Enhance value – Pass the Baton

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The article emphasizes on the need to have a succession planning to ensure health, wealth and happiness of self and future generation.

Success is to Preserve Legacy

All successful entrepreneurs are dreamers. Dreamers, who have an ability to convert an idea into reality. Risk taking, problem solving, men management are their tools. The pain they endure in growing the business and the risks they take would be adequately rewarded only if the value creation continues after them for generations to come. The legacy should be passed on. Legacy would mean continuity and constant growth of business, preserving brand image and reputation that the promoter has built, preserving family wealth and the lifestyles and careers of children or other successors. The best way to preserve legacy is by building someone up who can take over what is built and move it forward. This is possible only if leaders are identified and nurtured to take over from the promoter. However quite often important aspect of developing leadership is not consciously nurtured and often businesses fail the test of “Success” which is - Whether the business enterprise can evolve over generations from entrepreneurial start-up organizations into large, professionally managed corporations? It is observed that about 30 percent of family businesses survive into the second generation, 12 percent into the third generation, and 3 percent beyond that. It is truly said “A leaders lasting value is measured by his succession.”

Succession in a Family owned business (FOB)

FOB’s range from the neighbourhood shops (Chacha, Mama shops) to Medium and Small-Scale Enterprises (MSME’s) and large listed corporate. Mostly, large corporates are sensitised to have a succession plan in place, MSME’s do not seem to have woken to the reality. They are the largest employment providers and contributors to India’s GDP. Hence it is of great importance to preserve and Family businesses often start as proprietary or partnership concerns. Some of the businesses embrace corporate structure subsequently. In case of Nuclear families, the transition may be easier but in case of joint families there may be hurdles that need to be overcome. Whatever the organisational structure, in a joint FOB the income distribution may not truly reflect the effort put in by the members of the family. Income distribution and asset creation amongst the family members is often guided by immediate operational advantages which include availability of the person for signing documents, taxation etc. Asset creations based on these considerations invariably create inequitable and disproportionate distribution of family wealth. It becomes essential to address this inequitable distribution so that the business does not suffer. There are tax consequences and the best way out depends on case specific facts. Hence there cannot be a one size fits all approach. Services of tax consultants as along with advocates will have to be roped in for a low-cost workable solution. enhance value of such enterprises. Succession planning is important in Family owned businesses as ownership gets passed on to the lineal descendants of the promoter/s. While it is manageable in cases of first level of inheritance i.e. from the father to sons and daughters it becomes difficult once it passes further levels down. Also, in cases where the family business is managed by brothers and their legal heirs come into play the management becomes difficult and at this stage there may be a case of partition leading to dilution of business value. In case of first inheritance of an FOB, one of the important factors is the family demography where traditionally eldest male child has a definite advantage over others. This needs to be delicately handled in advance to avoid future generational conflicts when power and resources are transferred to advantage of one over other. Hence it becomes essential to begin the process when the family patriarch is still in action. It is a rarity in places other than metros to have ownership in the family and hire outside talent pool i.e. professional managers for operation of businesses. This has proved to be a successful strategy for many FOB's. Though this may not be a bad idea for businesses above certain operational threshold to have such an arrangement. In the Indian context, the FOB's may be able to execute succession better as often the family members get involved in the business early and if they are given a free hand in decision making and leadership roles.

Challenges of distribution in joint FOB

Family businesses often start as proprietary or partnership concerns. Some of the businesses embrace corporate structure subsequently. In case of Nuclear families, the transition may be easier but in case of joint families there may be hurdles that need to be overcome. Whatever the organisational structure, in a joint FOB the income distribution may not truly reflect the effort put in by the members of the family. Income distribution and asset creation amongst the family members is often guided by immediate operational advantages which include availability of the person for signing documents, taxation etc. Asset creations based on these considerations invariably create inequitable and disproportionate distribution of family wealth. It becomes essential to address this inequitable distribution so that the business does not suffer. There are tax consequences and the best way out depends on case specific facts. Hence there cannot be a one size fits all approach. Services of tax consultants as along with advocates will have to be roped in for a low-cost workable solution.

Regulatory and other issues

Transfer of business assets will vary as per the organisation structure of the business. Broadly there can be three possibilities of organisational structure (Proprietary, Partnership, Ownership through holding of shares in a company).

In a proprietary concern the promoter can prepare a document which is a Will. Will is a document by which assets gets transferred to the successors. The assets can be business assets and personal assets. It is often impossible to differentiate between business assets and personal assets in case of proprietary concerns. Hence it is always advisable to prepare balance sheets which differentiate the same.

A share in partnership is not transferable but the legal heir can be admitted as a partner only if other partners agree, otherwise the amount of capital in partnership will be paid to the legal heirs of the partner. It is always advisable to include the successors in partnership before the promoter passes away as there can be no dispute over admission of a partner afterwards.

In case of a corporate structure the transfer of ownership can be by way of transfer of shares. There is always a fear that the successors who are the new owners of the company may sale the shares to non-members without informing the existing shareholders. One can build safeguards such as shareholders agreement as well as in case of a Family owned business creation of a Family trust.

"The whole life is a succession of dreams. My ambition is to be a conscious dreamer, that is all." - Swami Vivekanand

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