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Changing Times

How India's Family-Run Businesses Are Transitioning to External Leadership

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Foreword

The evolution in the management of family-run businesses in India can be fraught with challenges. For this reason, Spencer Stuart sought to provide more clarity on how families can integrate external senior leaders into their organizations, and examine the issues and challenges this situation presents for the business's family — as well as the professional taking the executive role.

As we explored this issue, we confirmed that several practices — following predetermined processes, keeping an open mind, and ensuring management alignment between both family and external executive — are the best ways to ensure a smooth transition.

In the course of writing this article, Spencer Stuart interviewed four respected leaders of Indian businesses who have experience in these transitions:

Neeraj Garg, CEO of Apollo Health and Lifestyle, a large provider of Indian retail health care services.

Sanjay Jorapur, CHRO of Hero Motocorp, India's largest manufacturer of two wheelers.

Varun Khanna, managing director of Becton, Dickinson and Company (BD) who previously worked at Bharti Airtel and Reliance.

Adi Godrej, chairman of Godrej Group, an Indian manufacturing company that has expanded into Africa and South America.

For the purposes of this article, the definition of a family-owned but professionally run business is a company that has either a CEO, a managing director or an executive chairman who is not a member of the family. We chose not to consider firms that are technically managed by an external professional but the person is a close associate of the family.

We are focusing on mid-sized companies for three reasons:

1. Medium-scale companies grow rapidly, which provides a strong incentive for bringing an external professional aboard.
2. These companies are more likely to bring an outsider because they are younger and their culture is more open to attracting diverse leadership and inspiring change.
3. Professional leaders, who would not be hesitant to pursue a CEO position with a traditional company that has an established market and a history of successfully onboarding external leaders, may be more hesitant to join a less-proven young and medium-sized company.

The article will also explore why family-owned businesses choose to make the transition to professionally run, and how having appropriate motives impacts the success of the transition. We will also examine what makes for successful and unsuccessful practices, analyze the inherent challenges and make suggestions for best practices.

Introduction

For years, companies in India have been transitioning from family ownership to more professionally run operations. There are three primary reasons for this phenomenon:

1. The increased complexity of operations in today's frenetic business environment. Whether companies are expanding internationally or simply increasing the scale of their operations, there is a growing need for external professionals (i.e., someone from outside the family).
2. As promoters step down, the firms demand appropriate leadership as well as talent to help them succeed in the long term. While family members can help in this transition, history has shown that firms considering external executives are more likely to thrive.
3. Regardless of the industry, fields are becoming increasingly competitive. To stay viable, it's crucial that companies have diverse perspectives within management to objectively assess the organization's strengths, weaknesses and risks and help them plot a positive course of action.

For myriad reasons, some companies have been unsuccessful in completing this transition from being solely family run to hiring external professionals for leadership roles. Challenges vex the entire process, and there's not one successful model for making the transition to professional leadership, so each case will be unique.

In the initial part of the transition (pre-selection), the primary challenges are getting the family to agree to hire an outsider, setting criteria for the ideal candidate, and defining achievable goals and what success looks like.

During the second part of the transition (selection), the families must consider how much independence they want to maintain. The new hire will likely want to keep at least some of the company's traditions and culture, but the executive will also need the autonomy to institute policies. And after the enterprise selects a candidate, it's crucial that the business follow its previously established resolutions.

To become externally managed, companies need to plan for the impending challenges years in advance, then carry out their plan systematically. To be specific, the board must identify the expertise the company will need, given its strategy and circumstances. The board should develop a detailed plan that spells out the qualities and experiences required of the CEO.

The pre-selection process is about separating ownership from management, and the goal is to objectively select the candidate without letting emotions get in the way. Finally, once the family chooses a candidate, it must give the new executive the autonomy to create a new strategy. The family can guide the new manager, but independence is essential.

The candidate also has work to do, however: the new leader must assertively implement authority and strategy. That involves working with the family, who will likely be wary of an external professional, and with the employees, who can give insight into the culture and values of the company.

Company's point of view

WHY MAKE THE TRANSITION?

The importance of having an authentic motive

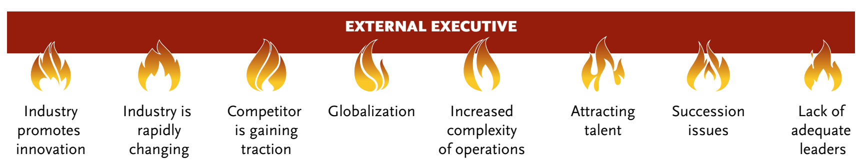
If a company wants to go professional simply because "everyone else is doing it," the transition will likely fail since it lacks a real motivation. That will result in less effort from the family to accept and empower the executive, creating a great deal of tension.

But if the reasons for the transformation are valid, the family will likely achieve a consensus or, better yet, come to a unanimous decision. That will directly influence whether the professional is accepted and how much authority the new leader will have.

"The company should have clear motives for bringing in external executives."

NEERAJ GARG
CEO OF APOLLO
HEALTH AND
LIFESTYLE

Burning Platforms



Let's examine the eight primary reasons families seek to bring in external leadership:

1. INDUSTRY PROMOTES INNOVATION

If an industry is innovating at a rapid pace, it's crucial that a company be able to stay with the latest trends. Family-run businesses can become insular and entrenched in their ways, so an external executive can help ensure that a company stays current.

2. INDUSTRY IS RAPIDLY CHANGING

Often, family-run businesses lack a willingness to cultivate management innovation. But if the industry is changing, the company likely sees the need for the change that external management brings to the organization.

3. COMPETITOR IS GAINING TRACTION

This is a particularly important factor for newer industries or industries that have changed drastically due to technological transformation, such as: banking, consulting, software, food, mobile and retail.

4. GLOBALIZATION

Families often seek external guidance when they set out to globalize operations, as the international mindset requires the ability to think across boundaries, disciplines and cultures. Companies must invest in education, experience and evolved HR models, as well as hire people who can help the company create networks and become more flexible and inclusive.

5. INCREASED COMPLEXITY OF OPERATIONS

Family businesses are often compared to startups, since they typically are founded by close friends and have loose hierarchies and decision-making practices. Both value loyalty and the ability to take on multiple/diverse responsibilities, and one of the biggest problems is scaling up too quickly. "Every time a company triples in size, everything breaks," as Rakuten founder Hiroshi Mikitani put it.

6. ATTRACTING TALENT

Retaining talent can be a serious challenge, because family-run businesses tend to be fairly insular, which can limit opportunities for external hires. Capable leaders often move on if they don't feel there are enough opportunities, and this migration can hurt a company's ability to keep the most promising leaders for the future.

7. SUCCESSION ISSUES

Succession within a family-run business can be a nettlesome issue. Bringing in an external professional ensures there are options for succession down the road.

8. LACK OF ADEQUATE LEADERS

If a family doesn't have the appropriate talent to manage the company (perhaps for lack of global experience), seeking external leadership can be a smart move.

Furthermore, a company needs to decentralize activities after it grows. Most family-run businesses have a flexible hierarchy and the manager makes most of the decisions based on the family's beliefs, whereas external managers are strong enough to manage with authority.

LIKELY CHALLENGES

THE PRE-SELECTION PROCESS

During this phase, the family will have to decide how much power to relinquish and how involved family members should be in the organization. Hiring the right executive is another challenge, which can resemble obstacles faced by non-family businesses.

Coming to an agreement can lead to tension among family members, so it's best to achieve consensus in these matters. For example, since most conflicts between family and executive stem from incompatibility, it's essential to perform a cultural evaluation of the firm. One step in that process will be defining the criteria and skills required by the new executive. In addition, the board and the promoter should express their expectations and goals for long-term success and draft a formal timetable, as opposed to simply hiring the professional immediately.

THE SELECTION PROCESS

In this phase, some aspects of the company's culture will be questioned. While candidates are interviewed, the family must reassess the firm's basic philosophy, values and goals to ensure the new environment is prepared to accept external management.

During the process of choosing the executive, the family must guarantee transparency. This will not only benefit employees, who will be highly affected by this transition, but also the incoming professional by ensuring legitimacy.

Finally, some members of the family are likely be apprehensive about losing power. This is why it's crucial to delineate the boundary between family and business/management and ownership.

TRANSITION

During the transition, the family must work with the executive to explain new basic work expectations to customers, vendors and other business connections. This rite of passage will set a tangible reminder of the executive's authority.

AFTERMATH

After this handover is concluded, it's crucial that the company set reasonable expectations for company performance and the pace of change. The family of a troubled company might expect overly positive results and even let the executive go if they're not met, only to start the process again.

In the future, the family may want to consider the board composition to add needed market and business expertise.

BEST PRACTICES

Timeline

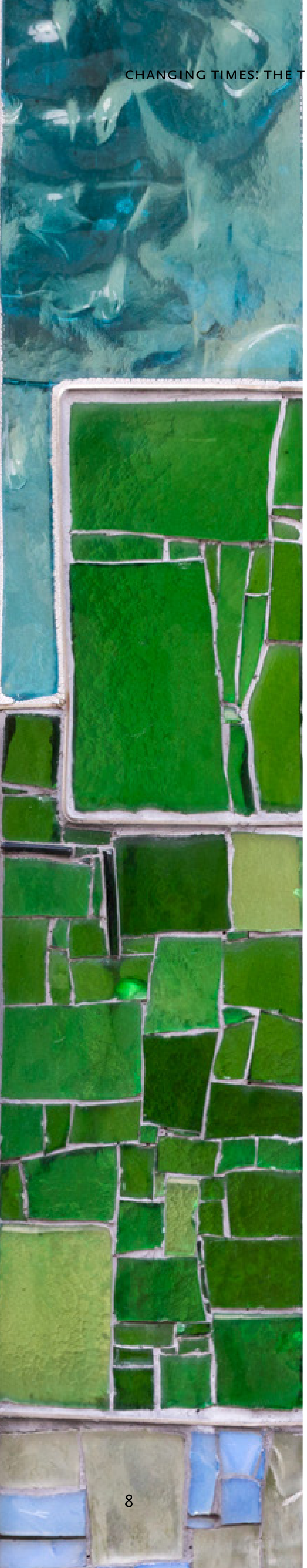
	Pre-selection	Selection	Transition Period
Practices	» Separate ownership and management through a family constitution » Define skills required from candidate » Decide on level of independence to be given to external executive	» Adopt method on how to handle failure » Agree on how conflict will be dealt with » Create transparency throughout selection process » Ensure strong involvement from family members	» Create juste milieu for a new company culture, preserving positive aspects while using new management as opportunity for more efficient operations » Maintain long-term goals' expectations » Transfer relationship of clients and vendors to executive
Challenges	» Achieving family consensus on how to hand over management of business » Outlining long-term goals and expected results » Creating procedures to be followed rigorously, despite traditional lack of bureaucracy	» Committing to the separation of family from management » Respecting procedures and processes established » Managing natural apprehension from family members » Assessing candidate's cultural fit	» Providing predetermined adjustment time to incoming executive and employees » Reconciling tension between old strategy and new strategy

STEPS TO SUCCESS

The first step in this process should not be introducing an executive as a direct report to the promoter. The new executive should start two or more levels down, since conflicts are more likely when the interaction between executive and family is high. The promoter's direct reports have a lot of interaction with the family and promoter, so the best move for the organization is to get familiar with external executives at the manager level. This placement softens the initial shock and creates the right context to bringing in an external leader.

One of the primary goals of bringing external management is to align the organization, so the promoter needs to be open to relinquishing control and letting the external professionals make the decisions. The family agreed to let managers to take control, so they should ensure they are living up to this agreement. They can help by empowering managers to select the course of their business, and helping guide the business into becoming an independent company.

In Mahindra & Mahindra, for instance, the family is the owner but not the manager. Board members can make independent decisions, as opposed to being only a "paper" position. Both the company and the family value this separation.



This example shows that having a distinctive boundary between ownership and management, as well as rigorously following processes, are complementary qualities. These practices are crucial, as they illustrate a commitment to helping the company evolve and grow. They also demonstrate the family has a professional mindset and understands that being externally driven will deliver better results.

"There are formal structures available, and it is important that they be applied," Godrej said. "There are good parts of family businesses processes and non-family models. The ideal is to mix the best parts and adopt them."

The firm's level of commitment to this separation is essential when considering external talent, since having independent leadership is one of the primary features sought by individuals considering working in a family-owned business.

These issues reinforce the importance of strictly following processes when choosing a successor. The company must know exactly where in the organization they need the executive, and the family needs to make it clear what they need the new professional to do so the executive can feel free to make decisions. The best approach is to create this environment, identify the needs, delineate them clearly — and only then begin the process of hiring an outsider.

The company also needs to clearly communicate its vision. Earlier, we established that the family must have a strong reason to bringing in an external executive, which is why having rigorous procedures for such transition is crucial: after communication has been established, the promoter should allow the new leader to take the vision forward.

Likewise, another way of making sure the executive is independent is to encourage the leadership to challenge the promoter's opinion. The professional has higher degree of experience and can likely interpret the events with more clarity than the family.

However, this works only if the executive was properly taught the culture of the firm and the promoter believes in the professional's judgment. Otherwise, negative tension will emerge and hamper progress. This is why it's important to ensure the board and the family are aligned on the hiring decision, and that process should be completely transparent.

An increasingly popular way to separate ownership and management is to draft a family constitution. The idea is to ensure that the business remains viable, even in case of a familial dispute. Family constitutions are often implemented mostly by second- or third-generation family members, but even members from the first generation are using this idea. The goal is to resemble larger conglomerates since they typically represent a model of efficiency, steady growth and long-term endurance.

A family constitution includes, but is not limited to, ways of allowing family members to start their own businesses while maintaining the ownership and procedures that prevent the group from further splits during future successions. A constitution aims to control three circles: family, management and ownership.

The family must also address the issue of talent retention to ensure accomplished executives feel optimistic about their futures with the company. “About 40 years ago, our organization observed that many capable leaders were leaving the company,” Godrej said. “They just weren’t reaching top positions, which meant that, in the middle of their careers, very good performers would look for outside options. We have now clarified that is not the case, so we have seen top-level leaders reach executive positions. However, we have publicly stated that the chairman position would be reserved for family professionals.”

Finally, the company needs to be aware that attracting top talent can be expensive. There’s a saying, “You get what you pay for.” Given that, companies should make an effort to understand the talent market and prevailing compensation expectations so that they are prepared when the time comes to make decisions about the appropriate investment.

CONCLUSION

The decision to bring aboard an external professional is not easy for family-run businesses. There can be a high degree of distrust, as some members of the family worry about losing control of something that has been internally controlled for years. The culture fit can be hard to mesh, at least initially. And there can be unreasonable expectations heaped upon the new executive.

But these obstacles, while arduous, are not insurmountable. And the results can be quite positive for the business, resulting in an external executive who brings a smart perspective on operations, wide-reaching personal connections and valuable global experience.

Executive's point of view

- » Why join a family business
- » The pre-selection process
- » After the offer
- » Likely challenges

WHY JOIN A FAMILY BUSINESS

External executives are often attracted to family businesses because of their informality. For example, changes in culture or processes are easier to make in an environment where information can be easily passed to everyone in the company.

Also, the executive's influence extends further than in the traditional non-family firm, and closer connections with employees ensure a stronger impact. This means external executives can see the workers' capabilities, and therefore devise a firm-specific strategy. Conventional wisdom holds that progress is faster in this environment, due to less bureaucracy — not unlike a startup.

Though there is a strong feeling that the culture and the promoter are interdependent, executives often find that this characteristic doesn't affect a company's ability to innovate. Just as in non-family businesses, whether the company accepts change or not is part of the culture.

THE PRE-SELECTION PROCESS

Before even getting the offer, it is imperative that executives confirm they are being hired to promote change or lead the company in a new direction, as opposed to being hired solely to be compliant. That means confirming the role will have actual decision-making power and the independence to develop a strategy.

The second step should be assessing the cultural fit and ensuring alignment with the promoter's idea of the business model. To evaluate the chemistry fit, the executive should spend time with the promoter or family to understand their point of view, making sure everyone is on the same wavelength.

It's also important to ensure there is a good level of communication, the decision-making process is well articulated and the family understands its influence over the business, since all will directly affect management.

AFTER THE OFFER

After the executive accepts the hiring offer, it's crucial to establish credibility with the promoter. The primary reason is because executives won't be able to make progress without successfully convincing the promoter to trust their judgment. That creates a level of personal trust and proves loyalty —in the end, it's as much professional dependence as it is personal.

Obviously, the professional should present data and financial metrics to make the case for important strategic and operational decisions, as one would with other companies. But initially, executives should be mindful that the family wants to feel confident that decisions about the business will be good for the promoter, the family and the company.

Similarly, executives should understand this dynamic and the possibility that there may be times when the interests of the company diverge from the interests of the family. Executives must put the company's interests first, and must be willing to step up and make a case for their decision, even when the family may disagree. In these cases, the executive should discuss the different views with the chairman in private. Ultimately, the decision will come from the family; however, the family should respect the executive's initiative.

Leadership in a family business also tends to come off-the-clock requirements. Usually — and especially with older promoters — executives will be expected to attend some family functions. So the professional will likely have to be integrated into the family's personal life. Executives should view their participation — and often their spouses' — in these activities as part of the job.

Finally, being open-minded is particularly important when joining a family business, where the culture often descends from the founder's vision for the company. Observing the accepted behaviors will go great lengths, since being familiar with the culture will help create a no-gaffe start and give a glimpse into how the family thinks and operates. It will also gain the trust of the employees, who may be wary of new leadership.

"You are actually allowing a professional to come to your kitchen and cook. And you're not looking over their shoulder to see what they are doing."

SANJAY JORAPUR
HERO MOTOCORP

LIKELY CHALLENGES

The main challenges facing new executives are fighting micromanagement from the promoter, the lack of hierarchy and difficulty learning the company's informal network.

The relationship between promoter and executive can only be positive if both are open to each other's advice. Executives can only lead if the family lets them be independent.

Once again, these issues illustrate the importance of a strong chemistry with the promoter. The most important work the executive must do before accepting the offer is having clear and candid conversations with the promoter.

BEST PRACTICES

Steps to success

Professionals are brought to companies because the family believes they are best suited to guide the business in a new journey. Therefore, newly hired executives should quickly offer their strategy for future growth.

However, contrary to popular belief, tension between the promoter and the executive rarely is the result of disagreements about strategic or operational decisions. Rather, conflict occurs when there is little personal alignment between promoter and executive — i.e., when the styles are different.

Often, the family hires an external professional because it is seeking different opinions, or the business needs a new strategy. Therefore, family members expect a certain amount of tension, at least initially. To overcome this tension, we advise the executive to provide feedback upfront, rather than silently disagreeing. Outbursts, which are bound to happen, will only be tolerated after credibility and trust have been built. However, if the family feels the executive does not have the best interest of the company at heart or they are not aligned with the firm's culture, then the family and the board will not accept the executive's ideas/strategy/advice.

Another key point to remember is that inspiring change is a slow process. First of all, the executive should listen to the family and employees — they're likely not averse to change. But the promoter can be inexplicably connected with the company, and pushing for change can transform the environment into a highly emotional setting. So it is crucial that the executive finds a way to allow all parties to let the emotions out, instead of repressing them.

Moreover, challenging status quo is more than merely inspiring change. Family businesses are focused on the long term and creation of value, not simply revenue and bonuses. This mindset tends to work in parallel with making sure the company is up to date, technologically. Change in any industry nowadays happens fast. To keep up, the leader must ensure that processes can be quickly adapted and integrate within themselves the space for change and innovation. Keys include effective communication, believing in the greater good of the company, holding functional meetings and using relevant metrics to assess performance.

CONCLUSION

Taking a position with a family-run business can be a daunting challenge for an external professional. The culture can be hard to grasp, and there can be a high degree of distrust when the new executive first starts. The new hire should remain resolute and be patient, though — success won't happen overnight. By trying to adjust to the accepted culture and bringing experience and connections to the family setting, a new professional can thrive within even the most entrenched family-run business.

Author

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"The competence you have as a professional is about bringing people together, creating alignment and ensuring you enable their performance. It is really about bringing alignment, creating professional competence, building robust processes, ensuring very clear goals and measure of performance, and finally, achieving flawless execution. This is a journey for the company, the family and the professional."

SANJAY JORAPUR
HERO MOTOCORP

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