Challenges of Family Growth

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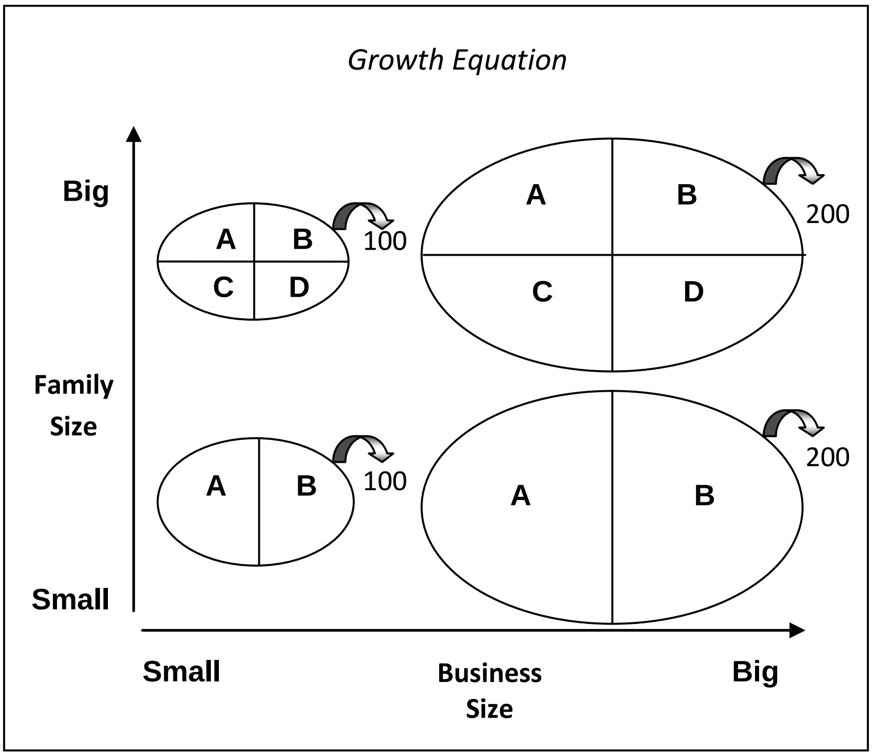
Family and business, both are dynamic systems. In most cases, family growth is inevitable over time. There is a famous saying relevant to family businesses – "Family grows faster than business."

Business growth is not guaranteed. This may give rise to many scenarios.

We will use an example to understand various implications. There are two brothers – A and B, each having 50% share in the business. Current profit level is Rs. 100 lacs. Various scenarios have been presented in the following graph:



We observe that:

1. The best scenario is the one where business growth is faster than family growth.
2. If business and family, both grow at equal rate, existing member will not enjoy any individual growth.
3. On the contrary, if business remains stagnant and family grows, existing members will have negative individual growth.

Imagine the situation when business declines and family grows.

No wonder, many a times, growing family creates a crisis situation for family businesses. "A crisis has been defined as a sudden and frequently unexpected gap between claims (or needs) and resources (Elder, 1964; Moen, Kain, & Elder, 1983). The discrepancy between what is required, expected or counted on, on the one hand, and the reality of situational and structural demands, on the other, can produce a stressful environment fostering emotional tensions and strain. This stress can be reduced either by reducing expectations/claims and/or changing the available options and resources."[i]

In the case of stagnation in family business, two scenarios emerge:

1. Business, which provides resources for employment and income, has stagnated, and
2. Family, which makes claims or expectations, keeps on growing.

This creates competition amongst the claimants, in this case, the family members. Life becomes a zero-sum game, i.e., gain for one means loss for another.

During stagnation, when people feel that they are not able to grow despite their best efforts, in their confusion they look for someone to blame. What happens to family harmony in such a situation is anybody's guess.

Declining business and growing family is a situation that cannot be sustained if all family members join in the family business.

During stagnation, family businesses and owners need to change their outlook towards their business and their careers. Many times, a business line may be dropped or sold or a family member can be encouraged to take a new job or start a new venture. Such shifts can produce a crisis for committed family members.

Failure of a family business is a painful situation. It is as if somebody close has died. The future of entire family is in question. There is no other source of income. In case of failure of a non-family business, people are unemployed, but they can get new jobs and continue with their lives. Arthur Andersen is the latest example, where its branches merged themselves with other similar firms or employees switched jobs. Emotional devastation makes family owners grieve for a longer period. Absence of marketable skills reduces employment options. Often, they are forced to serve their competitors, which brings their self-esteem down.

Family businesses are fuels for fresh entrepreneurship in the sense that they provide security and assurance to family members willing to try their luck elsewhere and in new ventures. These new entrepreneurs are assured of adequate income from the existing business and have something to fall back upon in case of failure.

However, it is a pity how family members fail to utilize the opportunity offered by this sense of security and support, which the founder never enjoyed. They rather indulge into protecting their existing domain, which keeps on shrinking on inclusion of new family members.

Absence of policy for entry of new members in the family business is to a large extent responsible for insufficient education, premature entry, improper induction and illogical placement. This deprives family youngsters of the necessary confidence in their own competence and also results in lack of respect from professionals.

Some of the reasons why owners are reluctant to exit from an existing business despite the over-crowding are:

1. Younger generation doesn't have experience or exposure of struggle; hence they don't have confidence in dealing with a crisis situation. A previous job experience provides one with the capacity for independent survival and makes one strong and confident.

2. Family owners are generally underpaid. They are paid more in kind than in cash. Absence of personal saving also reduces their risk taking ability.

3. The business is generally over-capitalized during boom period, resulting in poor financial discipline. This results in low liquidity to support exit decisions. The severance process, in turn, becomes very complicated.

4. There is no earmarked reserves like 'new venture fund'.

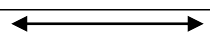
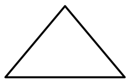
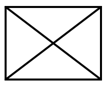
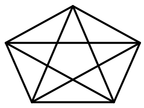
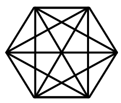
5. There is an absence of supporting infrastructure.

6. When founders are dominating, other members become reluctant to start a new venture under the existing setup as they apprehend that while they will be

responsible for the venture, they will not have adequate freedom to influence the ultimate outcome.

7. Absence of mechanism for evaluation and lack of process of market related compensation cause confusion in the minds of business owners with regard to their own competence.
8. Apart from the founder or the CEO, most family members are insulated from external exposure.
9. There is no culture of continuous learning, training or up-gradation of skills.
10. Absence of exit policy and lack of an enforcing mechanism creates uncertainty in the mind of members considering the exit option.
11. Communication since childhood that 'it's all yours' makes them feel cheated if they are asked to pursue their career elsewhere.
12. There is a feeling of shame as there is an apprehension that society may treat this as a sign of dissent, or for absence of family harmony or as an indicator of inefficiency of the concerned family member.

Financial implication apart, family growth enhances the complexity of communication. Even if we consider two-way communication only, as and when a new family member joins in, additional channels open up exponentially as shown in the following table where A, B, C, D…. represent various individuals:

<table>
<tr><th colspan="4">Cacophony of Family Growth</th></tr>
<tr><th>No. of Members</th><th>Description of Channels</th><th>Total Channels</th><th></th></tr>
<tr><td>2</td><td>A-B</td><td>1</td><td></td></tr>
<tr><td>3</td><td>A-B, A-C, B-C</td><td>3</td><td></td></tr>
<tr><td>4</td><td>A-B, A-C, A-D, B-C, B-D, C-D</td><td>6</td><td></td></tr>
<tr><td>5</td><td>A-B, A-C, A-D, A-E, B-C, B-D, B-E, C-D, C-E, D-E</td><td>10</td><td></td></tr>
<tr><td>6</td><td>A-B, A-C, A-D, A-E, A-F, B-C, B-D, B-E, B-F, C-D, C-E, C-F, D-E, D-F, E-F</td><td>15</td><td></td></tr>
<tr><td>7</td><td>..and so on...</td><td>21</td><td rowspan="6">Drawing the channels is difficult beyond this point, what about actually dealing with the ever-growing crowd?</td></tr>
<tr><td>8</td><td></td><td>28</td></tr>
<tr><td>9</td><td></td><td>36</td></tr>
<tr><td>10</td><td></td><td>45</td></tr>
<tr><td>11</td><td></td><td>55</td></tr>
<tr><td>12</td><td></td><td>66</td></tr>
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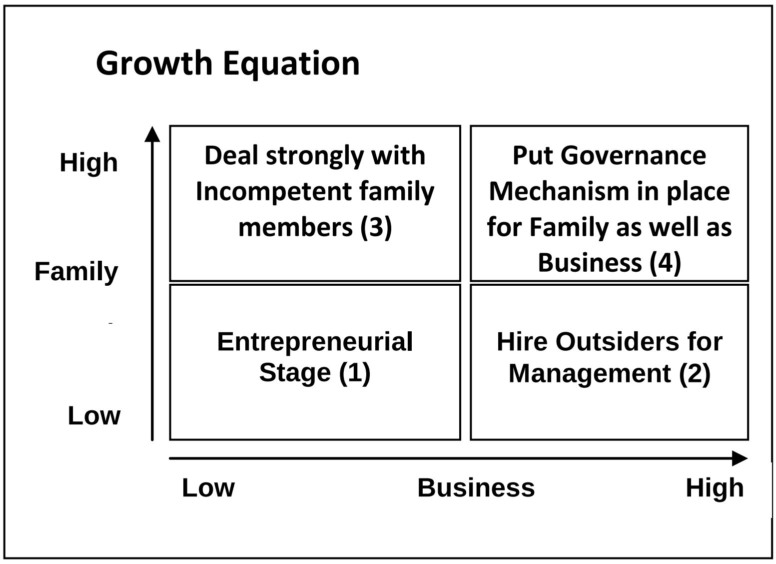
Communication gap, misunderstanding and difference of perception are bound to happen. Family growth thus poses challenges on all fronts.

Different combinations of family growth and business growth warrant different strategies as presented in the following diagram:



During entrepreneurial stage (1), family size and business size, both are small.

In the 2nd scenario, business grows with no corresponding growth in the size of the family. In this situation, the best thing to do is to hire outside professionals to assume management roles.

In the 3rd scenario, as is usually the case, family grows faster than business. In this situation, family leaders must deal strongly with the incompetent family members. Initially, they may be asked to hone up their skills and if they fail to do so, alternative career opportunities must be found for them.

In the 4th scenario, business and family, both grow. In order to avoid conflicts and to assure professional management, the family must put proper governance structures and mechanism in place.

Although the above discussion may make sense, it is difficult for family members to deal strongly with such emotionally charged issues as removal of an incompetent family member. A governing board can help in providing the necessary objectivity in such situations.

Some enlightened entrepreneurs begin the process of governance even if the size of the family and the business is small.

As the family grows and enters into 2nd or 3rd generation, the owners may become averse to take risk unless conscious efforts are made to revitalize the spirit of entrepreneurship. This can be done by putting an appropriate supervising body like family council in place with a separate family office, a separate family foundation to institutionalise charity and philanthropy work and formation of venture capital fund to support fresh enterprising ventures by youngsters and other interested parties. Moreover, an independent board of directors needs to be organized. A family, which is able to rejuvenate the driving spirit of entrepreneurship without exposing the existing family business to undue risks and which generates resources for new ventures in a systematic and gradual manner, may well churn out many new businesses which exploit all emerging opportunities. The diversification in the IT sector by the Tata and the Wipro group are examples of existing family businesses successfully launching into new ventures.

Existing family business can also keep on getting a fresh lease of life by continuously investing in new products and technologies.

Families who lack harmony and who are facing business stagnation will do well to exit from the business or to split. This is what the Bhai Mohan Singh group did with Ranbaxy, Max and Montari going to the three brothers. If division is not possible for any reason, they might sell the business instead of running it in an inefficient manner.

Strong families may also opt for selling the business if situation warrants such decision, but they will again bounce back with a new business in place, such is the power of their unity. However, in the Indian context, business owners continue to remain Abhimanyu as exit strategies are rarely contemplated and mastered. Sale of business (Thums-up, Quality Ice-cream, etc.) had been isolated cases. After the entry of foreign competition, Indian owners have started focusing on their core-competence and many have divested their unrelated and unviable businesses.

CONCLUSION

Family businesses must recognize the challenges posed by the growing family well in advance and clearly lay out a plan for its business and also for individual family members. Much value will be destroyed if they are taken by surprise.

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[i] A Life Course Approach to the Entrepreneurial Family (Part I), Paper by Phyllis Moen, Cornell University, www.fambiz.com, presently www.nmq.com