

*kcm*Heirloom

Succession Planning

SHAping Governance

Significance of Shareholders'
Agreements in Family Businesses

November 2025

Background

Welcome to **kcmHeirloom**

Succession planning and family governance are more than just legal or financial matters—they shape the legacy of generations. **kcmHeirloom** is a dedicated publication offering insights into the complexities of succession planning, wealth preservation, and the stewardship of family assets. From 'The challenges of passing down a family business' to 'Selecting the best instrument for succession' or 'Steps which can be taken to ensure effectiveness of a will'—these are not just technical topics but real-life concerns that influence families, businesses, and legacies.

Through expert perspectives, case studies, and evolving best practices, we aim to provide clarity on key challenges and opportunities in sustaining family wealth across generations. Whether you are a business owner, trustee, or next-generation leader, **kcmHeirloom** will serve as a valuable resource for informed decision-making and enduring legacies. Stay engaged as we explore the legalities, principles and strategies that define lasting family wealth.

It was a bright Sunday near noon, and Prakash was stretched out on the hammock, enjoying his book beneath the shade of their Neem tree. His son Shardul came up, grinning like a monkey with a banana. "Dad! This is amazing! You guys decided that we're going for an IPO! I was also thinking the same thing, but don't you think it is a bit soon?"

Prakash did not answer. He went pale, his heart sank. You see, Prakash, along with his three brothers – Prashant, Paresh, and Premal – was an equal partner in the family business. Prakash, being the eldest, had always assumed they'd make decisions together. But a few days back, during a heated family meeting, Prakash had firmly opposed the IPO. Paresh and Premal were all for it, and Prashant, sitting on the fence, seemed to have finally tipped over to their side. With the 3/4th majority votes stacked, the decision was made, and Prakash's trust in his brothers was cracked wide open. Could something have been done to prevent this? Maybe things would have gone differently if there was a Shareholders' Agreement (SHA) among the brothers. In this edition of the KCM Heirloom, we endeavour to go through the importance of an SHA in family businesses – mainly from the perspective of family governance.

Broad Overview of Shareholders' Agreement

We are all familiar with 'company' as a form of entity for carrying on business. At its core, the idea of a company is particularly relevant from its feature of separation of ownership and management of a business. Shareholders own the company, while the board of directors manages it. Shareholders have rights over "owner matters"¹ such as hiring and

¹These would include decisions which require shareholders' consent – e.g., hire & fire board members, going for an IPO etc.

firing the board, while directors handle "operational matters"². Corporate laws typically follow a democratic approach, with decisions made by majority vote. As mentioned earlier, one of the owner matters pertains to hiring and firing of board of directors. Accordingly, the majority shareholders also exercise significant control/influence over the executive matters. However, this comes with its own risks and downsides. Take this case for instance – in a joint venture where one party provides technical know-how and the other acts as a financier, the technical partner may hold only 25% of the voting shares, while the financier controls 75%. Despite generating the venture's value, the technical partner is vulnerable to the financier's dominant influence. In such cases, it's crucial to protect the technical partner with additional rights to prevent the financier from hindering the business. Similarly, the financier will want the technical partner to remain involved for a certain period to ensure the venture's success and profitability. This is a classic case which can be solved by a well-drafted SHA. An SHA is an agreement between the shareholders and their company which govern the rights and obligations of the shareholders. Both, the company law and the contract law, legitimize such SHAs and ensures their legal enforceability³. In fact, presence of a good SHA makes the stake more liquid especially in private deals/M&A because it gives clarity, certainty and assurance to the investor/buyer about important things like exit rights and inter-se arrangements among the present shareholders.

²These would include decisions which require board's decision – e.g., capex sanction, budget approvals, dividend distribution decisions etc.

³ For instance, refer Proviso to Sec. 58(2) of Companies Act, 2013

Family Shareholders' Agreement

Many of us would know that the most obvious and popular use of SHAs is in managing and governing joint ventures. Look at a family-owned company. What is it, if not a joint venture by and amongst members of the same family? That being the case, the relevance of a so-called "family SHA" cannot be understated. A family SHA has considerations which extend beyond the commonly used joint venture SHAs.

The question then arises – *how does one go about thinking about what to put in a family SHA?*

Almost without exception, the foundational thought process for determining the terms of an SHA would be *what major areas can lead to a dispute which I can avoid by clarifying today?* Some common thoughts around this are –

a. What are the key decision matters which should require consent from all family shareholders?

There could be a case where family members are involved in business, and one faction therein constitutes a majority some years (or generations) down the line. One would not want all the decisions to be controlled by the majority. This is generally handled through a set of voting agreement clauses within the SHA.

Example: going for an IPO, taking on a huge debt obligation in the business, firing the current CEO/MD etc.

b. Who would succeed me on the Board of the family company?

Look at a common scenario where presently the founder would be leading the business, but his two children are also actively

taking part in managing and growing the business. How would it be decided who becomes the CEO/MD? There can be a set eligibility criterion or maybe a plain vanilla statement that elder child would succeed me on the board. Irrespective of how it is addressed, this is one area which needs due consideration for family SHAs.

c. Can the next generation exit from this business at any time and sell the stake to anyone?

A common yet critical clause in SHAs is one pertaining to exit restrictions. There are some business families which like the idea of a lock-in on sale of family company shares for x no. of years post-demise of the founder. This helps in ensuring stability in the cap table especially in cases where there are many family shareholders holding significant minority (i.e., 26% or more). Then there are the more popular exit regulation clauses – "Right of First Refusal" (ROFR)⁴, "Right of First Offer" (ROFO)⁴, Drag-along rights⁴, Tag-along rights⁴ etc.

There are many other thought processes surrounding the family company which one may come across. For instance, a non-compete clause, board nomination rights to all family branches based on their shareholding, dividend distribution mandate, dispute resolution mechanisms (arbitration, mediation or any other sort of mechanism) and so on. Many a times, founders have unique requirements – for instance, when founders tend to be emotionally attached to the business they

⁴ For a better understanding of these clauses & more – refer KCM Insight, April 2023 edition, article titled "Key Protective Terms in Shareholders Agreement"

⁵ Regulation 30A of SEBI (Listing Obligations & Disclosure Requirements), 2015 [SEBI(LODR), 2015]

have built, they may want to make it very difficult for the family to change the company's name after their lifetime.

For Family SHAs, to ensure continuity of such agreements from one generation to the next it is essential to build a continuity mechanism into the SHA. The most commonly employed mechanism is mandating that a Deed of Adherence should be signed by any person who acquires the shares of family company (either by transfer or through transmission (i.e., inheritance)). The Deed of Adherence is essentially a legal document that allows a new party to join an existing agreement by formally agreeing to be bound by its terms and conditions. So, when the shares move to the next generation, they are bound to execute such Deed of Adherence to SHA and be bound by its terms.

It is important that (where possible) the critical terms SHA be incorporated in the Articles of Association ("Articles") of the family company. This inclusion allows for a better legal remedy in case there is a breach in the terms of SHA. Note that the Companies Act, 2013 (of India) also allows for entrenchment of clauses in the Articles of a company. What it means is that while ordinarily amending any part of the Articles would require approval from 3/4th majority, one can entrench certain parts/provisions of the Articles to make it even more difficult to amend – e.g., require 100% shareholder consent to amend that part of the Articles. This facility may be used by the advisors where found necessary in implementing/enforcing an SHA.

Additional Considerations in view of an IPO-bound entity

We see that recently many legacy businesses are looking for listing as a prospect to raise funds and command greater liquidity from their holdings. For a family-owned company going for an IPO, an SHA should specifically include some aspects which are specific to an IPO. For

instance, for an IPO in India there is a concept of Minimum Promoter Contribution (MPC), which is nothing but a mandate that the promoter shareholders must continue holding at least 20% of the company's stake for a longer lock-in period. A question would arise – Which family member would contribute how much to make whole the MPC requirement? It would be a good idea to clearly set this out in the SHA itself. Similarly, it should also be clarified as to which family member would offer how much of their shareholding for sale in the IPO process.

It is worth noting that the details of an SHA which binds the promoter shareholders (i.e., family) need to be disclosed in the prospectus (which is a public document) to be filed with the stock exchanges & SEBI, and the copy of SHA itself (considered a material contract) needs to be kept open for inspection at the company's registered office and the company's website. Hence, any concerns regarding confidentiality should be addressed before hand. Even post-listing, one must be aware of the fact that such SHA or voting arrangement (as the case may be) will have to be disclosed regularly by the listed companies in their filings with stock exchanges. Additionally, in case of any special rights granted to shareholders in such agreements, the regulations also provide that a listed company must avail 3/4th majority consent from its shareholders every 5 years for the same⁶.

Various special rights can be incorporated into SHA such as nomination rights, ROFO, ROFR, tag-along/drag-along rights, veto/affirmative rights, information rights, etc. Where the company is a party to the SHA containing these special rights, SEBI may require modification or cancellation to ensure that such special rights lapse upon listing except

⁶ Regulation 31B of SEBI (LODR), 2015

nomination rights and information rights. This is in line with the pari passu principle that IPO shares rank equally with existing shares⁷. Consequently, SHA are often modified or terminated to remove such special rights, while separate inter-se agreements (excluding the company) may be entered into among shareholders to preserve these special rights⁸.

While we have touched upon some essential aspects of SHAs in IPO-bound companies, there are other regulatory considerations as well which need due consideration for an SHA in case of an IPO-bound company.

Conclusion

In family governance, just like any other governance model, clarity and consensus are the key. Documentation of these clear and agreed upon guidelines are essential for the family memory. Does this mean that an SHA could have eliminated all conflicts between Prakash and his brothers completely? Of course not! However, for instance, affirmative voting rights to all the four brothers in respect of major decisions like an IPO could have simply discouraged the three younger brothers from even thinking of passing a resolution for IPO since it would be invalid. So, an SHA would have provided them with a certainty regarding factors which are peripheral to the family business. Because of this certainty the family members can better focus on growing the family business, and peacefully handing it over to the next generation. Shareholders' Agreements are good instruments which help us achieve a legally binding framework by creating rights and responsibilities amongst the family members and ensuring proper governance.

⁷ Para 6.1.2 to 6.1.4, SEBI Consultation Paper 21-02-2023

⁸ Adani Wilmar Limited IPO Documents (DRHP and Amendment Agreements), as filed with SEBI and BSE in 2021.

About **kcm**Heirloom

kcmHeirloom KCM Heirloom is a specialized publication by the Succession Planning team at K C Mehta & Co LLP, focused on inheritance planning, estate structuring, and family business governance. It explores key challenges, evolving regulations, and best practices in wealth succession, offering valuable insights for families, business owners, and trustees.

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