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CONUNDRUM OVER POSITIONS OF CHAIRMAN AND CEO IN A FAMILY BUSINESS: A CORPORATE GOVERNANCE CONCERN

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1. Overview of Corporate Governance in Family Businesses

Family businesses are one of the most significant contributors to the economy across the world. Substantial numbers of big-shot companies in the world are family owned. Family business in simple words means that the voting majority vests in the hands of a single family. Here the members of the controlling family hold majority number of shares in a company. In such type of companies, it is very common to find the family members of the controlling family at the top of the hierarchy of management of the company, which enables it to play instrumental role in the key decision making of the company. Family business acts as bedrock for the world economy. It considerably contributes towards creation of employment, wealth, reduction of poverty etc. and ultimately in growth of the economy. Such companies which are essentially a family owned business, also aims to simultaneously pass on the business from one generation to another in the same family. Family owned businesses have their own advantages and disadvantages. While on one hand, several distinguishing features add up to the value of the family business, on the other side, it suffers through the complexity of maintaining a balanced relationship between family and business. Family business can either be a good opportunity to expand the business or be a threat to the integrity of the family depending upon a number of factors. Special emphasis needs to be placed on the investors' role in a family run business. Both creditors and shareholders generally prefer a prior scrutiny of the risk involved in investing in the family run business in order to ascertain any risk of abuse of shareholders' rights by the family controlled business[1]. Apart from all this, on a number of occasions, there have been numerous instances of conflict of interests because both family and business are involved. Involvement of family indubitably involves emotions, which has no place in the corporate culture. In such situations, it becomes imperative that the governance of such companies is efficient and proper in order to ensure maximum productivity. The notion of corporate governance plays a very important role here. Past instances, one like Satyam fraud, are proof that the proper governance structure improves the performance and productivity of a business. This is especially true for the family owned businesses, as the efficient governance structure ensures a stable functioning of family and business together.

[1] Organisation for Economic Co-operation and Development, "Family Business Challenges" (Mar. 22, 2020, 09:15 PM), https://www.oecd.org/daf/ca/corporategovernanceprinciples/43654301.pdf.

Corporate governance is a blend of rules and regulations through which a business is regulated and operated. In other words, it is a process through which an organization is directed and controlled. It frames rights and responsibilities for different participants involved in the organization[2]. Its goal is to promote the best interest of corporation and its shareholders[3]. A good corporate governance practice is one which aims to further and promote the interests of maximum stakeholders of the business along with ensuring that the company continues to adhere to the ethical standards. The main aim of corporate governance is to bring in the best and sound management policies to ensure economic efficiency leading to the maximization of profit along with the welfare of the shareholders.[4] Best corporate governance practices ensure fair treatment of shareholders, due compliance of regulatory framework and formal laws and accountability and transparency from the end of the board of directors which is very important from the investment point of view in the business. Corporate governance practices also aim at maintaining conflict management by significantly reducing the conflict of interests arising in the business. Good corporate governance practices aim at taking a non-biased approach to tackle conflicts among different stakeholders in a business such as board of directors, executive, management and shareholders[5]. In special case of family owned businesses, the foremost aim of corporate governance practices is to reconcile the equipoise between ownership and management. Since most of the family members generally don't possess professional skills in management or execution of policies and despite that occupy some very important and high positions in family business, the element of professionalism in family business lacks significantly. In general, some of the most important principles of corporate governance to ensure sound business in all type of companies are:

1.1 *Healthy Balance*- right and healthy balance between ownership and management which will ensure the independence of board to make decisions.
1.2 *Proficiency*-enables the company to perform in diverse fields with proficiency by ensuring that the board of directors are experts and skilled at their work.
1.3 *Financial Transparency*- ensures financial transparency
1.4 *Adherence to Legal Framework*- Ensures that the company adheres to the formal and legal framework along with ethical standards.
1.5 *Mechanism for Checks & Balances*- It also puts in place a well-established mechanism for checks and balances.[6]

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[2] Dr. Raghuveer Kaur & Hamitesh Singh, *Corporate Governance in Family Businesses- A Review*, 11 PBR 131, 136 (2018) http://www.pbr.co.in/2018/2018_month/Nov/12.pdf

[3] Fred D. Tannenbaum, *All in the Family: Corporate Governance Issues Facing-Owned Businesses,* Gouldratner (Mar. 20, 2020, 03:15 PM), http://www.gouldratner.com/assets/publications/FDT_All-in-the-Family-Corporate-Governance-Issues.pdf.

[4] Shagun Bahl, *Corporate Governance under the Companies Act, 2013*, Pleaders (Mar. 23, 2020, 06:09 PM), https://blog.ipleaders.in/corporate-governance-companies-act-2013/.

[5] Margret Rouse, *Corporate Governance*, SearchFinancialSEcurity (Mar. 23, 2020, 02:35 PM) https://searchfinancialsecurity.techtarget.com/definition/corporate-governance.

[6] Supra note 1.

In order to promote and encourage corporate governance practices in the top listed companies, Kotak committee was formed on June 2, 2017 under the leadership of Uday Kotak. This committee was constituted with the goal of introducing new corporate governance practices to advance the corporate governance in top listed companies in India. The committee comprised and was represented by different stakeholders of the company including government, stock exchanges, academicians, proxy advisors, lawyers, etc. to have a holistic view. Suggestions advanced by the company essentially included activities like increasing the eligibility criteria for directors and disclosure of their expertise, increased role of audit committee, separation of CEO/MD and Chairman in top 500 listed companies, quorum etc.[7] It is pertinent to note that the Companies Act, 2013 already has such a provision included in the act. The provision for appointment of Key Managerial Personnel states that an individual shall not be appointed or re-appointed as the chairperson of the company as well as the managing director or CEO of the company at the same time. However, proviso to this provision states that if the Articles of Association of the company allows the same person to act as Chairperson and CEO, then the bar under the provision is not applicable.[8] Nevertheless, the suggestions of Kotak Committee aim to make it mandatory and not dependent upon Articles of the top 500 listed companies to adopt this practice of separation of positions of chairperson and CEO.

This paper majorly focuses on the impact of suggestion of separating the positions of CEO and Chairman especially in family owned businesses. By the notification of Security Exchange Board of India in May 2018, this suggestion was to be implemented from April 1, 2020. However, it has been deferred by two years so as to give more time to the concerned companies to make arrangements to separate the two positions of CEO and Chairman in the company. As per the new decision of the Securities Exchange Board of India, this suggestion of the committee will come into force from April 1, 2022. According to the suggestion of the Kotak Committee, the chairman of the company must be a non- executive director and must not be related to the managing director or the Chief Executing Officer of the company. This suggestion is more of a concern for the family owned business wherein, generally, the post of chairman and CEO are either occupied by the same person or by a family member, to be specific, or in other case the CEO is a relative within the meaning of relative under Companies Act, 2013[9] of the Chairman.

2. Reasons to Separate the Positions of Chairman and CEO in a Company

A family business has additional complexities involved than as compared to the non-family businesses, mainly due to the interface of family and business in family owned businesses. In such

[7] Diljeet Titus & Rai S. Mittal, *Kotak Committee recommendations on Corporate Governance gets SEBI sanction*, Money Control (Mar. 27, 2020, 04:50 PM), https://www.moneycontrol.com/news/business/economy/kotak-committee-recommendations-on-corporate-governance-get-sebi-sanction-2540971.html.

[8] Companies Act, 2013, Section 203.

[9] Companies Act, 2013, Section 2(77).

a scenario, it becomes difficult to separate family and business so as to create a balanced relationship between the two in order to ensure minimal conflict of interests.These challenges of maintaining the balance between the two is only possible by encompassing sound corporate governance practices in business. Corporate governance practices divorces ownership from management if applied properly. Following are the reasons for separating the two positions in a family owned business:-

1.6 The board of directors is a body entrusted with the responsibility to govern the affairs of the business and to holds management accountable for the functions performed by it. Whereas function of management is to look after the day-to-day working of the enterprise. In a small business, there is seldom any requirement of a very professional CEO and in most cases the post of CEO is handled by the chairperson himself or by any other member from within the same family. However, as the business grows in size, it demands a skilled and experienced executive talent. This requirement of skilled and professional executives compels the company to look outside the family members to fill in the position of CEO, which ultimately separates management from ownership as none of the family members or the owners controls the post of CEO. One of the major drawbacks of family owned business is that it prioritizes that the top management of the company remains within the direction and control of the family members exclusively and avoids handing it in the hands of non-family members. However, this ambition certainly creates far reaching consequences for business. To renounce the authority over the top management is one of the hardest tasks for the family owned businesses. Even in situations where family members of a family owned business are made familiar with the intricacies of business since a very young age, it does not mean that they possess the specific abilities required for acquiring and retaining the top management position in the company. Jobs such as CEO, requires a person with professional skills. For a business to grow and boom, it is absolutely essential to have a well-qualified Chief Executive Officer. At initial stage of setting up of a business, the governance of the business is generally informal and is majorly restricted to family members itself and barely goes beyond the family members. Gradually, as the business grows, more members are added to it and this is called the second stage or 'sibling partnership'. At this stage, a step towards the formalisation of the management is taken and clear policies, conditions of entry and exit from the business etc. are laid down. When the business reaches the third or the advanced stage, it involves more number of family members. This is generally the third generation stage or the advanced stage[10]. There is high possibility that the business can collapse at this stage because as the number of family members and their involvement in the business increases, right, skilled, and formal management is very important to synchronise the actions of different stakeholders. Generally, most separations occur at a succession stage, where the founder elects to retain his position as

[10] Supra Note 2.

a chairman[11]. When the business grows to such an extent it becomes essential that the ownership and management are kept apart to ensure smooth running of business. The same person acting as chairman and CEO, especially someone from the business owning family may lead to the collapse of business. The major function of board is to criticize CEO when needed, but when the two positions are not separated, it becomes difficult to keep sufficient check on CEO's powers.[12] The reason that these positions need to be separated is because the function of board is to govern the affairs of the company and hold management accountable. However, it creates immense difficulty to hold the management accountable for its functions if the same person acts as the chairman of the board and also the CEO of the company or relatives are placed on these posts. Moreover, the function of board is to ensure transparency to the stakeholders of the company especially for the investors so that the investors are aware about where their money is being invested. However, when both these important positions are held by the same person or by relatives from the same family, uncertainties are raised about the transparency, as at many times the board under the chairman might overlook the mistakes of the management if the CEO is a relative or might not disclose his own mistakes, if he himself holds the two positions. Not only this, there is also a possibility of abuse of positions if the same person handles both the positions as it results in monitoring oneself. Since the function of the board is to secure the wishes and interests of the shareholders, whereas, the executive or the CEO is responsible for driving these operations; it becomes very important to separate these two positions between a family member and a non- family member in family owned company.

1.7 Secondly, the chairperson's job on board is to look out for shareholders, fire and hire competent and incompetent managers or executive respectively. Moreover, he has duties of management oversight and board leadership. To make it more specific, a chairman decides whether to include minutes to the board meetings[13] or to order and scrutinize polls at the meeting.[14] He also presides over the general meeting as a chairperson,[15] has power to adjourn the meeting,[16] rule on objections raised during voting[17] and most importantly, he has the power to make a casting vote in the meeting.[18] On the other hand, the executive's job is to timely report to the board, carry out the policies or strategies decided by the board, and run the day-

[11] David F. Larcker & Brian Tayan, *Chairman and CEO: The Controversy over Board Leadership*, Harvard Law School Forum on Corporate Governance (Apr. 04, 2020, 09:45 PM) https://corpgov.law.harvard.edu/2016/07/26/chairman-and-ceo-the-controversy-over-board-leadership/.

[12] *Board Leadership: Should We Separate the Chairman and CEO Positions?*, SayLord (Apr. 04, 2020, 11:00 PM) https://saylordotorg.github.io/text_corporate-governance/s05-06-board-leadership-should-we-sep.html.

[13] Companies Act, 2013, Section 118(6).

[14] Companies Act, 2013, Section 109.

[15] Schedule 1, Table-F, Clause 45.

[16] Schedule 1, Table-F, Clause 49.

[17] Schedule 1, Table-F, Clause 56.

[18] Schedule 1, Table-F, Clause 68.

to-day operations of the company under the oversight of the board.[19] In short, his job is to regulate the governance of the company, more specifically of board, committees and meeting responsibly.[20] Board's task collectively, and chair's task individually, is to monitor or keep an oversight on management and not to become managers themselves.[21] It is the task of management or the executive, to be specific. Separation of both the positions ensures to eliminate conflict of interest inherently occurring in performance evaluation, succession planning, executive compensation, etc. from holding both the positions. However, when the same person looks after both jobs, it results in reporting to oneself. To quote Blenyth Jenkins, *"One of the major functions of the board is to supervise management. If the chairman of the board is also in management, then he is in effect marking his own papers."*[22]

1.8 When business reaches such great heights, it becomes essential that all the decisions are taken after taking everything into perspective. This ensures that a holistic view is taken so that maximum interests can be secured. When the family owning the business controls the top most hierarchy of the company, it restricts a divergent view to be deliberated from the view taken by the family members involved in the business. There is great possibility that subjective and not objective view is taken. Such subjective view might turn out to be detrimental to the business and for various stakeholders, since such a view might only favour some of the stakeholders. At this juncture, it becomes very crucial to ensure that decisions are not influenced by the emotions or subjective considerations of the family members and an objective view is taken in favour of the business. An appropriate decision needs to be conceptualized to secure maximum interests. A bird's eye view is vital to maintain stability and ensure success of a business. When the positions of chair and CEO are separated such that members of the same family cannot hold two positions, it enables an objective input provided by the CEO, who is a person from outside the business controlling family. Since this person is not from within the family and remains unaffected by any family influence of the controlling family, it ensures greater possibility that his objective view is in the larger interest of the business per se.

1.9 Another problem that arises with the non-separation the above-mentioned two positions is that the corporate board decides the corporate pay or the compensation given to the management officials. Since the same person functions on both the posts, there arises clear conflict of

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[19] David F. Larcker & Brian Tayan, *Chairman and CEO: The Controversy over Board Leadership*, Rock Center for Corporate Governance (Apr. 07, 05:48 PM), file:///C:/Users/hp/Downloads/SSRN-id2800244.pdf.

[20] Ankit Honda, *Separate Positions of Chairman and Managing Director/CEO: Tussle between Good Governance and Maximum Benefits*, The Indian Review of Corporate and Companies Law (Apr. 08, 2020, 03:09 PM),https://www.irccl.in/single-post/2018/09/01/Separate-Positions-Of-Chairman-And-Managing-DirectorCEO-Tussle-Between-Good-Governance-And-Maximum-Benefits

[21] Business Roundtable*, Principles of Corporate Governance*, Harvard Law School Forum on Corporate Governance (Apr. 11, 2020, 02:01 PM), https://corpgov.law.harvard.edu/2016/09/08/principles-of-corporate-governance/.

[22] Jonathan Foster, *Should the Chairman and CEO Roles be Held Separately?*, CFO (Apr. 15, 2020, 09: 48 PM), https://www.cfo.com/leadership/2019/10/should-the-chairman-and-ceo-roles-be-held-separately/.

interest as in this case the same person decides the pay or compensation for himself. This violates the principle of natural justice, which says that no man can be judge in his own case. [23]

1.10 Moreover, the two positions are the prime positions in a company. Meaning thereby that both are very responsible positions and positions calling for higher level of accountability and accordingly demands sufficient time. If the chairperson does not give sufficient time to board then he eventually fails at formulating appropriate policies for the company. Similarly, a CEO being the management chief needs to devote sufficient time to manage day-to-day affairs of the company. When a single person enjoys these two positions, it becomes very difficult to manage time for fulfilling both the functions. The result of such mis-management on the part of the chairperson and the CEO can lead to chaos and might turn out to be detrimental to the interests of the company.[24]

Conclusion

The SEBI regulation will go a long way to ensure legal basis for separating the two positions. Provision in the companies Act, 2013 provides for the above but same can be overhauled by the Articles of Association of the company. The newly introduced SEBI regulation for the top 500 listed companies is to maintain sound corporate governance. It is clear from the afore-mentioned discussion that One-Person Model i.e. where the chairperson and CEO of the company are two different persons, is desired in all types of companies. However, such model is more desirous in family business given the intricacies involved in such businesses. The love-hate relationship in family makes it difficult to ensure smooth functioning of the business. Needless to say, family businesses are encircled with emotions, which makes it more desirous to have two, most important positions under the control of unrelated persons. Separating the positions of chairman and CEO not only ensures transparency and accountability, much doubted characteristics when the business is controlled by members of one family, but it also ensures the opportunity to benefit from the skills of outsiders that the members of the family might lack. It ensures an environment of checks and balances, so that one important part of the company does not act as a puppet to other part, and where former is in position to object latter's views which are not necessarily in good interest of the company. And more so, such environment becomes a necessity in a business majorly controlled by a single family.

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[23] Angie Mohr, *3 Reasons to Separate CEO and Chairman Positions*, InvestoPedia (Apr. 20, 01:15 AM), https://www.investopedia.com/financial-edge/0912/3-reasons-to-separate-ceo-and-chairman-positions.aspx.
[24] Supra Note 9.

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