution as decision-making becomes more focused and coherent.

***Source:*** *Family Business Review, (2017), Vol. 30, No. 4, pp. 320–338.*

# ARTICLE SUMMARY

## To Nurture or Groom? The Parent - Founder Succession Dilemma

*- Jeffery S. McMullen and Benjamin J. Warnick*

Intrafamily succession is a critical event in family firms. Family business sustenance requires effective successors who can ensure good performance and retain the family's control over the business. Family firms with leaders having affective commitment to business are more likely to achieve their objectives. However, successor commitment and the parents' role in encouraging it has not been adequately examined. In this paper, the authors build on self-determination theory and conceptualize a model to promote affective commitment of child-successors while supporting their psychological needs. This summary succinctly presents the key observations authors make and their implications for family businesses.

### Child-Successor's Commitment to Business

Drawing from the extant literature and self-determination theory, the authors posit that successors having affective commitment to business invest more time and effort in the firm, get good response from the employees and are more likely to contribute to the firm's non-financial objectives. If the child-successor experiences autonomous motivation while working in the firm, s/he is more likely to accept family firm leadership when offered. The authors further posit that if the family business satisfies the successor's needs for building competence, autonomy and relatedness, s/he is likely to choose a career in family business over other career paths.

### Parent-Founder's Support to a Child-Successor's Needs

Parent-founders can help a child's integration with family business by satisfying child's need to build competence. This can be done by providing: positive verbal feedback, relevant education and experience, and entrusting responsibilities that fulfill the child's need for autonomy by empowering him/her to make choices within the firm. Parent can improve the child-successor's integration with business by satisfying his/ her need for relatedness. This can be done by promoting: (i) participation in family business decision-making, (ii) family harmony, and (iii) a shared vision for the family business.

### Practical Implications

The multi-level model of family succession presented in this paper suggests the pathway parent-founders may adopt to promote affective commitment to the family firm in child -successors. The model also places significance on supporting child-successor's needs for competence, autonomy and relatedness. Balancing these two objectives (i.e., nurturing the child's commitment to the business and supporting the child's needs) requires careful grooming by the parent. The suggested model can help family businesses effectively facilitate intra-family leadership succession and can simultaneously benefit the parent-founder, the child-successor, the family and the business.

***Source:*** *Entrepreneurship Theory and Practice, (2015), Vol. 39, No. 6, pp. 1379 - 1412.*

# ARTICLE SUMMARY

## An Exploratory Study of Firm Goals in the Context of Family Firms: An Institutional Logics Perspective

*- Gloria Aparicio, Rodrigo Basco, Txomin Iturralde, and Amaia Maseda*

Business organisations have multiple stakeholders who aim to achieve diverse goals. In case of a family firm, family is the dominant coalition and is likely to impose its aspirations on the firm. Hence, in addition to the business goals these firms are also likely to pursue family-oriented goals. However, the conceptualization and actual measurement of family business goals have not been adequately examined by scholars. In this paper, the authors use Hybrid Delphi methodology to develop a list of family business goals. Based on institutional logics the authors provide evidence of coexistence of multiple goals in family business context. This summary presents the key findings and implications of their research.

### Identifying Family Business Goals

The authors conducted two rounds of Hybrid Delphi process (among family business leaders, consultants and academic experts) to identify family business goals. They found that the main goals of a family business were based on three institutional logics: ***(i) market, (ii) community,*** and ***(iii) family***. Goals of a specific family firm reflected the institutional logic in which the firm was embedded.

The overarching family business goal identified was to ***'create sustained wealth over time and retain family ownership of the business.'*** The authors further classified the family business goals into four categories:

***(i) Business-oriented economic goal (BEG):*** such as, economic and financial performance, and business growth,

***(ii) Family-oriented economic goal (FEG):*** such as, business as means of economic support, preservation of family nature of the business and family equity, and cash payouts to shareholders,

***(iii) Family-oriented non-economic goal (FNEG):*** such as, emotional motivation, transgenerational family business, commitment to firm's project, concern for the family unit, preparing future generations and protecting the family name, *and*

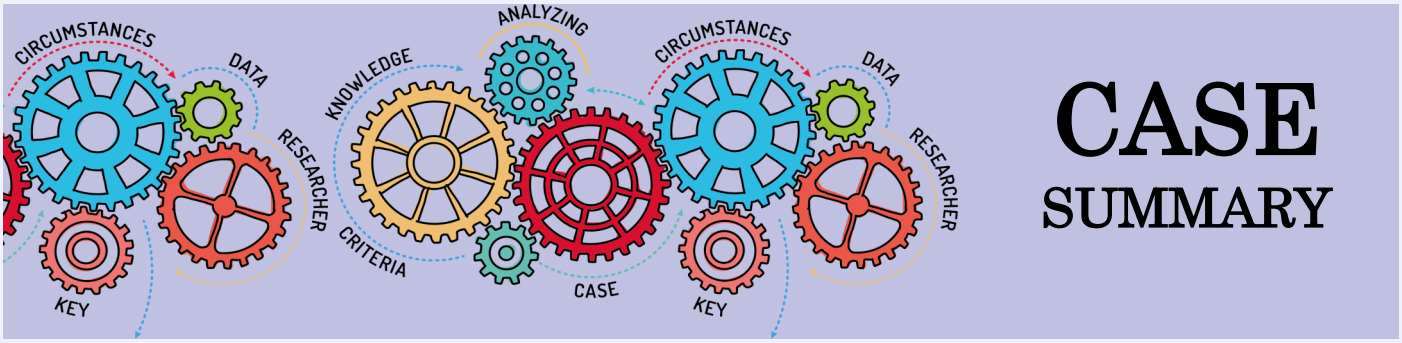
***(iv) Business-oriented non-economic goal (BNEG):*** such as, concern for employees, customer focus, contributions to the economic, social and environmental systems, preserving the local roots and conserving firm traditions.

*Economic growth, retaining family control, developing the next generation, promoting family harmony* and *succession planning* were ranked as the top priority goals that family businesses pursued.

### Practical Implications

This research helps family business owners, managers and consultants understand the diversity of family business goals and complexity in decision-making. Family firms may be extremely fragile to govern as some of their goals, anchored in different societal groups (i.e., market, community and family) may be in conflict with each other. Family firm managers would do well to prioritize these goals based on their importance and context. The list of goals that the authors identify in this paper can serve as a starting point to determine key decision issues, thus leading to effective management of family firm complexity.

***Source:*** *Journal of Family Business Strategy, (2017), Vol. 8, No. 3, pp. 157-169.*




## Aurobindo Pharma: Gearing Up for the Future

*- Kavil Ramachandran and Navneet Bhatnagar*

P. V. Ramaprasad Reddy founded Aurobindo Pharma Limited (APL) in 1986 with his close friend, Nithyananda Reddy and some of their capable associates. Since then, APL grew from a small pharmaceutical manufacturer to a global corporation with operations in 125 countries by 2011. This case illustrates the remarkable entrepreneurial journey of growth and professionalization of APL and its quest for an able successor. APL faced several challenges in its journey but maintained industry competitiveness by modernizing manufacturing facilities, investing in research and development, and scaling up facilities through organic investment and carefully planned strategic acquisitions. These measures helped APL build capabilities to tap global opportunities. In 2007-08, the founders developed an ambitious vision for APL to become one of the top 15 global generic drug manufacturers by the year 2015. However, this required APL to further professionalize its operations and governance mechanisms.

In the initial years the top management followed a hands-on approach to manage business operations. As the business grew and became complex, the founders brought in experienced outside professionals and experts as independent directors. With their help, professional governance mechanisms and more effective management systems were established. These efforts led to the company's successful development of a rich mix of products and a healthy pipeline of drugs while ensuring strict adherence to rules and standards required by the clients and regulators.

Ramaprasad had two sons. The elder son, Sarath (26) was involved in business, while the younger one (23) was still studying. Nithyananda had one daughter, Kirthi who headed production at one of the manufacturing plants. The founders identified the need to groom next generation members since they were growing old. However, this required considerable time and effort. While on one hand APL had to continue its growth journey by professionalizing governance mechanisms, on the other hand smooth leadership succession was essential to sustain continuity.

### Learnings for Family Businesses

This case highlights family firms' need to professionalize their business and to develop their next generation leadership. More specifically, as family firms grow, they need to:

- Develop a clear roadmap for professionalization. Beyond operations, they also need to professionalize their corporate and family governance mechanisms. These efforts must be supported by the necessary technical and managerial capabilities.
- Start early to plan for succession and grooming of next generation leaders.

These measures will ensure that the family business is geared up to deal with the challenges of growth and continuity.

***Source:*** Aurobindo Pharma: Gearing Up for the Future, Case Authors: Kavil Ramachandran and Navneet Bhatnagar || website link: http://sk.sagepub.com/cases/aurobindo-pharma-gearing-up-for-the-future.

# FAMILY BUSINESS LEADER

## Kasturbhai Lalbhai

## (1894-1980)

An institution builder par excellence, Kasturbhai contributed to the fields of industry, education, culture and religion.

His father passed away at a young age of 49. Young Lalbhai left college education then and took over the family business at the age of 17. With hard work and perseverance, Kasturbhai went on to create one of the most reputed business houses of India, now called Lalbhai Group.

Established in 1931, Arvind mills is one of the largest composite textile mills in the world. He founded Atul in 1947 with a dream to make India self reliant in chemicals, generate employment on a large-scale and create wealth for the society.

Kasturbhai funded, mentored and played key roles in the establishment of some of the finest educational institutions in India, including, Indian Institute of Management, Ahmedabad.

Kasturbhai had deep belief in Jainism and the Indian philosophy, culture and heritage. His work for the restoration of Jain temples, the preservation of ancient scriptures, manuscripts and art and instinctive understanding of buildings, beauty and symmetry led Louis Kahn to describe him as the greatest natural architect he ever met.

He was deeply inspired by Mahatma Gandhi and Sardar Vallabhbhai Patel. He supported the Swadeshi movement and committed to lifelong service to society.

He lived his life with perseverance, integrity, discipline, simplicity and austerity and aimed for excellence and a larger purpose.

Lalbhai was born in an affluent Jain family, to Mohini and Lalbhai Dalpatbhai, in 1894 in Jhaveriwad, Ahmedabad, Gujarat. His forefathers adorned the courts of Akbar. He married Sharda Chimanlal Jhaveri in 1915 and had two sons, Shrenik and Siddharth.

Kasturbhai was awarded Padmabhushan in 1969 for his exemplary contributions to the nation.

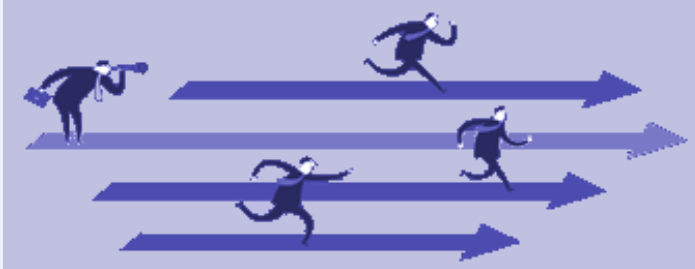
"*There is no substitute for integrity in business* "— Kasturbhai Lalbhai.

'*Kasturbhai was a great organizer and institution builder but he wanted no reward and no recognition. Time and time again he was asked to become the Chairman of the IIMA and every time he refused with the remark, "Why must you force this title on me? I am always here if you want me."*'- Ravi J. Mathai

*Source: http://www.jainlibrary.org/elib_master/article/250000_article_english/Shreshthivarya_Shri_Kasturbhai_Lalbhai_250424_STD.pdf*

*http://www.vizcomsolutions.com/portfolio/website/atul/about_us/pdf/atul_inspiring_centre.pdf*

*Piramal, G., "Business Legends", Viking Penguin India, New Delhi, 1998*



# BENCHMARKING

# LEARN

## FROM THE BEST

Dr. Reddy's Laboratories Ltd. (DRL) was established by Dr. Anji Reddy on February 24th, 1984, in Hyderabad, India, with personal capital of Rs2.5 million. DRL started as an Active Pharmaceutical Ingredient (API) manufacturer, making import substitution products serving Indian companies which were importing APIs.

Slowly and steadily, through calculated risks, the company moved up the value chain to produce branded generics and ventured into biologics. From a family managed firm, it transformed itself into a professionally managed global company with revenue of Rs 154 billion (FY2015-16) and market capitalization of Rs 520 billion. It has presence in 26 countries and has over 20,000 employees of 40 nationalities.

The journey of DRL has learnings for family businesses in particular and all businesses in general that are looking to build sustainable organizations.

### Learnings

- Create transparent governance systems and demonstrate through actions that the company's interest is paramount even above the family's.
- The leader must be open to signals, feedback and change.
- Doing the right thing for your **customers, stakeholders** and **society** leads to success.
- **Pursuing** financial success by itself doesn't lead to lasting success.
- Creating **increasing** value for all stakeholders, customers, shareholders, and society without trading off the interest of one group versus another leads to true sustainability.

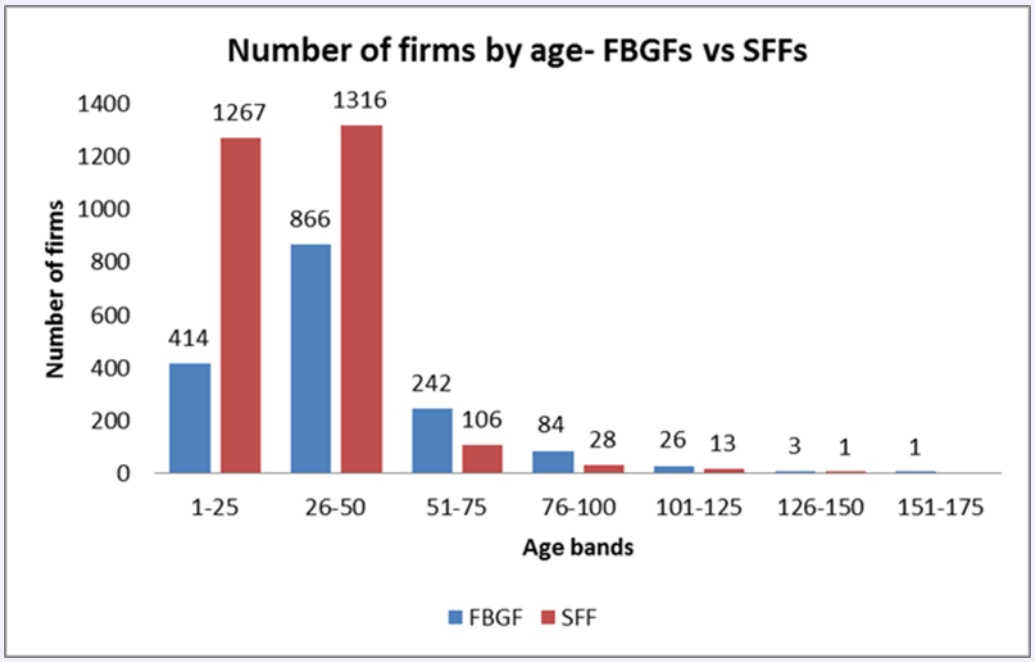
If a company has to be a lasting institution it must move from an entrepreneurial mindset to a professionally run organization. In hindsight there were three things that DRL really did well. One was that it was constantly innovating; doing things for the first time, doing big things and being on the cutting edge of the business. That helped the company grow very rapidly. Second thing was its focus on people development, people practices, in order to be able to get talent to work for DRL. The third thing was Governance.

*Source: Prasad G.V., Sharing wisdom, Building Blocks of a Lasting Organization: Learnings from the Dr. Reddy's Journey, presentation at the sixth Asian Invitational Conference on Family Business, Indian School of Business, February 4-5, 2017*

# DO YOU KNOW?

The listed standalone family firms (SFFs) in India are younger than the business group affiliated family firms (FBGFs). Family firms that were incorporated prior to the 1980s had greater propensity to create business groups by creating affiliated firms. The trend seems to have changed in the last three to four decades. More and more family firms are now standalone firms. This could be because in the pre reforms era, multiple firms were created to bypass the quota system and obtain licenses. That is no longer required.

The average age of FBGFs in a sample of 4,809 listed firms was 38.44 years while that of SFFs was 28.73 years.




It needs to be seen if the family businesses, especially the ones that are at the crossroad to either transition to the next generation or on the cusp of making non-family professionals their agents, survive the change. Succession remains the number one concern of most family businesses and rightly so, as, in Europe and the United States, succession challenges have contributed to the short life of the majority of family firms.

In India, the social fabric is quite different from that of the Western world. The progeny is initiated into the family business early on and his commitment to the business is inherently assumed. Apart from the direct heirs, the extended family system ensures continuity of the business after the entrepreneur's (first generation) or the business leader's retirement/death, even if the son or the daughter is not interested or not capable of running the business. Yet, succession is a challenge for Indian family firms and that cannot be undermined.

**Indian School of Business**

Indian School of Business (ISB) is a global business school offering world-class management education across its two campuses - Hyderabad and Mohali. The School has grown at a rapid pace over the past sixteen years since its inception and already has several notable accomplishments to its credit it is the youngest school ever to consistently rank among the top Global MBAs, one among the select 100 global b-schools to have AACSB and EQUIS accreditation, one of the largest providers of Executive Education in Asia, and the most research-productive Indian management institution. A vibrant pool of research-oriented resident faculty, strong academic associations with leading global b-schools and the backing of an influential Board, have helped the ISB fast emerge as a premier global business school in the emerging markets. For details visit www.isb.edu

**Thomas Schmidheiny Centre for Family Enterprise**

The Thomas Schmidheiny Centre for Family Enterprise, at the Indian School of Business, has emerged as the foremost authority on family businesses in South Asia. It undertakes training, research and outreach activities covering all major topics on family business. The Centre collaborates with global academic institutions and leading family businesses in India and abroad, for the exchange of insights and knowledge among diverse stakeholders.

For further information, please visit www.isb.edu/familybusiness or contact Sushma GNVS at fambiz@isb.edu or +91 40 2318 7189

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