Corporate Governance Issues in Indian Family-Based Businesses

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Introduction:

The family business is the simplest, easiest and oldest business form in India. A family business may be company, partnership firm or any other form of business owned, controlled and operated by members of family. In India, by virtue of law, businesses or properties may be held in the name of Hindu Undivided Family (HUF). HUF is assessed for income tax purpose as a separate person under Section 2(31) (ii) of the Income Tax Act 1961. Many companies that are now widely held company were once upon a time founded as family business either as proprietary concern, HUF or partnership. HUF is not required to be registered with any authority and is the result of birth and marriage of co-parcner in a family. HUF may be a partner in a partnership firm or member/shareholder in a company.

Family businesses are the major form of enterprise in India and across the world, viz. Corporation houses like Suzlon, Tata, Birla, Bajaj, Reliance, Ford Motor, Tetra Pak, Wal-Mart, DuPont, Cadbury, Acer Computers were started as family business. Several studies indicate that family business carry the weight of economic wealth creation in all economies. As per prudent estimates, the proportions of all worldwide business enterprises that are owned or managed by families are in range of 65 to 80% (Gersick, Davis, Hampton, & Lansberg). It is estimated that 40% of the Fortune 500 are family owned or controlled (Gersick et al, 1997). Large family businesses play a major role in OECD economies. Family-run businesses account for more than 85% of all firms in OECD countries (2006). Moreover, family businesses dominate many developing economies as well as figure prominently in certain developed economies. Sir Cadbury (2000) has also concluded that family businesses are one of the foundations of the world's business community.

In U.S.A., family business accounts for 80 to 90% of the 18 million business enterprises and contribute 50% of the employment. In Canada, 80% of the companies listed on the Toronto Stock Exchange are closely held in family trusts (Phan, Butler, & Lee, 2005). In Europe, family firms dominate the small and medium size firms and are the majority of larger firms in some countries (Gersick et al, 1997).

In Singapore and Hong Kong, the numbers are similar as many of the local business enterprises that have recently gone public were started by overseas Chinese entrepreneurs in the post-war period 40 years ago. In Taiwan the small and medium-sized family enterprise accounts for more than 98.5% of companies, 80% of employment and 47% of the total economy (Phan et al, 2005).

Bin Saleh (2006) estimates that family businesses employ between 50-60% of those who works in companies around the world. In the Gulf area, family businesses represent 95% of companies and in the Arab region; they form about 70% of the size of the economy. He estimates that the local investments of 20 thousand family businesses in the gulf area alone exceed $500 billion while their total international investments worth over $2 Trillion. These companies constitute 75% of the non-governmental sector in the Gulf area employing around 15 million employees. Mahayny (2007) has estimated that family businesses represent at least 55% of the GNP of any Arab country, 95% of all listed companies in the region and employ 70% of the jobs outside the government and public sector in the region.

During 1970, 93% of privately owned companies were family businesses in India (Bhattacharyya, 2004). As per CII study (2001), 75% employment, 65% of GDP and 71% market capitalization in India is contributed by family business. The study reveals that only 38% family business in India survives after 1st generation, 12% after second generation and only 3% after 3rd generation. Of those that do last, 88% either disintegrate or completely vanish before the fourth generation takes the reins. Among top 20 companies in terms of governance structure and value creation, 10 companies controlled are by family business group. Governance practices of Indian business houses changed after 1991 liberalization. Prima facie analysis of Indian corporate governance practices and rules differ for public sector, private sector, closely held and widely held companies. Family-based business houses have grown in number & size in last two decades. More than 35 percent of first 100 business houses are owned by families. Corporate Governance norms are set for listed companies. It is voluntary for public sector while there are no specific guidelines if a business does not fall in either of the category, irrespective of its size and volume of the business.

Corporate Governance norms are applicable to only listed companies in India; however, nearly 40% family-owned businesses surveyed by Grant Thornton International felt these guidelines will impact their businesses. The Grant Thornton International Business Owners' Survey (IBOS) in India was conducted among 504 mid-sized family-owned businesses employing 50 to 500 employees. Following results emerged out of the study:

Actions on governance	**India %**	**Global %**
Have already tightened up internal controls as a safeguard	66	71
Have already appointed non-executive or independent directors on their boards and introduced formal policies on directors' pay	25	28
Have formed an audit committee	46	34
Plan to put tighter internal controls	14	17
Plan to form an audit committee	12	13
Appointing non-executive directors	8	11

As per Grant Thornton International's Mr. Chandiok, the reasons for the pro-active response to corporate governance by Indian family businesses could be two-fold (i) they feel they would be covered by the guidelines in the near future and (ii) putting international best practices in place would give them a good standing in the current competitive marketplace and differentiate them in dealing with overseas associates or partners.

This paper examines corporate governance issues in selected family based business houses in India, spanning theoretical background & current practice of corporate governance in family businesses; the concepts, importance, pros and cons, barriers and governance tactics, and the reasons of applying corporate governance norms in family business, shareholding pattern, the ways and methodology used for applying corporate governance, the key challenges and problems they face, and the results of such changes. This research may help to design special policy measures for companies managed by family. It is concluded that corporate governance is important for appropriate synchronization between the business & family and to become adaptive so as to take positive changes, large number of business houses are using HUF shareholding pattern as mode of succession planning, tax planning tool, division of share and maintaining Indian ethos.

Research Objectives & Methodology

We have selected seven prominent family business houses for the study. We study corporate governance practice of selected companies namely, (1) Nirma Limited which is headed by first generation entrepreneur K. K. Patel. (2) Cadila Healthcare, which is headed by Pankaj R. Patel, a second generation entrepreneur, his father Ramanbhai Patel was one of the founders who adopted a policy of steady growth through the organic route; Pankaj Patel has accelerated growth through acquisitions. After buying a pharma company in France, he is scouting for more acquisitions in Europe & Latin America. (3) Torrent Pharmaceuticals is headed by Sudhir Mehta, who added up six group companies. Mehta's father, UN Mehta, established the Torrent group through the pharmaceutical venture. Later, the group took control of Ahmedabad Electricity Company and Surat Electricity Company from the state government and emerged as a major player in the power sector. (4) The Lalbhais of Arvind group is into textile and the group enjoys distinction of surviving after 3 generations. (5) Top exporter and port developer Gautam Adani heads Adani Enterprise dealing into energy, port, food & education. (6) Suzlon Energy Limited is headed by Tulsi Tanti and global leader amongst energy enterprises. (7) Nandan Exim Limited is controlled by Chripal family, headed by Ved Prakash Chiripal, a self developed businessman, who ventured with a small textile business in 1972, now into petrochemicals, export, infrastructure, retail & education.

It is far-sighted to explain “family business” rather than defining it. A family business is the companies that are owned or controlled and managed by the families. A family business refers to a company where the voting majority is in the hands of the controlling family; including the founder/s who intend to pass the business to their descendants (Abouzaid, 2007). As per Companies Act 1956, shareholders’ general meeting elects the board members by simple majority amongst who are present in the shareholders’ meeting. Hence, it is possible that, even holding less than 50% may empower promoters to elect board members of their choice. In our study, Arvind Mills and Nandan Exims have less than 50% voting rights, but are controlling company by electing board members of their choice. Rest of the companies is having more than 50% controlling shares with the promoters. Friedman defines a family business as a company that is either owned or controlled by one family (Friedman, 1998). Another study says that the founder family continues to have significant influence in the company, disproportionate to shareholding (Lubrano, 2005). Hunt & Handler define a family business as the business that is owned and managed by one or more family members (Hunt & Hamdler, 1999). In essence, as per various definitions of family business is a company controlled by a family, either through ownership, voting power, management or mix of those. It is founded by family members and influenced by the family and such business is intended to be passed on to future family generations on continuing basis. The family business is a unique business organization that integrates a business system with a fundamentally different family system. Family business is a system which is organized to achieve specific goals, driven by tasks, may or may not be characterized by competitiveness. Following inclusive list envisage possible combinations of a family business form in India, Table A depicts shareholding pattern of the selected companies:

1. Head of the family runs business in his name and hold property as trust
2. HUF
3. Partnership firm, controlling interest may be in name of family members
4. Partnership firm, where one of the partner may be HUF
5. Partnership firm, partner may be family trust or minor added as beneficiary
6. Company, majority members/ controlling directors are family members
7. Company, where HUF may be one of the shareholder
8. Company, where family trust may be a shareholder
9. Company, where HUF and family trust are shareholders
10. Company, where one/more of the shareholder is private company

Table A
Shareholding Pattern of Promoters

Shareholder Type →	**Individual HUF**			**Body Corporate**			**Any other**		
Company	**No.**	**% Share**	**Pledged %**	**No.**	**% Share**	**Pledged %**	**No.**	**% Share**	**Pledged %**
Nirma Limited	8	25.59	0	5	12.57	0	9	39.01	0
Cadila Pharma	10	0.01	0	-	-	0	1	74.78	0
Torrent Pharma	2	2.24	0	1	50.89	0	0	0	0
Adani Enterprise	5	0.18	0	2	12.18	0	9	61.83	14.83
Arvind Mills	22	0.14	69.32	19	38.62	52.16	0	0	0
Suzlon Energy	20	43.61	78.81	6	9.47	29.54	0	0	0
Nandan Exim	16	42.67	76.01	3	7.00	69.74	0	0	0

Family businesses prefer members as employee on the key post. Many family businesses have non-family members as employees particularly in medium & bigger enterprises. When only a few family members share decision-making authority, a company can be aggressive in the marketplace and quickly respond to changes in the business environment. Generally strategic posts & financial powers are vested in family members & relatives. Family business gets capital from the founder, family members and their relatives because of personal bond with each other. Family businesses are usually reluctant to apply corporate governance as it means reducing the family power and control over the business. The finance literature widely discusses the effect of family control on the firm's operation (Jensen and Meckling, 1976), the firm value (Fama and Jensen, 1985) and capital structure (Randy and Goel, 2000; Vries de, 1993; Leland and Toft, 1986). The terms "promoter family control", "founding family control", "ownership control", "ownership concentration" and "management control" are used interchangeably in literature. However, McConnaughy et al. (2001) have described the nuances between these terms. Anderson and Reeb (2003) clarified that "the family represents a unique class of shareholders with poorly diversified portfolios, who are long term investors (multiple generations), and often control senior management positions". Hence, family firms are those in which the founder and his or her relatives have a majority stake in managing and controlling the affairs of the firm.

Evidence shows that the level of equity held by the firm's management does influence the firm's efficiency, profitability and capital structure and therefore its value (McConaughy et.al., 2001). The study by Morck, Shelfier and Vishny (1988) found that the firm value (as measured by Tobin's Q) increased when the promoter family held top position in the firm. James (1999) argued that family traits such as altruism, paternalism would encourage an atmosphere of love and commitment towards the business. Fama and Jensen (1983) argued that the long-term nature of the family relationship is meritorious in monitoring and disciplining the managers. La Porta *et al* (1996) documented that many large organizations tried to adopt these family traits in an effort to compete more effectively and boost firm performance. Further, the family influence is yet another corporate governance mechanism as it involves replacing the other monitory mechanism (direct monitoring by appointed executives to run the firm). Therefore the family leadership enables the owners of the firm to exercise full control over the corporate insiders (paid executive directors of the board) and the overall management (Jensen and Meckling, 1976; Fama and Jensen, 1983). This frees the family controlled firms from incurring a huge agency cost and can therefore benefit the promoters enormously. Further, this ensures a lot of involvement from the promoter of the firm ultimately leading to the fullest utilization of the resources and other capabilities of promoter. This results in better firm performance for investors. There is enough evidence in the literature (Kang, 1998; Morck et al., 1988; McConaughy et al., 1998) suggesting that family controlled firms exhibit better performance in comparison to firms in which family control is insignificant. The success of business also depends upon possession of necessary technical skill by promoters. Our investigation shows that, Cadila was founded by pharmacists and succeeded by second generation technocrats. Founder promoter of Suzlon is an engineer. The founder or promoters of the companies are commerce/management graduates and all promoters have fair amount of business exposure through the family business.

However in family controlled firms, threatening factors such as family instability, lack of succession planning, etc. may negatively influence the firm value (Demstez, 1983; Demstez and Lehn, 1985). Family-owned companies are characterized as organizations in which the shareholders belong to the same family and participate substantially in the management, direction, and operation of the company. It is widely recognized that each family has its own unique unwritten rules, values, histories, and communication methods. As the family structure shrinks or expands, the company changes, particularly with the advent of the second and third generations. Changes instigated by new generations can improve or harm the business.

Families have a number of unique attributes that serve to strengthen a family business, including love, care, unconditional acceptance, generational hierarchy, emotion, informality, closeness, loyalty, commitment, stability, relationships, growth and development, safety, support, and tradition. Families can also have a number of negative traits such as anger, tension, confusion, competitiveness, and strangled communication, which can affect a company to the detriment of all. These qualities are reflected into business ownership methods and styles, and can support or harm a company. Good governance mechanisms can alleviate some of the problems that arise when family characteristics become a driving force behind company action. Despite having a close network of owner/directors and the ability to make decisions quickly, family-owned companies may unable to sustain growth and have a shorter lifecycle than a privately owned company due to is inherent disadvantages attached. Following are the pros & cons of a family business.

Family Business: Pros & Cons

The milieu	Pros	Cons
Family relation	Mutual trust & respect amongst family members, Employees committed; loyal; shared values and belief system; family spirit; family name; family dream; strong sense of mission/vision. Family, extended family and relatives have a very strong sense of loyalty to the family that automatically translates as loyalty to the business.	Can't keep family issues out of business; inability to balance family's and business's need for liquidity; lack of objectivity; inward looking; emotionally charged decision-making; can't separate work and family; rivalries
Culture	Informal; flexible; adaptable; common language; efficient communications	May restrict innovation; highly emotional; resistant to change; reactive; high risk for conflicts
Family Role: Entrepreneurship	Often play multiple roles; flexible; dual relationships; quick decision	Role confusion; nepotism overrule competency; dual

Oversight, Catalyst Leadership Symbiotic	making	roles interfere with learning and objectivity; no organization charts
Leadership	Entrepreneurial, ambitious; informal authority;	Autocratic; resistant to structure and systems
Survival	The single minded dedication of the CEO and the family ensures that family-owned business survives through the toughest times	If head of the family become incapacitated due to death or any other reason and no successor is ready to continue business, business may close
Time	Long-term perspective; committed; patient capital; loyalty; deeper ties; trust built up over time	Hard to change; tradition bound; history of family affects business decisions; trust affected by early disappointments
Complexity	Can foster creativity; rich interplay of roles and goals	Must be managed to avoid confusion; can be a drain of resources and energy
Governance	Closely held; family owned; high degree of control; earnings are motivators	May sacrifice growth for control; do not have to answer to stockholders; often no
	Clearly defined culture leads smooth governance	Autocracy and paternalism lacks democracy
	Fewer principal-agent problems	Messy organization structure
Succession	Training can begin early; mentoring a life-long process; can choose when to leave	Family issues get in way; unwillingness to let go; inability to choose a successor
	Continuity in leadership thereby encouraging long-term orientation	May have to depend on even weak leader
Infrastructure	Informal; flexible; entrepreneurial; innovative	Unclear; confusing; boundary problems; indecisive; resistant to change; lack of management development
Capital	Committed, sacrifice return for time being	Limited resource pool
Authority	Greater independence	Placing personal or family interest first
Decision process	Co-ownership within the family leading to better investment strategies	Family problem affect business decisions
	Quick decisions	Problems with succession planning
	Flexibility	Nepotism and favoritism
	Long-term family involvement without formal remuneration	Costly & complex inter-generational transfers
	Effective monitoring and	Family instability due to

Management cost	disciplining of managers, Low monitoring cost	conflict among the family members for control
Business skill	Family members' extensive knowledge of the firm	Limited technical knowledge
General	Good governance directly addresses the above issues for family-owned companies by Integrating the strengths of family and business. Improving shareholder relationships through effective communication and conflict management Systemizing wealth distribution mechanisms. Supporting growth and business diversification. Managing ownership and leadership transitions. Developing the next generation of managers, shareholders, and family members. Improving credibility. Attracting lower-cost debt and equity capital.	Clear lines of succession do not exist or are complicated by the importance of family relationships. Loose organizational structures do not attract and retain quality human resources. Personal interest in the success of the business leads to an unwillingness to take risks like expanding and diversifying into new business ventures.
	Family's reputation attract investors to invest Commitment to family values & beliefs Emotional attachment Capable members are appointed as professionals Gap of skill, knowledge, experience, expertise, licensing etc. is filled by outsiders	Lack of motivation for professional managers. Professional management is sub-servient to family's interest. Family governance determine corporate governance. Absence of succession plan. Induction of younger member without competence.

Features:

Owner defines the value of the company
The value of company reflects family value
Business group and not company decision makers
Relation in family business builds on trust between managers & owners and BoD and owners
Owner prefer to appoint kith and kin as manager if talent is available internally
Owner appoints directors from friends & philosophers

Family's unity and commitment have priority over objective of company, wealth maximization of shareholders
Entrenchment of management is more in family business
Reasons of decay: split in family, internal management problem, absence of succession plan, inability to face challenges of younger companies
Family charter: constitution of family, values & beliefs, code of conduct for family members, document that provides bondage, and direction for behaviour, define role
Family council: all major members of the family, meeting frequently for critical decisions

Even studies based on the integrative models encompassing board involvement, incorporating different theoretical perspectives and various board attributes such as board size, board composition and number of non-executive directors on the board, provide inconclusive results suggesting that corporate governance has, at least an indirect effect on the company performance (Zahra and Pearce, 1989).

The factors considered for measuring corporate governance have been identified and adopted differently by different researchers. For example Mishra et al. (2001) have used variables such as firm age, board size, outside directors on the board and multiple classes of shares. Few others (Millstein and MacAvoy, 1998; Bhagat and Black, 1999) have taken board characteristics while others (Karpoff et al., 1996; Sarkar and Sarkar, 2000) have considered "shareholder activism" as corporate governance. Further, the numerous indexes for measuring corporate governance developed by researchers (Mohanty, 2001; Black et al., 2003) have made the domain of corporate governance wider. However, most of these studies were conducted in developed countries that have evolved corporate governance to a larger extent (Black, 2001). Evidence also indicates that corporate governance practices are likely to have a larger effect on the firm value in those economies that are in the transition stage.

There are numerous factors that make family businesses governance needs unique. The first of these factors is ownership. Public companies are typically owned by a large number of shareholders whose primary interest in ownership is economic. However family businesses are often owned by a much smaller group whose ownership often has elements of personal identity, family legacy, and community responsibility intertwined with economic interests. This "emotional ownership" often results in family businesses having a longer-term view. Management of a public company is focused on the next quarter's results and the impact they will have on the share price, whereas a family business can focus on what is best for the business and the family in the long run, knowing that it is extremely unlikely that any of the family will want to sell their shares if the business has an off quarter.

Another factor that tends to separate successful family firms from their public counterparts is the concept of stewardship. Many family businesses have a clear understanding that the business is something to be preserved and grown for future generations. As Bill Ford, the chairman of Ford Motor Company once said, "I'm working for my children and grandchildren and feel I'm working for our employees' children and grandchildren as well." This longer-term focus and emphasis on stewardship often results in family businesses outperforming publicly owned businesses in terms of profitability and innovation. As summarized in *MSN Money*, July 28, 2004, Professors David Reeb and Ronald Anderson have identified that, "Whether your yardstick is some accounting measure like return on assets or stock-price performance, family run companies outperform the rest by anywhere from 6 per cent to 13 per cent. On average, across all measures, they beat other companies by 10 per cent." Key to effective governance for a family business is recognizing when the family business is moving from one stage to another and designing revisions to the governance structure that will meet its needs for the next stage.

According to Friedman, after 1970 only business researchers and scholars realized that family businesses represent indeed a distinct system (Friedman, 1998). A family system is bound and motivated largely by traditional responsibilities and loyalties; characterized by unity. James Lea explains that meshing one system with the other inevitable means that many of the family's biases, quirks, and internal relationships will bleed through into the business's operating style, decision making, and future prospects (James Lea, 1991). The literature on family businesses agrees that most family firms go through an evolution process of ownership and management over time that is made of three key stages:

Evolution stage in family business

1st Generation
Controlled by Founder

This is the initial step of the family business existence. The business is entirely owned and managed by the founder(s). It is estimated that 75% of all family businesses are owned by one person or couple at this stage. Other shares, if exist, are also owned by family members. Founders own and work in the business. Board of Directors is generally inactive and decisions rest with a small group. This is often the stage where family values are engrained in the business and the responsibilities of ownership are imbued in the next generation.

2nd Generation
Sibling Partnership

This is the stage where management and ownership have been transferred to the children of the founder/s. As more family members are now involved in the company, governance issues tend to become relatively complex. Some family shareholders may not be working in the business. Board of Directors may be active with help of advisers & Family Council. The leader has to balance the needs of the business with the needs of several families, not all of whom get their livelihood from the business.

3rd Generation
Cousin Confederation

At this stage, the business‟ governance becomes more complex as more family members are directly or indirectly involved in the business, including children of the siblings, cousins, and in-laws. Since many of these members belong to different generations and different branches of the family, they might have diverse ideas on how the company should run and how the overall strategy should be set. BoD may be active and governance issues may be more formalized. Society may view at this stage non-family business.

Keys to Success:

- A clear structure separating governance of the firm and affairs of the family
- An effective board with competent & independent directors
- Logical structure of the firm with clear chain of command and decision-making process
- Written recruitment, promotion and compensation policies

Critical issue in governance of family business:

• Distribution of roles & responsibilities	Process of taking key decision
• Access to Capital	Wealth & Power Diversification
• Any important family matters/business	Accounting quality
• Reliability	Charter of family value & vision
• Transparency	Effective governing board
• Appropriation of profit	Communication
• Value creation	Fair policies and actions
• Succession Planning	Election of family council members
• Approval of change in family values/vision	Selection of head
• Approval of family employment	Approval of compensation policies

Family Business in India

Many families have made significant contribution to Indian economy. Until the government of India took socialist stand on investment the family-owned businesses in India were successful and Tata Airlines was among the top 10 Airlines in the World. The economy of the country was gauged for several years on the basis of the growth and development of the family business. These businesses faced lot of problems and rendered it quite unfit for global standards. With the opening of the economy in 1991 and the influx of multinationals the family-owned businesses and the private sector was at a great loss and on a back foot. It was felt that the family-owned business and family-owned business houses would lose their place in the industrial map of the country. Time has proved this to be wrong because the family-owned businesses have proved to be very strong in their determination to carry the business on.

Even among large companies, shareholdings remain relatively concentrated with "promoters" and family business groups continuing to dominate the corporate sector. There is significant pyramiding and tunneling among Indian business groups and, notwithstanding abundant reporting requirements, evidence of earnings management. This is not surprising: concentrated ownership and family control are important in countries where enforceable legal protection of minority property rights is relatively weak. Family controlled businesses provide an organizational form that reduces transaction costs and asymmetric information problems under these conditions. (Corporate Governance in India, CFR Working paper)

Ownership Patterns

Family-run business groups clearly play a crucial role in the Indian corporate sector. About 60% of these companies (comprising about 65% of the total market capitalization of the Exchange), are part of these business groups. Recent studies have documented significant tunneling of funds among business groups. The actual ownership within these companies is far from being completely transparent with widespread pyramiding, crossholding, and the use of non-public trusts and private companies for owning shares in group companies. About 11% of companies comprising about 22% of the market capitalization are companies wholly or significantly owned by the Central or State Governments; about 20% of companies comprising about 8% of the market capitalization are non-Group companies controlled by Indian promoters; and about 9% of companies comprising about 5% of the market capitalization are non-Group companies controlled by foreign promoters**.** It is evident from our study that all seven companies under study has typical shareholding pattern. Nirma Limited has 51.58% shareholding with promoters' HUF, family trusts and private companies. Cadila Healthcare Limited has 74.78% with family trust, balance with HUFs and others. Torrent Laboratories has 50.89% held by private limited company controlled by family and 20.62% with family members.

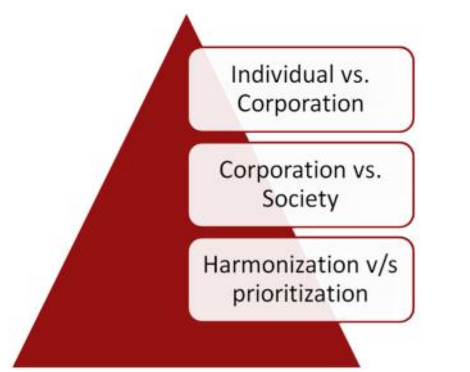
Shareholding patterns in India reveal significant concentration in the hands of the promoters. Jayati and Subrata Sankar (2002) find that promoters held 47.74% of the shares in a sample of almost 2500 listed manufacturing companies, and held 50.78% of the shares of group companies and 45.94% of stand-alone firms. As for the impact of concentrated shareholding on firm performance, an earlier study by these authors finds that in the mid-90's holdings above 25% by directors and their relatives was associated with higher valuation of companies while there was no clear effect below that threshold.

Before the word 'corporate governance' became a buzzword in the modern era, Indian culture & literature widely referred & advocated good corporate governance in spirit without naming it the practice as corporate governance. The Directive Principles mandates that the State should work to prevent concentration of wealth and means of production in a few hands, and try to ensure that ownership and control of the material resources is distributed to best serve the common good. [Article 38, Constitutional Law of India] Gandhian philosophy is based on 1st verse of sacred Hindu literature THE Ishopshinad which vows, "Tena Tyaktena bhunjithah…", where, one is asked to dedicate everything to God and then use material things only to the required extent. The message enshrines that one must not covet what belongs to others. A corporate entity stands on the pillars of Trusteeship and Accountability. According to a study (1998) conducted on ownership, 30% businesses are family controlled, 36% are widely held while 18% are state owned. In India, major business houses are equally controlled by family or otherwise. 17 of 30 companies in SENSEX (how security index at Bombay Stock Exchange known as) are family controlled.

Till 1980, majority of big corporate houses in India were family run businesses and founded by first generation entrepreneurs. The then biggest & successful business houses like Tata, Birla & Bajaj practiced voluntarily all good corporate governance practices by spirit. A century old Memorandum of Tata referred Corporate Social Responsibility and in spite of absence of any express code for corporate governance, there was no major failure on governance issues in these business houses. Indian Company Act, 1956 contains express legal code, which are pertaining to good corporate governance practices.

Issues in Family Controlled Business:

Due to high involvement of the promoters in business activities, either at strategic level or in day-to-day affairs, business performance is better. Due to explicit or implied concentration of power among family members, they are able to take quick decisions in response to market demands. Another benefit is obvious, that promoters are continuously monitoring & protecting assets of the company due to their own stake in the business and property of the company. On the other hand, modern corporate run as a democratic principles. If majority of the Board members are in favour of a family, they are able to take decisions (if not violating any express legal provision) as they like and in family's general interest. The good corporate governance principle requires decisions in interest of the company rather than in interest of member or members or family. More particularly, in circumstances of conflict of interest, human tendency is inclined to decide in own favour instead of the company. Corporate Governance insists otherwise. In second situation, when, there is a conflict of interest between society and company, human tendency is to take decision that favours company, corporate governance principles expects otherwise.



Corporate Governance vis-à-vis Conflict of Interest

This conflict generally happens more frequently & in higher magnitude in family controlled business after second generation.

Corporate Governance in India:

Corporate Governance involves a set of relationships between a company's management, Members of Board, shareholders and other stakeholders. Corporate governance provides a principled process and structure through which the objectives of the company, the means of attaining the objectives and systems of monitoring, measuring & rewarding performance are set. Corporate governance is a set of accepted principles by management of (1) the indubitable rights of the shareholders as owner of the company and of their own rule as trustees on behalf of the shareholders, and (2) duty of the key managers when any actions are detrimental to the society. It is about commitment to values, ethical business conduct, transparency, making a distinction between personal and corporate resources in the management of the company and to harmonize conflict of interest. The Annexure-I provides brief information on the provisions that are directly or indirectly relevant for good corporate governance, along with the consequences of violation of the particular provisions.

To ensure good corporate governance, historically there is strong legal framework existing in India. But due to globalization, cut-throat competition, IT & media invasion, increasing social expectation, liberalization, political, economical, financial & legal reforms; existing legal framework is at stake and new corporate governance norms are evolving. Constitutional Law of India is the source for direction in implementing good corporate governance. Article 38 directs government to ensure equitable distribution of wealth and advise state that the government should work to prevent concentration of wealth and means of production in a few hands, and try to ensure that ownership and control of the material resources is distributed to best serve the common good.

The structure of ownership of any business determines substantially, the way how the business is controlled and managed. The ownership structure in modern corporate generally is dispersed between numerous individual & group of individual or institute/s. If business is a company, the management & control vest in the hand of Board of Directors, duly elected by a democratic process as set up by the law. Due to various reasons, all shareholders are not participating in electing members of the board. The board members influence in setting & achieving objectives of the company and enjoy power of using companies' resources as they like within limits prescribed by Article & Memorandum of Association and Companies Act. Company has to follow mandates of relevant Accounting Standards in preparing & reporting Financial Statements. Company Act provides provisions relating to special procedure when there is conflicting interest of members of the Board or top management with the interest of the company. If the company is listed in any stock exchange, it has to further follow provisions of clause 49 of SEBI listing agreement. SEBI also ensure shareholder protection by various checks and preventing undue advantage of insider information and unfair takeovers. Financial Statements are the best indicators to report how corporate governance principles are executed. These statements are prepared on the basis of Generally Accepted Accounting Principles (GAAP). Accounting Standards prescribes recognition, valuation, reporting & disclosure of financial information. The parties to the business transaction may take undue advantages from international business. Transaction amongst associate concerns & relatives require special scrutiny. Income Tax Act has enacted provisions to assess value of the transaction by incorporating principles of Transfer Pricing.

By and large express provision for corporate governance exists for listed companies only. There are no special provisions for family controlled companies. In year 2007, Central

Government issued guidelines on corporate governance for central public enterprises. It is voluntary in nature and there are no similar guidelines for state controlled public sector units as such. Similarly clause 49 applies to the listed companies and there are no express provisions on corporate governance issues for un-listed companies how so big it is. Companies Act, 1956 have implied provision that has bearing on corporate governance that applies to all class of companies. Non-companies, how so big in operation & importance they have no similar provisions to follow for corporate governance norms. With the amendment of the Companies Act, 1956 through the subsequent amendment in 1999 & 2006, Accounting Standards are now indirectly integral parts of the Companies Act, which provides statutory backing. It says that every company and its auditor shall comply with the Accounting Standards in the manner specified in the rules. The Accounting Standards shall be applied in the preparation of Financial Statements. Sec. 211 (3) says that every P & L Account and Balance Sheet shall comply with accounting standards and deviations if any to be disclosed with reasons its financial effect.

The Government of India recognized the importance of financial reporting in providing essential financial information about the company to its shareholders and other stakeholders, as an integral and important part of good corporate governance. Such information needs to be reliable, free from bias and should enable comparison on the basis of common benchmarks and necessitates an appropriate financial reporting system in the form of accounting standards that incorporate sound accounting principles and reflect a true picture of the financial health of the company while ensuring legally enforceable accountability.

Requirements of the Audit Committee: Audit Committee has a critical role to play in ensuring the integrity of financial management of the company. This Committee add assurance to the shareholders that the auditors, who act on their behalf, are in a position to safeguard their interests. Besides the requirements of Clause 49, **section 292A** of the Act requires every public having paid up capital of INR 50 million or more shall constitute a committee of the board to be known as Audit Committee. As per the Act, the committee shall consist of at least three directors; two-third of the total strength shall be directors other than managing or whole time directors. The Annual Report of the company shall disclose the composition of the Audit Committee. The recommendations of the committee on any matter relating to financial management including Audit Report, shall be binding on the board. In case board does not accept the recommendations so made, the committee shall record the reasons thereof, which should be communicated to the shareholders, probably through the Corporate Governance Report. The committee shall act in accordance with the terms of reference to be specified in writing by the board. The committee should have periodic discussions with the auditors about the Internal Control Systems and the scope of audit including the observations of the auditors. If the default is made in complying with the said provision of the Act, then the company and every officer in default shall be punishable with imprisonment for a term extending to a year or with fine up to INR 50000 or both.

Director's remuneration: Section 309(1) of the Act requires that the remuneration payable both to the executive as well as non-executive directors is required to be determined by the board in accordance with and subject to the provisions of section 198 either by the articles of the company or by resolution or if the articles so require, by a special resolution, passed by the company in a general meeting. Further, Schedule VI of the Act requires disclosure of Director's remuneration and computation of net profits for that purpose.

Corporate Democracy: Wider participation by the shareholders in the decision making process is a pre-condition for democratizing corporate bodies. Due to geographical distance or other practical problems, a substantially large number of shareholders cannot attend the general meetings. To overcome these obstacles and pave way for introduction of real corporate democracy, section 192A of the Act and the Companies (Passing of Resolution by Postal Ballot), Rules provides for certain resolutions to be approved and passed by the shareholders through postal ballots.

Listed Companies:

Securities and Exchange Board of India (SEBI) guidelines on corporate governance to listed company is binding. Clause 49 of the Listing Agreement to the Indian stock exchange came into effect from 31 December 2005. This agreement is between listed company and the stock exchange with which it is listed. In corporate hierarchy two types of managements are envisaged: i) companies managed by Board of Directors; and ii) managed by a Managing Director, whole-time director or manager subject to the control and guidance of the Board of Directors.

Five broad themes predominate in SEBI corporate governance norms:

1. The independence criteria for directors have been clarified.
2. The roles and responsibilities of the board have been enhanced.
3. The quality and quantity of disclosures have improved.
4. The roles and responsibilities of the audit committee in all matters relating to internal controls and financial reporting have been consolidated, and
5. The accountability of top management, specifically the CEO and CFO has been enhanced.

As per Clause 49, for a company with an Executive Chairman, at least 50 per cent of the board should comprise of independent directors. In the case of a company with a non-executive Chairman, at least one-third of the board should be independent directors. It would be necessary for chief executives and chief financial officers to establish and maintain internal controls and implement remediation and risk mitigation towards deficiencies in internal controls, among others. Clause VI (ii) of Clause 49 requires all companies to submit a quarterly compliance report to stock exchange in the prescribed form. The clause also requires that there be a separate section on corporate governance in the annual report with a detailed compliance report.

A company is also required to obtain a certificate either from auditors or practicing company secretaries regarding compliance of conditions as stipulated, and annex the same to the director's report. The clause mandates composition of an audit committee; one of the directors is required to be "financially literate".

Following are the non-mandatory requirements:

1. Independent directors may not have tenure not exceeding in the aggregate a period of nine years on the Board of the company.
2. Companies moving towards a regime of unqualified audit report.
3. Training of board members in the business model of the company as well as risk profile of the business parameters of the company and responsibilities of directors and how best to discharge it.
4. Performance evaluation of non-executive directors by a peer group comprising the entire Board.
5. To set up a whistle blower policy in the company.

Who is an independent director?

The definition of independent directors as given in the amended clause 49 of listing agreement is an inclusive definition, which defines independent directors as "For the purpose of this clause the expression 'independent directors' means directors who apart from receiving director's remuneration, do not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in judgment of the board may affect independence of judgment of the directors."

The definition of the term 'independent directors' has been amended to mean a non-executive director who:

- Does not have a pecuniary relationship with the company, its promoters, senior management or affiliate companies.

- Should not be related to promoters or the senior management.

- Has not been an executive with the company in the immediately three preceding financial years.

- Is not a partner or executive of the auditors/lawyers/consultants of the company;

- Is not a supplier, service provider or customer of the company;

- Does not hold 2% or more shares of the company.

Further, there is certain minimum information that is required to be made available to the members of the board prior to the board meeting which ranges from annual operating plans and budgets to labour problems. In addition, a company is also required to lay down a code of conduct for members of its board as well as the senior management.

These conditions shall apply only to a listed company and unlisted company with paid-up capital and free reserves of Rs 100 million, or a company having a turnover of Rs 500 million and above for the financial year beginning 2003. The number of independent directors who are to be on the board shall not be less than 50 per cent of its total strength for these companies.

In any case, nominee directors are to be excluded while computing the percentage of the independent director. The minimum number of directors for a listed company, and to the categories to whom these rules are applicable, shall not be less than seven, of which, four shall be independent directors.

As regards the three categories of companies to which the various recommendations apply, it has been specifically stated that the audit committee would only constitute independent directors.

Failure to comply with clause 49 of SEBI's listing agreement is punishable with imprisonment of up to 10 years or a fine of up to INR 250 million or both. Besides, stock exchanges can suspend the dealing/trading of securities.

Public Sector Companies:

The Government of India issued guidelines on corporate governance for central public sector undertakings in June 2007. The government emphasized the need for public accountability of the public sector management regarding its duties and responsibilities and hence it was considered necessary to formally adopt guidelines on corporate governance for the public sector undertakings. The ministry formulated guidelines on Corporate Governance for Central Public Sector Enterprises. These guidelines were evolved keeping in view the provisions of the relevant laws, rules and instructions and through a consultation process where the stakeholders have participated. Thus, it was imperative that ethics and probity are maintained in the functioning of CPSEs. Good Corporate Governance practices, therefore, should be built into the management systems of CPSEs.

These guidelines cover issues like composition of Board of Directors, setting up of Audit Committees, role and powers of Audit Committees, issues relating to subsidiary companies, disclosures, accounting standards, risk management, compliance and schedule of implementation, etc. These guidelines though voluntary in nature should be followed by all CPSEs as proper implementation of these guidelines would protect the interests of shareholders and relevant stakeholders. The compliance with these guidelines requires to be reflected in the Directors' report, Annual Report and Chairman's speech in the Annual General Meeting. This Department would also grade the CPSEs on the basis of their compliance of the corporate governance guidelines.

For the purpose of evolving Guidelines on corporate governance, CPSEs have been categorised into two groups, namely, (i) those listed in the Stock Exchanges; (ii) those not listed in the Stock Exchanges. In so far as listed CPSEs are concerned, they have to follow the SEBI guidelines on corporate governance. In addition, they may follow those provisions in these guidelines which do not exist in the SEBI guidelines and also do not contradict any provisions in the SEBI guidelines.

- Board of Directors
- Audit Committee
- Subsidiary Companies
- Disclosures
- Report, Compliance and Schedule of Implementation

Family Based Business & Corporate Governance:

Family relationships have to be managed in addition to business relationships
Special requirements to manage growth;
Picking and promoting the right members of the family;
Providing attractive opportunities to managers from outside the family;
Demonstrable even-handedness in training, promoting, compensation and benefits
Formal structure; if family firms are to manage growth successfully, they have to adopt a clear organizational structure which would include:
An effective board concentrating on policy and strategy

In a typical non-family business, any involved individual can be an employee, a manager, an owner, a director, or some combination of these roles. In a family-owned business however, matters become more complex as an individual can have multiple roles and responsibilities. These multiple roles are usually associated with different incentives, which increase the challenges that family businesses face as opposed to their non-family counterparts (Neubauer *et al*, 1998). The complex interaction of the family and the company that it controls creates several difficult governance issues in addition to those faced by other companies, including: succession planning for the family management; family versus non-family employment and promotion; equitable treatment of non-family shareholders; and the role of family meetings vis-à-vis Board meetings and shareholders meetings (IFC, 2007).

Challenges, Strengths and Weaknesses

Globalization has led to fierce competition and increasing consumer demands. Family businesses especially have to respond to these challenges effectively in order to avoid shrinking in size and diminishing accordingly. Because of their nature, family businesses face their own set of challenges and obstacles on many fronts: operational, legal, marketing, financial and business-development. Hughes argues that successful family businesses feature a strong and compelling vision of their future development, which is the characteristic horizon of family businesses as opposed to other ownership models. Such a vision has to be sustained by entrepreneurial values like respecting the company as a public good, to be preserved and developed to the benefit of all relevant stakeholders. Sometimes, vision and values are implicit and somewhat “hidden” behind entrepreneurs’ thoughts and ideas. On the contrary, in successful companies these values are shared by all owners, whose cohesion is constantly kept alive and monitored through open and systematic communication

This is a fundamental challenge for family businesses, as they tend to neglect the importance of communication in the erroneous belief that being part of the same family naturally makes it happen or, worse, means it is not really necessary. Instead, even within the same family, lack of communication undermines trust amongst its members; in turn, decreased trust undermines unity which will sooner or later affect the company, therefore decreasing the quality of decision making (Hughes, 2004). Other major challenges faced by family-owned businesses include differing family member goals and expectations, and jealousy and interference from some disgruntled family members can plague the operation of family businesses in ways that do not affect non-family run businesses. The degree to which the business depends on one individual, namely, the principal owner-manager substantially affects how well a family business works (Friedman, 1998). Risk Aversion: Family businesses are commonly at a disadvantage when it comes to acquiring resources, largely because their owners are predisposed to being more risk averse.

Family-owned businesses have been hit by the economic downturn like many others. But while they have suffered along with everyone else, they are able to leverage an inherent competitive advantage to ensure they survive and prosper despite the poor business and financial climate.

According to Randel Carlock, Professor of Family Business and Berghmans Lhoist Chaired Professor in Entrepreneurial leadership at INSEAD, this advantage encompasses committed owners, long-term strategies, industry knowledge accumulated over generations, and values such as trust, stewardship and longevity.

However, such characteristics on their own do not ensure survival or success. More than at any other time, businesses need competent leadership. Some 95 per cent of businesses in Asia, the Middle East, Italy and Spain are family-controlled. So are over 80 eighty per cent of companies in France and Germany, and between 60-70 per cent of those in the US.

Wal-Mart, Fiat, Ford, Peugeot, Cargill, Michelin, Gap, IKEA, BMW. There’s a family behind the largest block of voting stock in each of those companies. Make no mistake about it, family business are a major source of wealth creation and employment.

“Family businesses are unique in two main ways,” Carlock says. “First, they hold a long-term perspective; and second, they are driven by values. Their decisions tend to be based around what’s good for the family, what upholds the values they hold. But you also have family emotions, and so you need professional management. It’s all about these ‘professional-emotional’ families – combining family passion with professional management.”

Ford was the only of the three US carmakers not forced into bankruptcy. Did the family's name on the dashboard make a difference? "The Ford family made sure Ford was protected: ownership and legacy. They took on long-term debt before the real trouble hit so the company wouldn't have to go to the government and beg for money. Toyota, Fiat, BMW and VW (all family businesses) are also well-positioned."

Carlock has similar stories in the banking sector. "Pictet, Banco Santander, Julius Baer, Lombard Odier … all family-controlled, none of them in serious trouble because the family owners said to the employees 'we're not out to make quick money; don't see how many risky products you can sell, just make good solid investments for our clients.' They were concerned about their businesses, not their bonuses."

Then there were the battling Bancrofts – heirs to the Dow Jones publishing business. The older generation acted as stewards of a great journalistic heritage, heralded by the Wall Street Journal; the younger, third generation saw a bleak future for the industry itself and a share price that wouldn't budge. Rupert Murdoch – himself embroiled in family business skirmishes – faced no competition in his bid for the Bancroft family business. The Bancrofts lost their business because they lacked a shared vision and which to build the family's commitment.

"Firms don't last more than three generations," Carlock says. "They go bankrupt or they merge or they close down because they just can't face the competition. If you look at the Fortune 500 in 1955, you will see just 77 of those companies are around today. In family firms, problem is part strategy, and part the family itself. If a family can align its values and vision and communicate its values and agree to invest their human and financial capital, they will succeed."

Carlock believes communication among family members is the main key to success. "If a family doesn't communicate, they are no better than any other business," he says. Other strengths that family businesses have and which translate well in the business world at large include:

Stewardship:

This is like corporate social responsibility, says Carlock. Thinking in the long term instead of 90-day cycles. Family businesses do this naturally. It's their name on the business, out in the community, for posterity."

Values:

Look at Apple, Carlock says by way of example. "The fear everyone had over Steve Jobs' health was not so much about him per se; it was about his values – who would be able to be the innovator, staying out there in front of the competition?"

Encourage entrepreneurship:

Almost every family business in the world was started by an entrepreneur," says Carlock. This spirit continues to keep the company alive and regenerating. And it shores up long-term performance levels.

Ability to crystallize the family's vision for itself in the future:

In times of economic crisis this vision is especially important, as it can re-direct otherwise destructive and inhibiting emotions such as fear and anger. "Real leaders recognise the emotional impact of their leadership style on the company and its employees," states Carlock.

Risk Aversion:

Family businesses are commonly at a disadvantage when it comes to acquiring resources, largely because their owners are predisposed to being more risk averse. Another major challenge facing family businesses is the human resource challenge. In family-owned business, the family has to be always accommodated first with jobs. This is a facet nobody can deny. But the bigger problem is not hiring of incompetent family members but how they affect other employees. In some cases, family members and relatives can demoralize the organization by their dealings with other employees. They may loaf on the job, avoid unpleasant tasks, take special privileges, make drastic errors and not be reprimanded etc. (Hughes, 2004). HR challenge also includes defining authority. It is very difficult in family businesses to define authority. If a younger member is made CEO, he/she may find it very difficult to tell elder members of the family to change their style of functioning. The younger cannot caste off his role in the family of an obedient youngster and take on the role of the leader of the business.

The HR challenges discussed above create another serious problem; retaining non family professionals. Mahayny suggests that it is a huge challenge in some family-owned companies to retain non family professionals. This is mainly because promotions are closed to them after a certain point and they see relatives being pushed into executive offices in spite of not being competent. This affects their growth aspects because no family can have members that can look after all aspects of business (Mahayny, 2007). Allen further suggests that this makes family businesses avoid bringing in outsiders because they believe that it threatens the security of the family (Allen, 2007). Non participative family members: Every family business has some members who are actively involved in the business but there are stake holders who are not actively part of the business like mother, sisters, uncles, aunts, in-laws, etc. These people are interested only in dividends and earnings and not in the growth of the business. On the other hand, relatives who are engaged in daily operations judge major matters from the viewpoint of the production, sales and personnel necessary to make the company successful. Obviously, these two viewpoints may conflict in many instances (Hughes, 2004).

Family businesses are much more about family than business. Family businesses begin as families, and each family has its own unique unwritten rules, values, histories, and communication methods (EJB, 2006). These variables each have impacts on the business in different ways, sometimes positive and sometimes not. Therefore, a family business cannot be truly understood unless there is an understanding of the family and individuals behind the company. Family participation in a business can strengthen the business because family members are very loyal and dedicated to the family enterprise. However, and as Mahayny put it, one of the key reasons for family business failure is the inter-relationship between the family and the business which results in business decisions being strongly affected by social and non-business related factors (Mahayny, 2007).

Rivers has also emphasized that managing a family business, and particularly succession planning, can present some unique problems for similar reasons as family interests often conflict with business interests, for example hiring a family member who is less competent than a non-family member or keeping an underperforming family member in a position when their performance is hurting the company. Psychologists are often consulted to help families successfully manage issues that affect both the family and the business (Rivers, 2005).

While it is helpful to understand the conditions that lead to healthy and unhealthy family businesses, most family businesses cannot be classified as either completely healthy or unhealthy; each has certain strengths and weaknesses. Indeed, the uniqueness of family businesses is best understood by examining their strengths and weaknesses, often different sides of the same coin. Whether a particular dimension of a family business is strength or a weakness depends on three factors: (1) the degree to which the boundaries between the family and the business are managed; (2) the health of each system; and (3) the degree to which adaptability and learning is inhibited or encouraged in the boundary interface.

Some of the major challenges faced by family-owned businesses are:

Non participative family members: Every family-owned business have some members who are actively involved in the business but there are stake holders who are not actively part of the business like mother, sisters, uncles, aunts, in-laws etc. These people are interested only in dividends and earnings and not in the growth of the business they are unable to comprehend the problems of operating a business. Relatives who are engaged in daily operations judge major matters from the viewpoint of the production, sales and personnel necessary to make the company successful. Obviously, these two viewpoints may conflict in many instances.

Family emotions: Emotion is a big dimension in family-owned firms, as brothers and sisters, uncles and aunts, nephews and nieces, and fathers and children work together. The problem arises in recognition of these dimensions of emotions and to make objective decisions. It is hard to make objective decisions about the skills and abilities of each other, especially when some members rake up unpleasant instances to question abilities. Emotional outbursts are many in family-owned businesses and the quarrels and ill feelings of relatives have a way of spreading out to include non-family employees. It is very difficult to keep the bickering from interfering with work and the company becomes divided into warring camps.

It is very difficult to keep emotions out of anything. It is believed by many business thinkers that emotions are very essential to operate a business. But these emotions and passion have to be related to business. Family-owned business finds family emotions playing havoc with business. Ego clashes, sibling rivalry, hurt among the earlier generation, dissatisfaction, feeling of being left out, deriving importance etc are some of the problems that are general seen. The head of the family has a very large role to ensure that these emotions stay out of business. Controlling of ego clashes and sibling rivalry is tough but all the same if the head of the family encourages open communication among family members and has a system of mentoring every member who enters the family business then these issues can be controlled. Family or Business what comes first?: The family-owned business management needs to be very clear about the demarcation between family and business. The blurring of line between the two leads to business decision that is in the interest of the family and not in the interest of the business. In case the business needs to survive along side the international organisation the family needs to take a back seat and the interest of the business needs to precede, some time at the cost of certain family relations.

Priority of family vs. business: India as a country has a very high family orientation. It is therefore seen that family members are trusted with all important jobs. It is difficult to give a job to an outsider if a member of the family has shown an interest in the same. Some times jobs and responsibilities are given to family members in spite of being aware of their inability to perform assigned duties. This ultimately affects the business and its bottom line.

Defining Authority: It is very difficult in family businesses to define authority. If a younger member is made CEO he/she may find it very difficult to tell his father/mother, uncles/aunts, grandparents or elder members of the family to change their style of functioning. The youngster cannot caste off his role in the family of an obedient youngster and takes on the role of the leader of the business. Many members in the family also tend to overlook decisions taken by younger members even if they are at positions of authority. This makes management of the business very difficult for the younger generation. "Family employees" should discipline themselves to work within the bounds of these lines of authority.

Every family members needs to be told clearly about his/her role in the business and overstepping into other peoples authority especially those of non-family professionals must be discouraged. Even among family members even if a younger members of the family is at a position his authority should not be overlooked by other elders of the family because if that is done other employees may also not respect his position and may spread rumours outside of the business to the effect that can harm the business.

Human Resource: In family business the family has to be always accommodated first with jobs. The bigger problem is not hiring of incompetent family members but how they affect other employees. In some cases, family members and relatives can demoralize the organization by their dealings with other employees. They may loaf on the job, avoid unpleasant tasks, take special privileges, make drastic errors and not be reprimanded etc.

Untalented family members should be put in jobs where they will have minimum contact with other employees, out of the mainstream of decision making.

Retaining non family professionals: It is a big challenge in some family-owned companies to retain non family professionals such companies are plagued with a high turnover. This is mainly because promotions are closed to them after a certain point and they see relatives being pushed into executive offices in spite of not being competent. Family-owned businesses have not been able to keep the morale of their non family professionals very high this has effected their growth aspects because no family can have members that can look after all aspects of business. Outsiders are necessary and managing them is very important.

Recruitment and human capital management are major factors in a family firm's long-term success. A governance system that provides clear guidelines for employing family or non-family members and impartial performance based promotion is essential to the sustainability of business.

No family-owned firm can have enough, aptly trained family members to look after all the all the functions of the business. As family-owned firs grow in size they also need professionals at top positions. Non-family professionals have always felt left out or alienated, the management may not be going out of its way to make them feel so but the closeness of the family makes the divide very strong plus the preferences given to family members the absolute absence of punishment or reprimand to them also creates a problems. If the family is promoting non competent members for top position it is even worse. In order to grow family-owned firms need to strictly put in HR policies that are same of both non-family and family members. Thos the compassion and familiarity will not and cannot change efforts can be made to curb it.

Speed of accepting change: Change is something that does not happen in family-owned Businesses in India, change is undertaken as a last resort when it is believed that the business will close down. In order to survive in the global arena it is essential for business houses to change at a fast rate and adapt to changing business times.

Family-owned businesses in India have lived in a protected business environment of very long. They are a little slow when it comes to accepting change as compared to their counterparts across the globe. Family-owned businesses are not used to spending money on R&D and also ploughing back profits into technology development. The family (which also holds the majority of the stock) has got used to fat dividends and is not ready to give them up for the purpose of growth of the firm. The younger members in the family understand the importance of change and they must try and convince the elder members and non-participative members on the importance of change and the increase in earning capacity after the change.

Fair to all approach: Family in India have always prided themselves in being fair to all in the family. Inspite of large families with limited resources, traditionally believe in "mil bant ke khanna" this philosophy has also manifested itself in family-owned businesses where the business pie must he shared by all equality and the sharing must not mean that any member of the family gets less. This thus results in fragmentation of business and cross holdings to ensure that the weaker family members share is taken care of even if he/she cannot operate his business. In families this philosophy has worked wonderfully but in business it has spelled doom because Indian family businesses are split up in every generation thus keeping the size small and uneconomical as compared to global standards. Cross holding have meant that the rivalry within the business continues and there is bitterness among family members that adversely affects business.

Open decision-making and procedures that ensure fairness in evaluating and rewarding both family and non-family employees are essential tools in avoiding tensions and raising the reputation of company.

Succession Planning: Succession planning is almost absent in family-owned business in India. Even the biggest private sector company in India Reliance faced huge problems after the patriarch died because there was not clear succession planning it was believed that the younger brother would stay under the wings of the elder brother though the cracks were visible even when Dhirubhai Ambani was alive. The split in the company was not amicable and resulted in a lost of loss to the investors wealth and Reliance slipped from its position in the Forbes List. If business leaders like Dhirubhai Ambani who is revered for his foresight in Indian business did not tackle the issue of succession very little is expected from other business houses.

Leadership succession is a challenge for all companies, but particularly for family businesses. To ensure that leadership transition does not disrupt company's growth, you need to have clear policies for the selection of the right family member. Successful family businesses are the result of years of hard work and dedication. To pass on this success, corporate governance needs to be made part of the family firm's culture.

Managing Growth

As family firms expand, the relationship between owners, managers and employees becomes more complex. A good corporate governance system puts in place the right policies to manage this complexity. It creates a solid organizational structure that clarifies roles, reporting lines and delegation of responsibility. Corporate governance also draws the line between ownership and management and separates policy direction from the day-to-day running of the company. Family members may have conflicts among themselves on the running of the company. A solid governance system helps resolve such conflicts allowing family members to focus on other key issues.

Succession planning is more specific in family business. Succession planning must not mean dividing the pie among all family members but it must mean finding a role of each family member in the group without having to divide the group. This is a long way but if planned right from the time the younger generation enters the enters the business. If the younger generation is convinced about their skills and role in the firm where the eldest may or may not necessarily be the group CEO and the best man is the CEO, he may be non-family too the business has a larger chance of staying together.

If the business is not split they have a chance to compete with the best in the world. If all the cotton mills and jute mills of the all the Birla Group are put together they will be a very formidable force in the world cotton and jute market but since they are fragmented over different family groups they are not even leaders in the domestic market. Being fair to all in succession planning is absolutely not possible because all children may not be equally gifted in business such family members who do not have a flair for business can be compensated in other terms like giving them a fixed income or giving them property which is worth same in value etc. What need to go to whom should actually not be decided by the family this job should be handed over to an outsider who will not be biased in his assessment.

As is evident from the challenges listed the biggest challenges of family-owned business are not being able to demark between family and business. The line between the two is very blur and they seem to intermingle. It is very difficult to keep the family aside and then manage the business because family has always held center stage in India and traditions do not permit to be straight forward and tell family members some home truths. This inability to communicate will family members on their role in the business has resulted in conflicts that have ruined the growth of family businesses. The person designated by the family and the shareholders to manage the family firm has to take a few strong steps even if they may hurt family members in the interest of the business. If the business prospers the family also stands to gain.

The challenges can be taken care of without going into drastic mode of getting an outsider to manage the business, though some times it may be necessary, but have a strong communication network by the CEO with the family and the non-family members in the business. Non participative family members: Every family has non-participative family members. These are members of the family who are given a share in the business for reasons that make no business sense most of the time. Stock holding is given to parents out of respect and they generally think in the interest of the business but some times their interests may clash with the business because they are trying to protect the interest of the family.

Strengths

Research shows that family businesses enjoy many advantages. When a family commits itself to building a profitable enterprise this gives it a competitive advantage due to the market trust in the company due to family reputation as well as the perception that the family has vast interest in preserving the company for future generations (Bin Saleh, 2006). Also, one of the strengths of a family business is that all family members are committed to a single common goal that they work on achieving. There is no conflict of interest because the family owns and manages the firm which makes decision-making a somehow easier process. In addition, operating a family business involves incurring minimum overheads because a family firm depends on the family's own resources. A family firm is managed out of a long term perspective because the family interest is viewed as a continuing one. Families in business make it a priority to pass their accumulated knowledge, experience, and skills to the next generations. Family firms usually have a clear identity in a faceless world that has become now almost with no identity. Therefore, family businesses usually enjoy a strong and homogenous culture that s shared by all family members as well as those who work with them. Family firms work on improving their outputs and maintaining good relationships with their partners (customers, suppliers, employees, community…etc. because they have their name and reputation associated with their goods or services (see Cadbury, 2000 and Abouzaid, 2007).

Weaknesses

Despite all their strengths, family businesses have some serious weaknesses that threaten their success and even existence sometimes. Research shows that family businesses face significant challenges of continuity, longevity, and ultimately success. In many family businesses there is no formal succession planning. For instance, a recent study on North American films showed that 58% of surveyed family businesses did not have any succession plans (EJB, 2006). Another family business weakness is that the family relationships are not separated from the business relationships and that there is no relief from the one in the other, this, according to Mahayny, results in many business decisions made based on family, rather than business, considerations(Mahayny, 2007). Zidan gives some examples of factors leading to non-economic factors affecting business decisions. This includes job creation for the family, generating income for some family members, family peace, and enhancing the family image in the local community (Zidan, 2008). Furthermore, when the second generation comes to the firm, the business relationships may not be managed successfully because in this case the business hierarchy might not match that of the family. In addition, when the firm grows it usually has to draw in non family managers which will call for managing relationships between family and non family members of the firm. Besides, as the firm grows, ownership is spread more widely among the family, the proportion of non family to family managers increases, and tensions between family members increase because their interests become diversified particularly between those who are actively involved in managing the firm – caring about its growth and more investments – and those who are solely concerned about dividends and the capital value of their holdings (Cadbury, 2000).

Friedman argues that in the majority of cases, family businesses fail to survive a transition in leadership from one generation to the next due to conflicts between family members (Friedman, 1998). Furthermore, and according to the Small Business Administration's Office of Advocacy, 580,900 new businesses were launched in 2004, the most recent date available for data, while 576,200 closed. Given that only one in three family businesses succeeds in making it from the first to the second generation, it's clear they have their own inherent risks. Each succeeding generation has its own ideas about taking the company forward - or if; indeed, it wants to join the family business at all. Successful transition has always been crucial to the continued success of family businesses - and the next 10 years will see a major increase in the number of companies facing that hurdle, as more baby boomers begin to retire.

Access to Capital

But firms can obtain external financing in a number of ways besides issuing shares to the public, such as reinvesting profits, borrowing money or selling shares through private placements.

In such cases, providers of non-public sources of capital (banks, pension funds, insurance companies, venture capitalists, private-equity investors, etc.) expect to look out for themselves. They will want to secure their loans with company assets, to be able to accelerate repayment of loans if the company's performance falters, and to review books and records directly. They will seek direct assurances from the company's auditor and officers, or personal guarantees from the company's owners. They will demand the right to approve major transactions or money transfers. For these capital providers, typical corporate-governance practices, such as board review of transactions between management and the company, board committees, non-executive directors, or separate CEO/board chairmen, hold little interest.

Data on family-run firms raise additional questions about the access-to-capital argument. Of those 244 OECD family-run firms with revenues of $1 billion or more ("large firms"), only half are publicly traded. At the same time, the average ages of publicly traded and privately held large firms are about the same, suggesting that large private firms have been able to access sufficient capital without inevitably "evolving" into publicly traded firms.

This observation is bolstered by European data showing that the average company operates for 40 years before going public, and that when such a company does go public, nearly 60% of the money raised from its initial public offerings goes into the pockets of family shareholders rather than into the business. In many cases, therefore, wealth diversification or liquidity may be a greater issue for family-run businesses than financing operations.

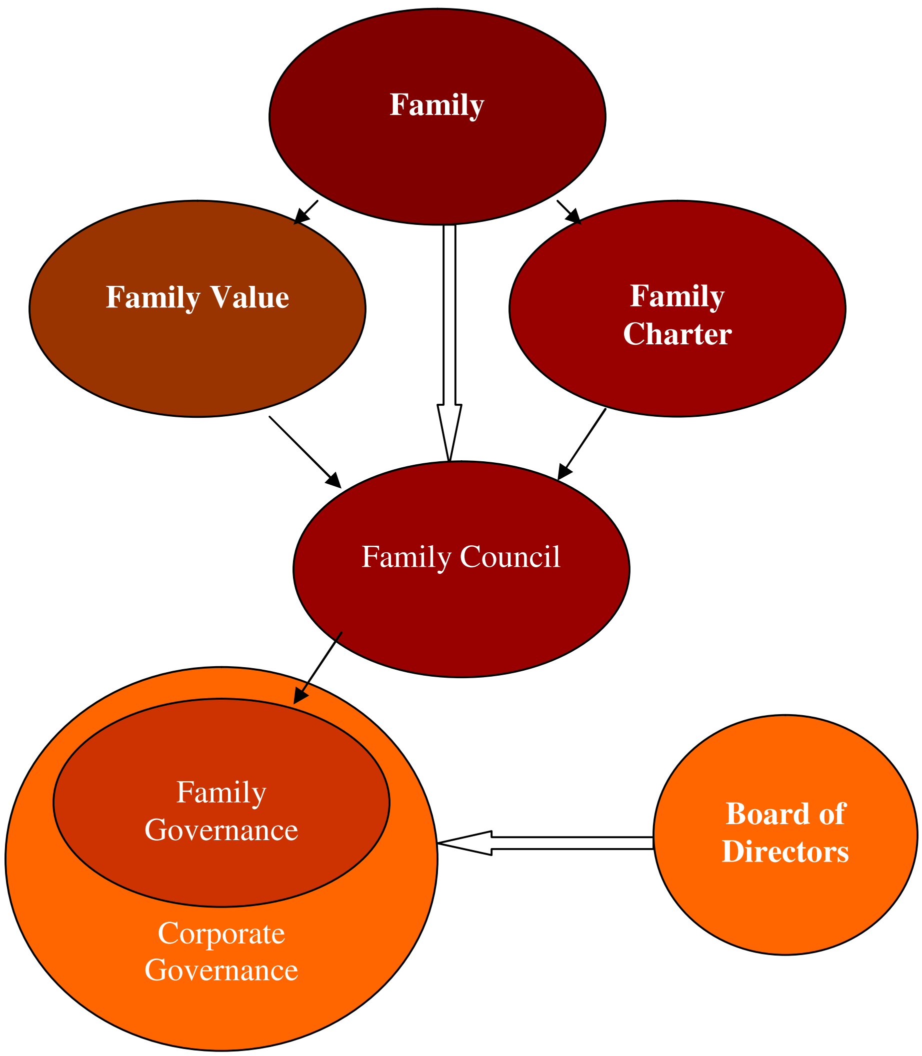
Studies indicate that the stronger a country's corporate governance, the more robust its capital markets and the higher its level of external financing as a percentage of GNP. However, while these findings may persuade policymakers, at the level of the individual family firm the slogan "embrace corporate governance in order to access capital" can remain a tough sell.

Wealth & Power Diversification

Transparency

Executing Corporate Governance

Family Council, Value & Governance



Corporate Governance in Family Owned Business

Which strategic asset does the family bring to the business?

Shareholder Capital
Business Networks
Management Capability
Personal Networks

Advisory Boards

Board of Directors

Independent Directors

Governance Structure

Family businesses draw special strength from the shared history, identity, and common language of families. When key managers are relatives their traditions, values, and priorities spring from a common source. Verbal and non verbal communications can be greatly speeded up in families. Spouses and siblings are more likely to understand each other's spoken preferences and hidden strengths and weaknesses. Most important, commitment, even to the point of self-sacrifice, can be asked for in the name of the general family welfare. Allen considers that the “Agency Theory” explains most of the difference between family businesses and other companies where she makes the contrast between agent-managers who manage but not own and owners-managers who own as well as manage (Allen, 2006) However, this same intimacy can also be detrimental to the professionalism of executive behavior. Life long histories and family dynamics can intrude in business relationships. Authority may be harder to exercise with relatives. Roles in the family and in the business can become confused. Business pressures overload and burn out family relationships. When they're working poorly, families can create levels of tension, anger, confusion, and despair that can destroy good business and healthy families amazingly quickly. The public is well aware of family tragedies that can accompany business disasters (Gersick et al., 1997). Zafft argues that family businesses tend to believe that principles of good corporate governance do not really concern them but he considers this to be a wrong view (Zafft, 2002). family businesses operate in almost the same work environment as publicly traded companies, and they have some strengths and weaknesses. Also family firms face many problems that are specifically related to this type of business such as problems with recruiting and retaining capable non family managers, succession planning, etc. The key to running a successful family firm is to select and retain the right members of the family and equally to provide attractive opportunities to non family managers. This requires a clear line to be drawn between direction, which is the job of the board, and management which is the job of the executives (Cadbury, 2000). Therefore, family firms need to apply the principles of corporate governance in order to capitalize on the strengths and avoid or minimize the weaknesses. In fact, some of the family businesses can be quite successful and enjoy a long life. Bhattacharyya documents for example that some of the worlds’ oldest firms are in fact family businesses such as Kongo Gumi in Japan that was established in 578 AD and is now managed by the 30th generation (Bhattacharyya, 2004).

In a family-run firm, a single person or group enjoys a controlling interest and can appoint family members as managers, or can unilaterally appoint, monitor, compensate and fire third-party managers. This situation may threaten minority shareholders with exploitation, but offers the controlling family the best of both worlds: it can run the business as it sees fit and gamble, at least partly, with other people’s money. As a consequence, if the purpose of corporate governance is to constrain managers and control shareholders, one may well ask whether a family-run firm would ever really want it.

The answer to this question is “yes”, but not necessarily for the reason most commonly given: better access to capital. One often hears the argument that, when investors refuse to put their money in companies with bad governance, the cost of capital for such companies goes up, making them uncompetitive. Eventually, so the argument goes, the owners/managers of such companies must either mend their ways or go out of business.

Fortunately for the corporate-governance industry, a compelling case for corporate governance can still be made, and it involves the greatest challenge family-run businesses face: management succession. Succession issues resonate strongly with business owners. While the founder of a family-run firm might believe that raising money or diversifying wealth will never pose a problem, one thing he does know for sure is that some day he will die.

Keeping a business going across generations is hard. In fact, North American and UK studies indicate that only about one in six family-run firms survives to the third generation. Failure to maintain the family business can stem from any number of causes. Divisions form between those relatives enjoying both salaries and dividends and those receiving only dividends. Jealousies emerge as some family employees rise higher than others or work less hard for the same pay. Supervisors find themselves incapable of firing an under-performing subordinate who is a child or a sibling or a cousin.

As the business grows and markets evolve, finding sufficient managerial talent and experience within the family becomes harder. Where the family decides at last to hire an outside manager, failure to motivate and monitor him can damage or destroy the business.

Corporate governance goes to the heart of these problems, though many family-run firms have never thought of it in these terms. Families need corporate governance both to operate the business and to promote family harmony. This means putting in place decision-making and monitoring procedures that are open and fair, as well as possibly hiring non-family members as advisors, managers and directors.

It is not an overnight exercise, and often, by the time the need for corporate governance has been recognized, family relationships or the business’s prospects have deteriorated beyond repair.

Family-run businesses can represent the work, and the wealth of several generations. If business owners want to preserve, enlarge and pass on this legacy, they need to make corporate governance a family affair.

Corporate governance refers to the processes, structures, policies and laws that govern the management of a company. It also refers to the way the Board oversees the operations of a company and about how board members are accountable to the company and its shareholders. The key purpose of corporate governance is to promote accountability, transparency, fairness, disclosure and responsibility - core values that are relevant to the success of all businesses, irrespective of where they come from. Companies with sound corporate governance usually perform better than other companies.

Good corporate governance results in:

• Better access to external capital
• Lower financing costs
• Higher credit ratings
• Strong investor confidence

In two important recent studies Franks, Mayer and Rossi (2004, 2005) put together an ownership time-series for the United Kingdom and establish that ownership in the United Kingdom has dispersed very quickly once a company has been taken public or following mergers and acquisitions. They find, in particular, that rapid dispersion occurred and substantial amounts of external finance were raised even in the early 19th century, at a time when corporate law gave very little protection to minority shareholders.

Other recent studies have revisited the link between ownership concentration and shareholder monitoring. Thus, Anderson and Reeb (2003) study the performance of family-controlled listed firms, which they point out represent a significant proportion of the largest listed companies even in the U.S. (18% of the S&P 500). They find that family firms consistently outperform their peers, as measured by both accounting yardsticks like return on assets and market-valuation measures such as Tobin's q. This above average performance can also be seen in the lower cost of debt financing for family-run firms (Anderson, Mansi and Reeb, 2003). This evidence thus provides strong support for the view that ownership concentration improves governance and performance at least for family owned firms.

Most of the theoretical literature on large shareholders only considers ownership structures where all but one shareholder are small. Zwiebel (1995) is a recent exception. He considers ownership structures where there may be more than one large shareholder and also allows for alliances among small block holders. In such a setting he shows that one of the roles of a large block holding is to fend off alliances of smaller block holders that might compete for control [see also Gomes and Novaes (2000) and Bloch and Hege (2000) for two other recent formal analyses of ownership structures with multiple large shareholders]. An entirely different perspective on the role of large outside shareholders is given in Muller and Warneryd (2001) who argue that outside owners can reduce inefficient rent seeking of insiders and managers by inducing them to join forces to fight the outsider's own rent seeking activities. This story fits well the situation of many second-generation family-owned firms, who decide to open up their ownership to outsiders in an attempt to stop feuding among family members.

Aghion and Bolton (1992) consider a situation where ownership is concentrated and argue that family-owned firms want to limit control by outside investors because they value the option of being able to pursue actions in the future which may not be profit maximizing. They may value family control so much that they may want to turn down acquisition bids even if they are worth more than the net present value of the current business. Or, they may prefer to keep the business small and under family control even if it is more profitable to expand the business. In some situations, however, they may have no choice but to relinquish some if not all control to the outside investor if they want to secure capital at reasonable cost. Aghion and Bolton show that under some conditions the efficient contractual arrangement is to have a state-contingent control allocation, as under debt financing or under standard venture capital arrangements. Although their model only considers a situation of bilateral contracting with incomplete contracts it captures some basic elements of a multi-constituency situation and provides a rationale for extending control to other constituencies than shareholders.

Recent failures include undetected off-balance sheet loans to a controlling family (Adelphia) combined with alleged self-dealing by CEOs and other company employees (Computer Associates, Dynegy, Enron, Global Crossing, Qwest, Tyco), deliberate misleading of investors (Kmart, Lucent Technologies, WorldCom), insider trading (ImClone Systems) and/or fraud (Rite Aid) ("Accounting Scandals Spread Across Wall Street", Financial Times, 26 June 2002).

The method was also applied in other countries, finding the owner-controlled firms significantly outperform manager-controlled firms in the UK [Radice (1971), Steer and Cable (1978), Cosh and Hughes (1989), Leech and Leahy (1991)], 156 profitability is higher with family control in France [Jacquemin and de Ghellinck (1980)]. 157 Demsetz and Lehn (1985) explain that ownership concentration is endogenous. Some firms require large shareholder control while others don't. They argue that without accounting for this endogeneity it is to be expected that a regression of firm performance on a control dummy in a cross-section of heterogeneous firms should produce no statistically significant relation if the observed ownership-performance combinations are efficient.

This is true especially in an area such as shareholder meetings and voting processes where the fix is relatively simple and inexpensive to implement. Prompt action will make Indian markets more transparent and appealing to foreign capital and enable India to become an increasingly important international financial center.

- Shareholder meetings and voting
- Related-party transactions
- Preferential warrants
- Corporate disclosure
- The auditing profession

A question of performance accountability…the various legal frameworks for corporate activity to ultimately deal with the questions, to whom and for what corporations shall be held accountable

A company in which a family or a business group has controlling interest and family and group is free to appoint members or manager

Family capitalism precedes shareholder capitalism

Concentrated ownership exists at any point of time because of institutional voids, the absence of specialized intermediaries in capital market

Pyramid structure helps in tapping equity capital while retaining controlling interest

Groups and concentrated ownership are robust form of business

They lasts centuries and changing their footprints and functional form and weathering shocks

If family business is not rent seeking or entry deterring then it is not bad

1. Accounting quality
2. value creation
3. fair policies and actions
4. communication
5. effective governing board
6. reliability

Detailed agenda for shareholder meetings are often not easily available. Many companies neither upload these documents to the websites of the two main Indian stock exchanges (the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE)), nor do they make them clearly available on their own websites. Second, votes are customarily counted in India by a "show of hands" rather than by a "poll." This former method effectively gives each shareholder an equal voice regardless of the number of shares it owns. But the inequity does not stop there. Under Indian law, proxies are not allowed to speak at meetings or vote on a show of hands. Even though they can vote on a poll, since voting by a show of hands is the norm, the proxy votes of shareholders who cannot attend meetings are seldom counted. Third, the lack of voting by poll also means a lack of detailed information on the results of meetings. Even if polls are called, the results are not always published on the company's website because there is no legal requirement to do so.

Governance (Openness Index) and the decision-making quality (Extension Index) BoD composition

1. Does the company have its own written corporate governance rules that clearly describe its value system and board responsibilities?
2. Does the company offer other ownership right beyond voting?
3. Does the company explicitly mention the safety and welfare of its employees?
4. What is the quality of the notice of the Annual General Meeting?

5. Does the company have a corporate vision?
6. Does the company have a transparent ownership structure?
7. Does the board of directors provide a code of ethics and statement of business conduct for all directors and employees?
8. Is there any membership to allow minority shareholders to influence board composition?
9. Is the chairman an independent director?
10. Do the shareholders approve the decision on the remuneration of board members or executives annually?
11. Does the board appoint independent committees with independent members to carry out critical responsibilities such as audit?
12. Does the company have an internal audit operation established as a separate unit in the company?
13. Does the company have a board of director's report in the annual report?
14. Does the board disclose critical information to the public through effective channels?
15. Does the disclosure include profit forecast and operation guidelines?

Torrent Pharmaceuticals Limited

Company's Philosophy on Corporate Governance

The Company believes that the Code prescribes only a minimum framework for governance of a business in corporate framework. The Company's philosophy is to develop this desired minimum framework and institutionalise the spirit it entails. This will lay the foundation for further development of superior governance practices which are vital for growing a successful business. The Company recognises that transparency, disclosure, financial controls and accountability are the pillars of any good system of corporate governance. It is the Company's endeavour to attain highest level of governance to enhance the stakeholder's value.

Board of Directors

The Board comprises of 8 directors of which 6 are Non-Executive Directors (75% of the Board strength) and 4 are Independent Directors (50% of the Board strength). The composition of the Board complies with the requirements of the Code.

Nirma Limited

Company's Philosophy on Corporate Governance

Corporate Governance is the application of the best management practices to achieve the Company's objectives of enhancing the shareholders value and discharging social responsibility by complying applicable laws and adherence to ethical standards.

The company has a prime responsibility to achieve transparency and equity in all aspect of the operations by following fair and ethical practice towards all the stakeholders of the Company. The Company believes in maintaining a simple and transparent corporate structure driven solely by business needs and is committed to achieve good standards of Corporate Governance on continuous basis.

Board of Directors

The Board of Directors comprises 10 Directors with a Non-Executive Chairman. There are 8 Non-Executive Directors out of 10 directors and of which 6 are Independent Directors. The Board's composition is in conformity with the Clause 49 of the Listing Agreement entered into with the Stock Exchanges.

The Independent Directors of the Company are experienced, competent and renowned persons from their respective field. The Independent Directors take active part at the Board and Committee meetings which adds value in the decision making process.

The names and categories of Directors of the Company, their attendance at Board Meetings & last Annual General Meeting held during the year and the number of Directorships and Committee Chairmanship / Membership held by them in other Companies as on 31st March 2009 are given below. The Directorship does not include alternate directorship, directorship of private limited companies, Section 25 companies and companies incorporated outside India.

Audit Committee

The Audit Committee comprises 3 Non-Executive Directors. During the year under review, the Committee met Five times on 28th April 2008, 28th July 2008, 19th August 2008, 23rd October 2008 and 29th January 2009. The attendance of the Committee is as under:

All 3 members Non Executive / 2 Independent + 1 promoter

The Company has adopted the Non-Mandatory Requirements and formed the Remuneration Committee and other Committees. The Company affirms that no employee has been denied to access to the Audit Committee. As regards the non-mandatory requirements, the Board has taken cognizance of the same and shall consider for adopting the same as and when necessary.

Adani Enterprise Limited

Company's Philosophy on Corporate Governance

The company believes to conduct business in an ethical and responsible manner. Strong corporate governance has been termed as the blood that fills the veins of corporate entities for Fairness, Transparency and Accountability. It is a road map which guides and directs the Board of Directors of the Company to govern the affairs of the Company in a manner most beneficial to all its stakeholders.

Adani Enterprises Ltd. (AEL) being a flagship Company of Adani Group is committed to the adoption of best Corporate Governance Practices and their adherence in the true spirit, at all times. The core values that drive Company's business are (i) Accountability: Towards stakeholders and society for companies' acts and decisions. (ii) Excellence: Strive relentlessly and constantly improve in offerings. (iii) Legacy: Strong legacy and roots of stringent corporate governance principles that strives to conduct business fairly, with honesty and transparency.

The Company perceives good corporate governance practices as a key to sustainable corporate growth and long term shareholder value creation. The primary objective is to develop and adhere to a corporate culture of harmonious and transparent functioning. All actions and strategic plans of Company are directed towards delivering the value to all stakeholders, as well as conform to the highest standards of corporate behavior.

Company's philosophy on corporate governance envisages the alignment of the highest levels of transparency, accountability and equity in all facts of its operations and in all its interactions with its stakeholders. The company strongly believes that principles of Fairness, Transparency and Accountability are the cornerstones for good corporate governance. Hence, Corporate Governance to AEL means not only compliance with the provisions of Company law, allied acts and listing agreement but also management's responsibility to work with morality, ethics and accountability towards stakeholders and society for their acts and decisions.

Board of Directors

As on date the Board of Directors of Company comprises of eight Directors of which six Directors (75% of the total board strength) are Non Executive. Of these six Non Executive Directors, five (63% of the total board strength) are Independent Directors. Hence, the composition of the Board is in conformity with the provisions of the Corporate Governance Code of the Listing Agreement.

Board Procedure

The company has a well-defined process of placing vital and sufficient information before the Board pertaining to the matters to be considered at each Board and Committee meetings, to enable the Board to discharge its responsibilities effectively.

The Company Secretary in consultation with the concerned person in the senior management finalizes the agenda, which is distributed to the Board members in advance before the meetings. The required information as enumerated in Annexure 1A to Clause 49 of the Listing Agreement is made available to the Board of Directors for discussions and consideration at Board Meetings. The Board reviews the declarations made by the

Managing Director regarding compliance with all applicable laws on a quarterly basis, as also the Board Minutes of all its subsidiary companies.

Audit Committee

Audit Committee consists of three Non Executive and Independent Directors as, all 3 Non-Executive Independent.

Cadila Healthcare Limited

Company's Philosophy on Corporate Governance

Cadila Healthcare Limited believes in continuous good corporate governance and always strives to improve performance at all levels by adhering to corporate governance practices, such as managing its affairs with diligence, transparency, responsibility and accountability, therefore, designed systems and action plans to enhance performance and stakeholders' value in the long run. To create a culture of good governance, Company has adopted practices that comprise of performance accountability, effective management control, constitution of Board Committees as a part of the internal control system, fair representation of professionally qualified, non-executive and independent Directors on the Board, adequate and timely compliance, disclosure of information on performance, ownership and governance of the Company and discharge of statutory dues.

The Executive Committee comprising the Managing Director, Deputy Managing Director, Executive Director (functional), the Chief Financial Officer and the various business heads manage the day-to-day business affairs of the Company. The Board of Directors monitors the overall business operations based on updates of the Company's performance provided by the Managing Director on a regular basis.

Composition of the Board:

The Composition of the Board of Directors, with reference to the number of Executive and Non-Executive Directors, meets the requirement of the Code of Corporate Governance. The Board is headed by the Executive Chairman, Mr. Pankaj R. Patel, who is also the promoter Director. As on 31st March 2009, Company's Board comprised seven Directors; which include two Managing Directors and five Non-Executive Directors who have considerable experience in their respective fields. Except Mr. Pankaj R. Patel and Dr. Sharvil P. Patel, al l other Directors are independent Director s in terms of Sub clause-I (A) (iii) of Clause 49 of the Listing Agreement. Independent Directors have expert knowledge in the fields of finance, taxation, legal and industry, thus the Board represents a balanced mix of professionals, their knowledge and expertise.

Audit Committee:

As on 31st March 2009, the Audit Committee comprised of four Independent Directors. All 4 Non-executive/independent

Arvind Mills Limited

Company’s Philosophy on Code of Governance
The Company’s philosophy on Corporate Governance is to attain the highest levels of transparency, accountability and integrity. This objective extends, not merely to meet with statutory requirements but also to go beyond them by putting into place procedures and systems which are in accordance with best practices for governance. Corporate Governance at Arvind means being responsive to aspirations of all the stakeholders; customers, suppliers, lenders, employees, the shareholders and expectations of the society. The Board of Directors supports the broad principles of Corporate Governance and lays strong emphasis on its trusteeship role to align and direct the actions of the organization to achieve its avowed objectives of transparency, accountability and integrity.

Board of Directors

Board has 7 directors, 2 Executive director (MD + CFO), 5 Non-Executive directors

Audit Committee

The Audit Committee of the Company comprises of 3 members, all of whom are Non-Executive Independent Directors. Mr. Tarun Sheth, an Independent Director acts as Chairman of the Committee. The Committee members are professionals having requisite experience in the field of Finance, Accounting and Banking

Suzlon Energy Limited

Company's Philosophy on Corporate Governance

The Company's corporate governance philosophy rests on the pillars of integrity, accountability, equity, transparency and environmental responsibility that conform fully with laws, regulations and guidelines. Keeping this in mind, the Company's vision is to leverage opportunities towards powering a greener tomorrow with inclusive growth and ethical business practices. The Company has always set high targets for the growth, profitability, customer satisfaction, safety and environmental performance and continues its commitment to high standards of corporate governance practices. To the Company, corporate governance means living its corporate values with the goal of having a minimal impact on the environment, enabling local communities to develop their potential, empowering employees to be responsible civil society members and committing itself to business practices that are fair to all stakeholders so that it can collectively contribute towards creating a better and greener world for all.

Board of Directors

The Company has a balanced mix of executive and non-executive independent directors. The Board consists of six directors as on March 31, 2009, out of which two are executive directors and four are non-executive independent directors. The chairman of the Board is an executive director and more than half of the Board is independent. The composition of the Board is in compliance with the requirements of Clause 49(I)(A) of the listing agreement with the stock exchanges. All the directors have certified that they are not members of more than ten mandatory committees in terms of the listing agreement and do not act as chairman of more than five mandatory committees in terms of the listing agreement across all companies in which they are directors.

Board Procedure

Board members are provided appropriate documents and information under Annexure IA to Clause 49 pertaining to the matters to be considered at each board and committee meetings, to enable the Board to discharge its responsibilities effectively and the chairman and managing director reviews the overall performance of the Company.

Audit committee

The Audit Committee of the Company has been constituted as per the requirements of Clause 49 of the listing agreement. The composition of audit committee is in compliance with the requirements of Clause 49(II)(A) of the listing agreement. It consists of three members, all of whom including the Chairman are independent directors

Financial results for 2008-09

Company	**Promoter share %**	**Sale** (Million INR)	**Profit** (Million INR)	**Share capital** (Million INR)	**Reserve** (Million INR)	**Share price*** (INR)	**Share Face value** (INR)
Nirma Limited	77.17	33540	1183	795	25214	189	5
Cadila	74.72	20051	2964	682	11646	652	5
Torrent Pharma	74.09	11482	1911	423	6903	561	5
Adani Enterprise	74.91	115750	3746	246	16184	534	1
Arvind Mills	35.42	22977	(469)	2601	9404	34	10
Suzlon Energy	53.27	260820	2360	2996	61774	58	2
Nandan	49.67	2228	131.71	303	349	2	1

*As on 9th July 2010

Governance Structure

Company	Promoter share % (a)	No. of Directors (b)	Independent Directors (c)	% of ID (d=c/b)	Audit Comm. (AC)	Independent Directors in AC	Ind./ Promoter Ratio e=d/a
Nirma Limited	77.17	10	6	60	3	3	77.75
Cadila	74.72	7	5	71	4	4	95.02
Torrent Pharma	74.09	8	4	50	4	4	67.48
Adani Enterprise	74.91	8	5	62	3	3	82.76
Arvind Mills	35.42	7	5	71	3	3	200.45
Suzlon Energy	53.27	6	4	67	3	3	125.77
Nandan Exim	49.63	4	2	50	3	2	100.30

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Annexure – I
Legal Framework for Corporate Governance in India

The Legislation	Provision	Penalty
The Constitution Law of India	Article 38 & 39, The government is directed that the ownership & control of the material resources are so distributed as to conform to the common good & operation of the economic system does not result into concentration of wealth & means of production to the common detriment	It is source of legislation to enact rules to conform directions given by constitution and by such rules, if fundamental right of a person is violated, courts give priority for common interest
Companies Act, 1956	Sec. 59, If any prospectus is issued in contravention of section 57 or 58, the company, and every person, who is knowingly a party to the issue thereof, shall be punishable with fine which may extend to fifty thousand rupees	Punishable with imprisonment for a term which may extend to five years, or with fine which may extend to one hundred thousand rupees or with both
	Sec. 63, Criminal liability for misstatements in prospectus, Where a prospectus issued includes any untrue statement, every person who authorized the issue of the prospectus	Punishable with imprisonment for a term which may extend to one/two year, or with fine, or with both
	Sec.68, Penalty for fraudulently inducing persons to invest money	
	Sec. 105, Penalty for concealing name of creditor	
	Sec. 162 provides penalty for contravention of not filing annual return & statement as prescribed	Punishable with fine which may extend to five hundred rupees for every day during which the default continues
	Sec. 211 (3A) Every profit and loss account and balance sheet of the company shall comply with the accounting standards. (3B) Where the profit and loss account and the balance sheet of the company do not comply with the accounting standards, such companies shall disclose in its profit and loss account and balance sheet, (a) the deviation from the accounting standards; (b) the reasons for such deviation; and (c) the financial effect, if any, arising due to such deviation.	The statutory auditors are required to make qualification in their report in case any item is treated differently from the prescribed Accounting Standard. In addition to this Section 227(3)(d) of Companies Act, 1956 requires an auditor

	Section 217 sub section (2AA) the Companies Amendment Act, 2000 states that The Board's report shall also include Directors' Responsibility Statement indicating therein that in preparation of annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departure	to report whether, in his opinion, the profit and loss account and balance sheet are complied with the accounting standards referred to in Section 211(3C) of Companies Act, 1956.
	Sec. 225 deals with Statutory Audit of a company, company require to take certificate of auditor that certify financial statement as true & fair Auditor ensures financial statement is the result of financial transaction recorded and reported as per GAAP Sec. 232 provides penalty for not complying with preparing, presenting, submitting/filing audit report as prescribed u/S 225-231	The company, and every officer of the company who is in default, shall be punishable with fine which may extend to five thousand rupees
	Sec. 279 prescribe penalty for holding directorship in more number of companies than prescribed Sec. 297 prescribe taking sanction of the Board of company if a director has interest in certain contract with the company Section 299 of the Act requires every director of a company to make disclosure, at the Board meeting, of the nature of his concern or interest in a contract or arrangement (present or proposed) entered by or on behalf of the company. The company is also required to record such transactions in the Register of Contract under section 301 of the Act.	For each additional company in which he is director, INR 50000
	Sec 299 provide accountability of a director to disclose his interest in the contract with the company. Sec. 300 states that the interested director can not participate or vote in Board's proceedings	Interested director can not participate in the voting in Board meeting for the purpose
	Sec. 371 prescribes penalty for contravention of section 369 (Loans to managing agent), 370 (Loans, etc., to companies under the same management) or 370A, pertaining to intra-company loan	Shall be punishable with fine which may extend to fifty thousand rupees or with simple imprisonment for a

	or borrowing or creating liabilities like guarantee etc. Sec. 372 prescribes restriction on purchase of share etc. of any company by putting limits	term which may extend to six months
	Sec. 628, 629 prescribes penalty for false statements or false evidences	Punishable for imprisonment which may extend to 2 to 7 years, and shall also be liable to fine.
Security Contract Act, 1956	Contracts of security trade in designated area, time, licensing, to deal with recognized dealer, through stock exchange etc. Contract otherwise than this may be void	Punishable with imprisonment for a term which may extend to one year, or with fine, or with both, authority is empowered to de-list a company
SEBI: Listing Agreement, Clause 49	Composition of Board (at least half should be non-executive, independent), Non executive directors' compensation and disclosures, board meetings (minimum 4 in a year), ceiling on director's membership in committees (maximum 10), ceiling chairman of committees (maximum 5), Audit Committee chairman should be independent director, 2/3rd members should independent & finance or accounting expert, applicability of code of conduct over Board members & top management, appointment of independent director as director of a subsidiary company, procedure to assess risks & disclosures thereof, CEO & CFO certification of financial statement, report on corporate governance compliance	Company may be de-listed from stock exchange
SEBI: Takeover & Insider Trading, Shareholder Protection etc.	Four prone control/ penal provisions: Directions in investor interest, Adjudication Proceedings, Criminal Prosecution, Enquiry Proceedings Any person who, directly or indirectly, acquires or agrees to acquire shares or voting rights in the target company, or acquires or agrees to acquire control over the target company, either by himself or with any person acting in concert with the acquirer shall inform on crossing 5% or 10% or 14%, 54% and 74% inform Target Company and Stock Exchange within 2	Penalty of INR 100,000 per day of continuing violation, penalty is 3 to 5 time of undue gain or advantage, Violation may leads to freeze of transfer of share, voting rights, debarring from access to capital markets, forefeet escrow money, imprisonment up to 10 years and penalty of INR 2.5 million in criminal offenses

	days, Persons holding between 15% & 55%, to disclose purchase or sales aggregating to 2% or more, within 2 days to target company and the stock exchanges, open offer to purchase at least 20% of share at same price if holding cross 15%. Ban on using inside information for personal gain by way of purchase or sale securities for those who have access of internal information	
Indian Penal Code	Sec. 120B (Criminal conspiracy) 406, 409, 420, 468, 471, 477A relating to fraud, cheating public, creating false documents, duping money etc.	Imprisonment up to 10 years
Income Tax Act 1961	Regulations (2002) contained the mechanism to ensure that income arising out of international transactions between related parties (associated enterprises) is computed on the basis of arm's length.	Authorizes the assessing of officer to refer the process of determination of arm's length price to the transfer pricing officer amounts to reassessment

Financial Performance Analysis (Million INR)

Company	Over all Rank	Profit Rank	ROI Rank	ROIE Rank	Promoter Share %	Sale	Profit	Equity	Reserve	Market Value	Face Value	Profit %	ROI	ROIE	Ave Rage
Torrent Pharma	1	1	2	1	74.09	11482	1911	423	6903	561	5	16.64	451.773	26.1	1.333
Cadila Health Care	2	2	3	2	74.72	20051	2964	682	11646	652	5	14.78	434.604	24	2.333
Adani Enterprise	3	5	1	3	74.91	115750	3746	246	16184	534	1	3.236	1522.76	22.8	3
Nandan Exim	4	3	6	4	49.67	2228	131.7	303	349	2	1	5.912	43.4686	20.2	4.333
Nirma Limited	4	4	4	5	77.17	33540	1183	795	25214	189	5	3.527	148.805	4.55	4.333
Suzlon Energy	6	6	5	6	53.27	260820	2360	2996	61774	58	2	0.905	78.7717	3.64	5.667
Arvind Mills	7	7	7	7	35.42	22977	-469	2601	9404	34	10	-2.04	-18.032	-3.91	7

Non Mandatory Requirements:

Adani Enterprise

The non mandatory requirements have been adopted to the extent and in the manner as stated under the appropriate headings detailed below:

Company has an Executive Chairman and hence, the need for implementing this non mandatory requirement has not arisen.

Company has a Remuneration Committee to recommend appointment / re-appointment and to recommend/ review remuneration of the Executive Chairman / Managing / Whole time Directors.

The quarterly / half quarterly results of Company after being subjected to a Limited Review by the Statutory Auditors are published in newspapers and posted on Company's website. The same are also available at the sites of the stock exchanges where the shares of the Company are listed i.e. www.bseindia.com and www.nseindia.com

The provisions relating to Postal Ballot has been complied with in respect of matters where applicable.

Company adopts best practices to ensure the regime of unqualified financial statements. Statutory Auditors have issued an unqualified opinion on the statutory financial statements of Company.

The employees of Company are accessible to the senior management for any counseling or consultation and Company has not denied any employee access to the audit committee.

All the Non-Executive Directors have rich experience and expertise in their functional areas. During Audit and Board Meetings, the management and working Directors give extensive briefings to the Board Members on the business of Company.

Nirma Limited

The Company has adopted the Non-Mandatory Requirements and formed the Remuneration Committee and other Committees. The Company affirms that no employee has been denied to access to the Audit Committee. As regards the non-mandatory requirements, the Board has taken cognizance of the same and shall consider for adopting the same as and when necessary.

Suzlon Energy

Besides mandatory requirements, the Company has voluntarily constituted a Remuneration Committee to consider and recommend the remuneration of the directors and approval and administration of the employee stock option plans (ESOPs).

The Company does not have a formal whistle blower policy; however, the Company has its intranet portal, wherein all the employees are free to express their feedback/suggestions/complaints, if any. The same is further supported by surveys of employees conducted by independent global agencies.

The quarterly/annual results and notices as required under Clause 41 of the listing agreement are normally published in the 'The Economic Times'/'Business Standard'/'The Financial Express' (English & Gujarati editions).

The annual/quarterly results of the Company, shareholding pattern, the official news releases and the presentations made by the Company to analysts and institutional investors are posted on its website www.suzlon.com. Quarterly results and shareholding pattern are also displayed on EDIFAR facility of Securities and Exchange Board of India (SEBI) website www.sebiedifar.nic.in for the benefit of public at large.

Details of unclaimed shares in terms of Clause 5A of listing agreement As per terms of newly inserted Clause 5A of the Listing Agreement, the Company is in process of crediting the shares allotted pursuant to the Initial Public Offering (IPO) of the Company completed in year 2005 which are unclaimed and are lying in escrow account to a demat suspense account and the details as required to be disclosed in the Annual Report.