ISB | Thomas Schmidheiny Centre for Family Enterprise

Family Business Briefs

Issue 59 / April 2020

Welcome!

*I have the pleasure to share with you the latest issue of our newsletter, '**Family Business Briefs**.' This issue contains some riveting facts and information about family businesses that you may find interesting. The briefs have been organized into the following sections:*

- *Summaries of research articles on **Family Firm Franchisors, R&D Decisions, and Development of Socioemotional Wealth within Next-Generation Members***
- *Summary of a family business case on **Dabur***
- *Inspirations from the life of **K. P. Paul***
- *Interesting insights on **Sudarshan Chemical Industries***
- *Infographic on **Market Valuation Trends of Family and Non-Family Firms in India***

Please also find below, the link to my recent article in the Harvard Business Review Ascend.

Making Career Choices - Should you Join the Family business or Work Elsewhere First?

We hope that you will find these insightful and stimulating.

I encourage you to send your feedback and share suggestions about something interesting and relevant, which you may want us to include in future.

Best regards

Ram

Kavil Ramachandran, PhD

Professor & Executive Director

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ARTICLE SUMMARY

Family versus Non-Family Firm Franchisors: Behavioural and Performance Differences

- Francesco Chirico, Dianne H. B. Welsh, R. Duane Ireland, and Philipp Sieger

Franchising is a key driver of entrepreneurial activity. In this arrangement, a franchisor grants a franchisee, the right to market its branded products or services using the prescribed business processes. However, franchising as an entrepreneurial activity in family firms, is inadequately probed. This study examines data from 200 private family and non-family US firms and probes whether franchising processes, practices and performance differ between family and non-family firms. This summary succinctly presents the study, its findings and implications.

The Franchisor-Franchisee Relationship

Family firms are known for their long-term orientation and patient capital. They have rich and unique social capital and a strong desire for positive family reputation. Hence family firm franchisors are more likely to build strong, trust-based, durable relationships with their franchisees compared to those made by the short-term oriented non-family franchisors.

Family firms invest efforts to develop employee commitment and loyalty. This also extends to franchisees. Hence, a family firm franchisor is likely to commit substantial resources in franchisee training and learning opportunities compared to a non-family franchisor.

Franchisor's Performance, Age and Size

Family firms are known to follow path-dependent behaviours and favour status-quo because family members perceive that to be less risky. Similarly, family firm franchisors would want their franchisees to follow the established routines and support the status-quo. Their inability to look for new resource combinations and alternate solutions would make them less competitive. Hence, family firm franchisors are likely to have lower performance compared to non-family franchisors.

If the family firm franchisor is older than the non-family franchisor, it is likely to be better skilled in managing business relationships and more efficient in resource utilization. If the size of the family firm franchisor is larger than that of the non-family franchisor then it would have the advantages of sharing resources with franchisees at a large scale. Hence, older and larger family firm franchisor is likely to perform better compared to a similar non-family franchisor.

The results of the statistical data analysis provided support to all the hypotheses.

Practical Implications

The study has significant practical implications for family businesses:

- Family firm franchisors need to be patient to carefully nurture franchisee relationship before they can leverage it to enhance firm-performance.
- Family firms must identify the resources, skills and capabilities that can be shared with the franchisees to contribute to their capability development.
- Family firms need to constantly work with their franchisees to find new ways to garner resources, create value and convert opportunities into tangible returns.

Source: *Journal of Management Studies (2020), DOI: 10.1111/joms.12567.*

ARTICLE SUMMARY

When Can Families Fill Voids? Firms' Reliance on Formal and Informal Institutions in R&D Decisions

- Jasper Brinkerink and Emanuela Rondi

Firms make R&D investments when confident of intellectual property rights (IPR) protection. However, in markets where institutions protecting IPR are weak, do firms rely on formal institutions when they make R&D decisions? Whether firm R&D decisions are affected by informal institutions, such as, the family and society? This study probes these crucial questions by analysing data on R&D activities of 15,000 manufacturing firms in EU countries.

Firm-Level Innovative Activity and Formal Institutions

Innovation is a key driver of business growth, revenues and profits. Legal protection of intellectual property rights (IPR) of a firm is assured and enforced by formal institutions of a country. This safeguards returns on R&D investments and incentivizes firms to undertake innovative activities. Hence, the authors argue that a firm's R&D intensity is likely to be positively affected by the strength of their home country's formal IPR institutions.

Firm-Level Innovation and Informal Institutions

In a context that has institutional voids, firms disproportionately depend on informal means like, employee commitment and loyalty or vigilance, to safeguard their R&D investments. The authors argue that in weak institutional contexts, informal institutions (such as, family or society) fill the void and protect firm R&D activities. In family firms, the values and norms imbued by the family institution limit the leakage of critical knowledge and reduce firm dependence on formal IPR protection institutions in making R&D decisions.

The authors also suggest that in the macro environment, societal culture as an informal institution shapes the way of thinking and influences strategic decisions and innovations. While individualist cultures value autonomy, collectivist cultures lay stress on relatedness and loyalty. Hence, the authors argue that family institution is likely to be a more effective substitute for weak formal institutions in deciding firm R&D, in a collectivist society compared to that in an individualist society.

Key Findings

Statistical data analysis did not find significant effect of formal institutions on firm R&D intensity. However, family firms were found to be less dependent on formal institutions in allocating human resources to R&D activities. The institutional void-filling ability of the family institution in allocating financial resources to R&D activity was found to be influenced by the collectivist societal culture.

Practical Implications

- Family involvement is vital in supporting firm R&D activities especially when formal institutions for IPR protection are weak.
- Family firms must ensure that members internalize shared values and norms to prevent leakages of knowledge generated through R&D activities.
- Family firms need to calibrate their R&D strategy in tune with the prevalent societal culture. In an individualist culture, it is advisable that family refrains from exerting excessive influence on firm R&D activities.

Source: *Entrepreneurship Theory and Practice (2020),*
DOI: 10.1177/1042258719899423.

ARTICLE SUMMARY

The Origins and Development of Socioemotional Wealth Within Next-Generation Family Members: An Interpretive Grounded Theory Study

- Linda Murphy, Jolien Huybrechts, and Frank Lambrechts

Socioemotional wealth (SEW) comprises non-economic emotional benefits (such as, social status and reputation) that the family derives from business ownership. Since its introduction in 2007, SEW has emerged as a major area of family business research. However, the origin and development of SEW within next-generation family members has not been adequately explored. Hence, to study this phenomenon, the authors conducted interviews of 12 next-generation members from six family businesses in Ireland. This summary outlines the study, its key findings and implications.

Socioemotional Wealth and its Dimensions

Socioemotional wealth is defined as "*the non-financial aspects of the firm that meets the family affective needs such as identity, the ability to exercise family influence and the perpetuation of the family dynasty.*" SEW can be **positively** demonstrated such as joy, pride and hope. It can also be **negatively** valanced such as immense pressure among siblings to join the business.

SEW Origin, Development and Influence

Origin of SEW is linked to the next generation member's ***early life experiences***. SEW ***develops*** through various ***life stages*** and ***influences*** the member's life path/ decisions:

1. Originates with Early Life Experiences: All the early life events and childhood memories of the next-generation family members are intertwined with those of their family business. This early exposure to business forms the core of their individual SEW development.

2. Develops through Life Stages: As family members steer through various stages in life, their identity with the firm gets secured. They also start to decipher the non financial aspects of the firm. Events such as, taking up a part-time job in family firm during summer vacation or understanding their parent's passion for the business venture, facilitate SEW development.

3. Influences Life Path and Decisions: Once SEW is originated and developed, it acts as a frame of mind which influences the next-generation members' decisions in their course of life. They remain protective of SEW, which in turn, updates their frame of mind.

Key Findings

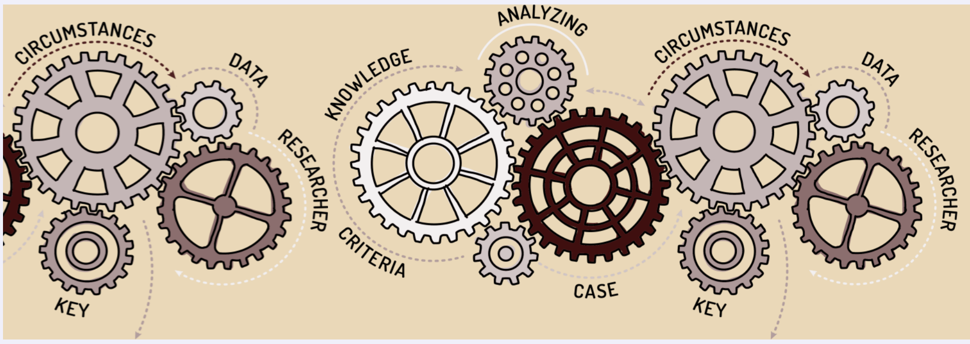
The authors find that SEW, as a state of mind, is continuously built, internalized and updated over time. During the origin of SEW, a sense of identity and belongingness with the firm is established within the next-generation member. In development phase, this identity is further strengthened and causes understanding of influence, succession and reputation. These then lead to preservation, protection and strategic use of socioemotional wealth.

Practical Implications

This study has significant practical implications for family businesses:

- It is crucial for family firms to understand how socioemotional wealth originates, develops and influences their next generation members.
- This understanding can help them enhance the virtues of socioemotional wealth and reduce its burdens for next-gen members. This can help family firms in mitigating the challenges of intergenerational succession.

Source: *Family Business Review, (2019). Vol. 32, No. 4, pp. 396–424.*



CASE SUMMARY

Professionalization at Dabur

In 1998, the 4th and 5th generation members of the Burman family that controlled the New Delhi based, Indian Ayurveda and FMCG company, Dabur, decided to hand over its management to professionals. Dabur was setup in 1884 by Dr. S. K. Burman in Kolkata to make affordable natural (ayurvedic) medicines for people in remote areas. Since then, the company had diversified into FMCG products, expanded operations globally and gone public in 1993. The family had realized that the firm had to be professionalized for the next phase of growth.

The family held detailed discussions over 18 months and finalized the restructuring and professionalization process. The family members stepped down from executive positions and were replaced by high-caliber, talented professionals. The family was keen to retain the culture and value system of the company. They decided to limit family members on the Board of Directors four, including the Chairman and Vice-Chairman positions. However, they chose to not draw a salary from the company and only receive dividends. These members were chosen from the two branches of the family tree hierarchy that descended from the two grandsons of the founder. The family successfully transitioned to an advisory role.

A family council was setup, which was to meet every quarter and liaison between the family and business. Periodically, it discussed the business performance, strategy and new venture creation. They also developed and adopted the family constitution. It clearly laid out the family vision, values, the family charter and the guidelines for family members' relationship with the business, succession process and dividend policies. The family council encouraged new venture ideas and investments in areas which would lead Dabur to the next growth trajectory.

Two decades since the restructuring and professionalization process, Dabur has continued to grow. The company registered revenues of INR 85,330 million and profit of INR 1,442 million for the year ended March 2019. The 135-year-old company has a rich heritage and experience in natural (Ayurveda) products in consumer care, healthcare, food, home and personal care segments. The family holds 67.86 percent stake in the company. The long-tenured professionals have worked hard for outstanding financial performance of Dabur over the last two decades. However, it remains imperative that the family continues to be vigilant of its advisory role and periodically reviews the family constitution as the business, family and external forces continue to evolve.

Learnings for Family Businesses

The key takeaways from the case are:

- Family managements must realize the need to let-go of the operational control of the business to non-family professionals.
- Professionalization helps the family business acquire skills and talent to handle complexity
- Family governance mechanisms such as, the family council and constitution are critical to keep the family united across generations
- With growing complexities in the family and business, plans need to be periodically revised and family involvement in strategy building must be ensured.

Sources: https://www.forbesindia.com/article/indias-family-businesses/a-family-constitution-can-bridge-the-gap-between-family-and-business-values/46417/1

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 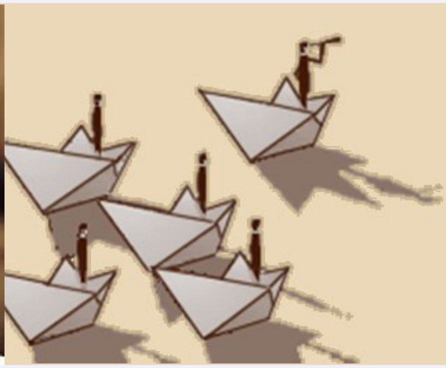

FAMILY BUSINESS LEADER

K. P. Paul

(1914 - 2007)

Born in Kuttukaran Family in Trichur, Kerala, K. P. Paul was the eldest son amongst the 12 children to his parents. He started his career as a clerk earning Rs.4 per month. Soon he was working in a rice and provisions store to help his family financially. This forced him to leave his formal education at an early stage. Soon, he started to manage the shop on his own and ponder upon the pursuits of entrepreneurship.

The seeds of entrepreneurship were sown in him at a very young age by his mother who was a micro-entrepreneur herself. His mother along with other neighbors formed an all-women enterprise where they processed rice grains from Burma and sold them to hotels in Kochi, Kerala, as polished rice was in huge demand.

He began his entrepreneurial journey with a laundry business in 1939 with a capital of just Rs. 150 at the age of 25. Even though there was social stigma against doing such businesses in those times, his business grew. Within six months he made profits in a month that were equal to his capital investment.

His success in the first venture did not stop him from exploring other business opportunities. Living near army establishments in the south Indian town of Trichur, he watched military vehicles pass by and get serviced. Sensing the supply shortage of tyres due to World War-II and opportunity for vehicle servicing, he started a tyre and battery repair shop named Popular Industrials. Soon, he realized that there was no scope for battery repair and witnessed increase in demand for spare parts for vehicles which made him transform his business into a full-fledged spare part business.

Deeply rooted in the communist ideology, K.P. along with eleven other labourers formed “Thrissur Labor Brotherhood”. This later became a precursor to the leftist movement in Kerala. Paradoxically, K. P. Paul became one of the most successful entrepreneurs in Kerala. He always encouraged his fellow entrepreneurs and became one of the few to share profits with his employees as bonus, even before the Bonus Act was passed in India. He not only provided livelihoods to thousands of people who worked with him but also encouraged those who left his firm to start their own ventures.

His two sons Francis K Paul and John K Paul became Mechanical Engineers and joined KP in the 1970s. Under his guidance they learned the nuances of the business and led the group to further diversification and growth.

The first major shift in the business came with the launch of Popular Vehicles and Services Ltd in Trivandrum in 1984. It was the first Maruti Suzuki dealership in Kerala. After the age of 75, though KP handed over the business leadership to the next generation, he played a dynamic role in advising the group on its future course. Even today, the group continues to carry forward its founder’s vision and business philosophy. The Kuttukaran group today has a total turnover of ~Rs 4,200 crores and over 8,000 employees.

In a literally rags-to-riches story, KP did not have much to boast of by way of his business background, financial backing or education. K. P. Paul’s life is an inspiring journey of enterprise, enthusiasm and business acumen.

Sources:

- *https://www.oneindia.com/2007/03/16/entrepreneur-kuttukaran-porinchu-paul-dead-1174290465.html*
- *https://en.everybodywiki.com/K_P_Paul*
- *https://www.popularmaruti.com/about-us/*
- *https://auto.economictimes.indiatimes.com/news/aftermarket/this-dealerships-success-is-part-of-case-studies-at-iim-harvard-while-its-unique-outlet-idea-was-adopted-by-maruti/60269709*
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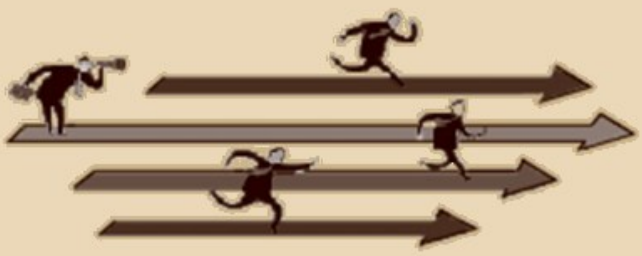


BENCHMARKING

LEARN

FROM THE BEST

Most family businesses do not survive beyond two to three generations. Of the ones that are able to thrive, the primary reason for their growth and longevity is the professionalization of the business. The process of professionalization enables successful family businesses to overcome the growth challenges that are unique to a family business. Since its inception in 1951, the spirit of professionalization has been an integral part of the organisational culture at the Rathi family promoted chemicals business, Sudarshan Chemical Industries Limited (Sudarshan). In 2003, when the second generation took over the leadership, the professionalization process was undertaken systematically with the help of an external advisor.

Professionalisation of the Organization

The process of professionalization at Sudarshan was undertaken at multiple levels:

1) **Corporate Governance:** Since the latter half of 1960's, under the leadership of its founders, the corporate board of Sudarshan mostly consisted of independent directors. When second generation took over the leadership, the board was further strengthened with the formation of various subcommittees for its effective functioning. All the family directors have also always been highly qualified professionals.

2) **Family Governance:** Under the first generation leadership of Sudarshan, family issues were informally regulated because of the 'self-imposed discipline' of the family. The second generation leadership took initiatives to formally establish a family council with various sub-committees to reinforce the family governance primarily because of the growing size of the family across two or even three generations.

3) **Professional Management:** Sudarshan Chemicals created a system of meritocracy where roles and responsibilities were assigned to managers, family or non-family, based on relevant competencies which were determined through fair and objective evaluations. Family members are appointed to management roles on merit alone; existing employees are persuaded to enhance their skills or leave; also, highly talented non-family mangers were hired from outside and retained.

Later, the company reinforced some of these and redefined itself with the help of an external advisor. The top management revisited the vision and mission of the organization, developed new strategies, shifted to a divisional structure, institutionalized performance management systems, and proclaimed meritocracy as its core value. There was no favouritism or preferential treatment for a family member.

Source: *"Professionalization of Sudarshan Chemical Industries" (Mathew, A., Bhatnagar, N. & Ramachandran, K), Ivey Publishing-ISB case series, 9B14M145 and 8B14M145.*

DO YOU KNOW?

In an industry wise analysis done by the Thomas Schmidheiny Centre for Family Enterprise, we found that the Non-Family firms in the manufacturing sector lost their favour with the investors by the year 2000. Their market value (in terms of market capitalization) grew slower than the market capitalization of firms in services sector and family firms in the manufacturing sector (Exhibit 1). This could be due to weak outlook for future growth for existing non-family firms in the manufacturing sector.

Exhibit 1: Total Market Cap - Family vs Non-Family

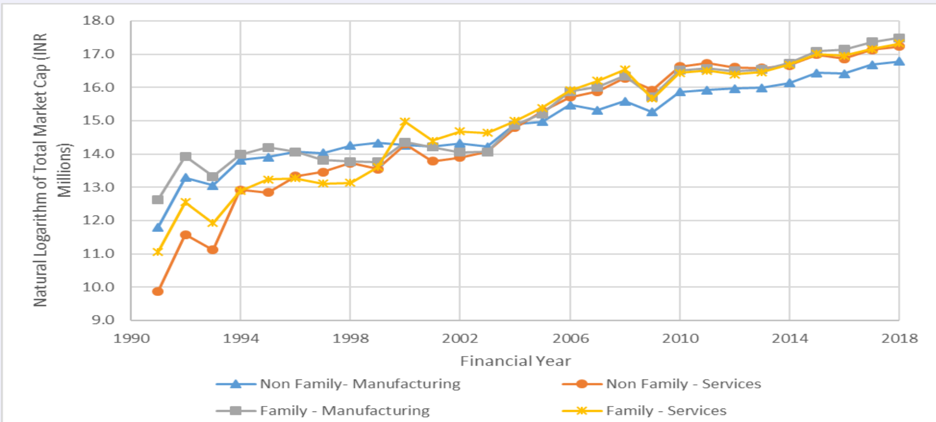
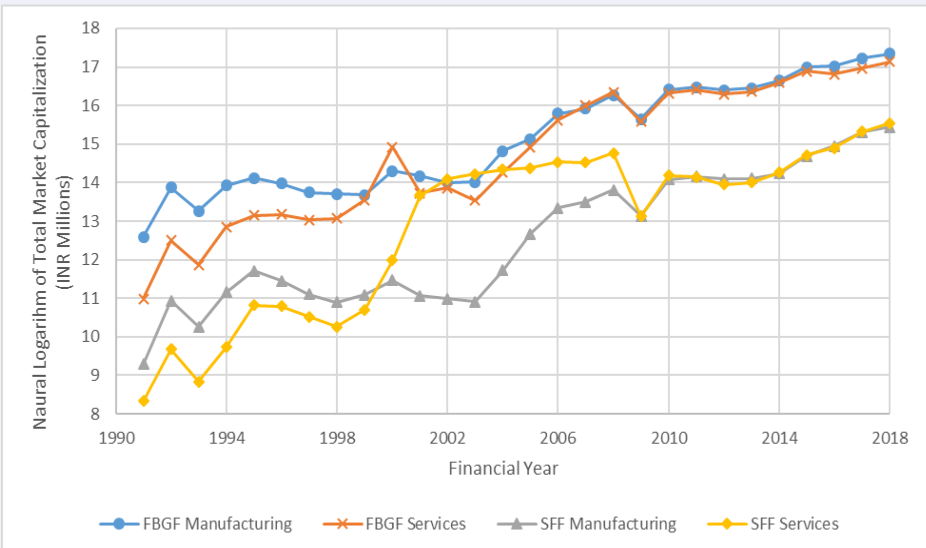


Exhibit 2: Total Market Cap - Family Firms



Standalone Family Firms underwent a valuation boom (along with a rapid increase in assets) in the early 2000s which can be correlated with the global bull phase of the market prior to the recession (from 2002-2007) along with increased global demand for Indian services during this phase. After the recession (2009 onwards), the valuation settled into a steady growth rate (Exhibit 2).

Source: *Bang, N.P., Bhatia, N., Ray, S. & Ramachandran, K. "Family businesses and India's transition to a services led economy (1991-2018)", Thomas Schmidheiny Centre for Family Enterprise, March 2020.*

Indian School of Business

Indian School of Business (ISB) is a global business school offering world-class management education across its two campuses - Hyderabad and Mohali. The School has grown at a rapid pace over the past eighteen years since its inception and already has several notable accomplishments to its credit it is the youngest school ever to consistently rank among the top Global MBAs, one among the select 100 global b-schools to have AACSB and EQUIS accreditation, one of the largest providers of Executive Education in Asia, and the most research-productive Indian management institution. A vibrant pool of research-oriented resident faculty, strong academic associations with leading global b-schools and the backing of an influential Board, have helped the ISB fast emerge as a premier global business school in the emerging markets. For details visit www.isb.edu

Thomas Schmidheiny Centre for Family Enterprise

The Thomas Schmidheiny Centre for Family Enterprise, at the Indian School of Business, has emerged as the foremost authority on family businesses in South Asia. It undertakes training, research and outreach activities covering all major topics on family business. The Centre collaborates with global academic institutions and leading family businesses in India and abroad, for the exchange of insights and knowledge among diverse stakeholders.

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