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Identity, longevity and returns: Recasting your operating model to cut costs and grow stronger

Pointers for Indian family-led businesses

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At nearly a trillion dollars, family-led businesses account for 42% of India Inc.'s market cap.[1] Relevant studies indicate that India has one of the highest shares of family-led businesses worldwide (55% of all businesses compared to <5% in the USA),[2] with the third-highest number of mega (above USD 250 million) publicly listed family-led businesses.[3] In recent years, family businesses have been witnessing superior to market growth in profits by nearly eight percentage points.[4] Clearly, the Indian growth story has been driven significantly by its family-led businesses.

Indian family-led businesses: A unicorn among unique beasts

Family-led businesses are, in general, quite different from other businesses due to the complex balance that needs to be maintained between ownership and business. The inherent challenges they face are encapsulated in PwC's 'The Owner's Agenda'[5] framework, which focuses on the entwined pulls on management across the family and business.

Across intergenerational family-led business owners, there is often latent conflict between old and new owners – around 50% of Indian family-led businesses differ in their view of the direction their businesses need to take.[6] Family involvement in business operations, including continuity planning, consideration of the aspirations and shortcomings of family members, and the impact of this on business, needs to be continually balanced through the right grooming, structural fitment and engagement.[7]

Indian family-led businesses have the added complexity of being shaped by Indian social norms – there is significant emotional investment in being involved, and in being seen to be involved, in the business by the various family members. This is reflected in the greater share of owners managing the business and the large number of management positions filled by family members, compared to family-led organisations in Western economies such as the USA, UK and Germany.

In the West, scale, increasing capital requirements, and differing perspectives on growth and innovation have been observed to force a separation down the line. However, we have seen numerous instances of Indian families preferring continued operational involvement, and hence, choosing to split the business and allow separation of ownership and management rather than continue as an integrated entity. Consequently, it is important to understand what it takes to ensure the continued growth of such businesses in the unique context of Indian family businesses.

1. https://economictimes.indiatimes.com/markets/stocks/news/family-businesses-are-doing-better-than-rest-of-india-inc/articleshow/74109424.cms?from=mdr
2. https://www.hindustantimes.com/analysis/the-global-variations-in-family-business-structures/story-NrikbnqLCGQUVlw0VEwTcO.html
3. https://www.hindustantimes.com/business-news/india-has-third-highest-number-of-family-owned-mega-businesses-credit-suisse-report/story-dbXKdZ6sA4V6Rq3wOXMWFP.html
4. https://economictimes.indiatimes.com/markets/stocks/news/family-businesses-are-doing-better-than-rest-of-india-inc/articleshow/74109424.cms?from=mdr
5. https://www.pwc.com/gx/en/services/family-business.html#oa
6. https://www.aonhumancapital.co.in/Home/Resources/Talentscapes/Vol-3-Issue-1/Family-Businesses-%E2%80%93-Journey-from-Aspirations-to-Re
7. https://www.pwc.in/research-insights/2018/family-legacy-and-you.html

Anatomy of future growth poses new capability imperatives

For family businesses, future growth will have a materially different constitution and, hence, different capability imperatives.

1. **International expansion:** Most family-led organisations have grown domestically with opportunity-driven expansions in countries where there is a demand for cost-competitive Indian products and/or services, often facilitated by the presence of an Indian diaspora. In the next phase, there would be significant onus to make this expansion truly global across all potential markets. **According to PwC's Family Business Survey 2019, 89% of Indian family-led businesses plan to export their goods and services (against a current share of ~78%), with expectations of the turnover from exports growing from 25% to 33% over the next five years**.[8]

2. **Balance across innovation-led and profitable growth:** A global conquest necessitates product leadership and class-leading innovation. This is likely to require organisations to have a different focus as against extreme cost consciousness, operational excellence and 'jugaad innovation', which have worked well until now. The challenges faced in innovation are particularly daunting considering the central emphasis on cost control seen across most traditional family businesses. **It is therefore no wonder that only 14% of next-generation owners feel that their businesses are performing well on innovation.[9] This highlights the need for a different structural approach**.

3. **Digital leverage for business flexibility:** Digitalisation helps in reconciling the otherwise competing objectives of flexibility and standardisation, as well as risk management and business velocity. **Indian family business, in view of their entrepreneurship and centralised decision making, have been able to achieve speed, but at the cost of standardisation. This has sufficed till now due to the relative lack of scale.** However, this state of affairs is rapidly drawing to a close, and digitisation is set to become an imperative. While 64% of family businesses feel that they will take significant measures in terms of their digital capabilities over the next two years, it remains to be seen if they will actually walk the talk, since very few Indian family businesses consider digitisation to be among their top two priorities.[10]

Future growth requires 'Fit for Growth' organisations

In the context of Indian family-led businesses, achieving future growth will require them to become 'Fit for Growth' with three major imperatives:

1. **Institutionalising a sustainable 'right-to-win' culture (de-personalising future success):** Many family businesses were launched and flourished based on their 'speed' (by being entrepreneurial about market opportunities). **In the future, they will need to leverage the success achieved till date, to ensure their continued competitive advantage without relying on the entrepreneurial instinct (which necessitates ability to move away from continued personal involvement) – that is, their institutional agility and speed.** This needs to translate into a formalised capabilities framework – how best to identify, nurture and strengthen the advantage, as reflected in a new capabilities-centred operating model.

8. https://www.pwc.in/assets/pdfs/research-insights/fbs/2019/pwc-india-family-business-survey-2019.pdf
9. Ibid.
10. Ibid.

2. **Institutionalisation and delegation of decision making (letting others take decisions):** Such capability-led growth requires governance structures that were centred in the corporate core or chairman's office to devolve to various focused entities. This will necessitate a clear transition to governance through key performance indicators (KPIs) rather than the personalised, trust-based controls and personal interventions of owner-managers often seen in family businesses.

   As of now, around 35% of Indian family businesses either do not have KPIs or have only either financial KPIs or non-financial KPIs.[11] However, **with increasing scale, institutionalisation of data-driven decisions is crucial for balancing quality and agility of decisions.** Furthermore, segregation of decision making and hierarchy is critical for family members who continue to be operationally involved unlike in the case of non-family management.

3. **Infusion and retention of the right talent ('mini me' vs 'better me'):** Building new capabilities for scale-up, innovation (including digital disruption) and international expansion necessitates a talent model that infuses and retains external talent in leadership positions. Putting in place an effective talent model in an organisation to achieve this purpose requires simultaneous achievement of three objectives:

   a. **remaining true to the culture and family values** that have led to the scale and growth so far across external talent and family members ('mini mes')

   b. **ensuring induction of superior capabilities** through external talent infusion for the best continued interests of the business ('better mes')

   c. **ensuring infusion and grooming of the next generation of family members** aligned with the established ethos, culture and values while enabling continued innovation.

The true reason why such institutionalisation, from personalities to institutions, is harder is the cultural challenge this imposes: **how do the owners ensure that those with authority and decision-making powers operate with the same entrepreneurial intensity, sense of belonging and ownership as the family – that is, how to ensure that they 'care' enough?**

For family-led businesses looking to take this leap, scepticism about loss of control and dilution of commitment is natural when they first decide to expand beyond their inner circle of family and close confidants. This leap is more than a change in operating model and strategy; it involves **depersonalising success while at the same time deeply personalising an organisation's culture and values.**

11. https://www.pwc.in/assets/pdfs/research-insights/fbs/2019/pwc-india-family-business-survey-2019.pdf

Lessons from Indian family-led businesses

From our study of and experiences with Indian family-led businesses, there are five key underlying practices seen in businesses that have successfully taken this ‘Leap of Growth’ (Figure 1). These are discussed below.

Figure 1: Success drivers of Leap of Growth

Source: Strategy& analysis

1. **Commitment to a family constitution:** Several Indian families have embraced the practice of documenting a ‘family constitution’ – a set of principles that provide guidance for family engagement in business (strategic, operational or governance) as well as guidance on critical issues such as shareholding decisions, succession, board appointments and voting rights, and conflict resolution, which can help balance the ‘Owner’s Agenda’. Best practices include, paradoxically, prioritisation of the business above the family. While articulation and documentation of such prioritisation are relatively easy, consideration of all disparate agendas and upcoming challenges (with full agreement) is usually more difficult, especially in the case of second- and third-generation families.

2. **Articulation and institutionalisation of ‘Our Way’:** Articulation and propagation of Our Way is probably the most critical action that is needed to preserve entrepreneurial intensity as new talent enters the organisation and authority is distributed beyond a closed circle. This requires clear and formal articulation of implicit behaviour and attitudes (‘The Critical Few’ behaviour[12]) that define the work mode and should be the lodestones for the culture. It is equally critical to ensure the right way to propagate this across the entire organisation, including for new joiners.

12. https://www.pwc.in/assets/pdfs/research-insights/fbs/2019/pwc-india-family-business-survey-2019.pdf

3. **Alignment of Fit-for-Growth capabilities with accountabilities:** To enable any growth, focus on the right capabilities (referred to as Fit-for-Growth capabilities) is a prerequisite – each capability being a coherent combination of people, processes, knowledge and systems. **Once identified (identification being a critical strategic exercise in itself), these capabilities need to be propagated through the right set of KPIs across an organisation.** Right alignment of personnel is a part of this exercise, which needs to be shared across those within the inner circle, those outside it as well as new talent and leadership within the organisation.

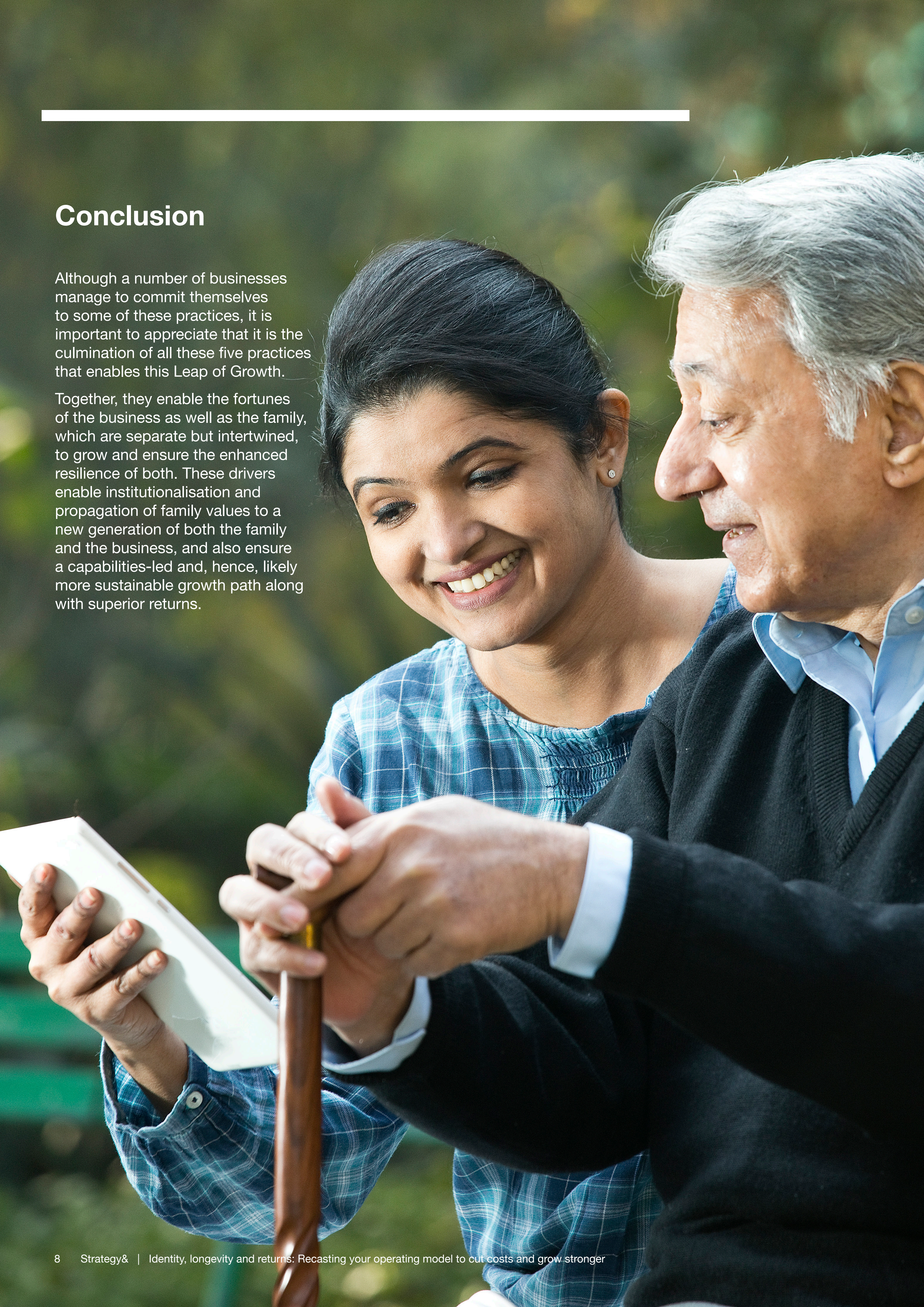
   For example, a large Indian chemical business clearly identified a roadmap for its geographical expansion. This included product portfolio growth of speciality chemicals. The company augmented its capabilities to follow this roadmap by bringing in external talent and ensuring meaningful jobs and responsibilities for them. It also made sure that compensation for executives was tied to their performance across key strategic targets as well as the development of these capabilities. These measures enabled the organisation to overcome stagnation of sales and become a formidable player in the global market over the next five years.

   Another (manufacturing) company that has been transitioning to services has embraced new capabilities across R&D and data analytics, with the infusion of external talent as well as clear mandates for personnel aligned with its strategic goals for growth. It is also crucial for organisations to only focus on their critical capabilities – for example, an Indian multinational conglomerate augmented its treasury function (considered critical) with the right top-tier talent, while its IT function (considered non-critical) was outsourced to an IT vendor.

4. **Alignment of accountabilities with autonomy:** Propagating the accountabilities (as KPIs) also mandates cascading the right autonomy for decision making. **It is critical to ensure that the autonomy enabled is not just on paper, but also in practice. While decisions taken by those outside the inner circle should be challenged as relevant, there should be no encumbrance in any way to align with the inner circle.** In conjunction with institutionalisation of Our Way, this will make employees feel empowered, develop the founder's mindset and also increase the focus on agile decisions being taken rather than a significant effort being made to refine the messaging from the implied intent of the decision. This was another theme apparent in a manufacturing (auto components) company looking to grow five times in seven years. While the company had multiple family members joining it (with most of them trained in business management or engineering), the management ensured that the decision-related rights rested with the internal and external talent, based on the mandates assigned to them.

5. **Data nirvana:** One of the biggest challenges family-led businesses face is in terms of balancing controls with agility. Existing risk management frameworks – which rely on conjoint ownership and decision making – need to transition. Unless carefully managed, this often results in either a system where stalling decision making outside the inner circle becomes the norm or where there is significant leakage of value due to broken or circumvented controls.

   The solution lies in viewing key processes from the perspective of controls and ensuring that all the data for the right decision making is available to the right person at the right time (what we call data nirvana). In some of the key digital transformations supporting family-led businesses, **establishing data nirvana as the first and primary outcome** – including the centralisation of controls through data sanctity (through automation and right maker-checker controls) and automation of objective control mechanisms grounded in revised delegation of authority with the right KPIs – **has enabled a 'no-trade-off' balance between control and agility as well as the core foundation for continued success.**



Conclusion

Although a number of businesses manage to commit themselves to some of these practices, it is important to appreciate that it is the culmination of all these five practices that enables this Leap of Growth.

Together, they enable the fortunes of the business as well as the family, which are separate but intertwined, to grow and ensure the enhanced resilience of both. These drivers enable institutionalisation and propagation of family values to a new generation of both the family and the business, and also ensure a capabilities-led and, hence, likely more sustainable growth path along with superior returns.

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