Thomas Schmidheiny Centre for Family Enterprise

Family Business Briefs

Issue 57 / December 2019

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 **Founder–Successor Relationship, CEO Humility,** and **Multi-family Firms***
- *Summary of a forthcoming family business case on **Deccan Chronicle***
- *Inspirations from the life of **Kailash Chandra Mahindra***
- *Interesting insights on **Merck, Darmstadt***
- *Infographic on **Evolution of Indian Family Businesses in Post-Liberalisation Era***

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

Thomas Schmidheiny Centre for Family Enterprise

Indian School of Business

ARTICLE SUMMARY

The Effect of Value Congruence Between Founder and Successor on Successor's Willingness: The Mediating Role of the Founder–Successor Relationship

- Jean S. K. Lee, Guozhen Zhao, and Feifei Lu

The quality of relationship between the founder and the successor and the latter's willingness to takeover, are crucial to family business succession. However, this relationship is only studied in isolation, either from the founder's or from the successor's perspective. Adopting a social exchange perspective, this study examines how value congruence between the founder and the successor affects the founder-successor relationship and the successor's willingness to takeover the business. The sample of the study comprised 102 founder-successor dyads in Chinese family firms. This summary presents the gist of the study, its key findings and implications.

Social Exchange Theory and Value Congruence

Reciprocal exchanges are the basis of social relations. Family-oriented values are highly emphasized in family business succession context. In particular, the family prosperity (FP) value, i.e., determination to sustain the **family's honour** and **fortune**, is significant.

Adopting a dyadic social-exchange approach, the authors argue that value congruence between the founder and the successor can take four forms. The founder and successor may have: ***1. High FP value*** or ***2. Low FP value***. In both these cases value congruence between the founder and successor is high. In the other two scenarios, the successor may have: ***3. Higher FP value than that held by the founder*** or ***4. Lower FP value than that held by the founder.*** Hence, there is less value congruence between the founder and the successor.

Founder-Successor Relationship Quality and Successor Willingness

The authors argued that the greater the congruence between the founder's and successor's FP value, the better is the quality of the relationship among them, especially when both are at the high level of FP value. In case of incongruence, the founder-successor relationship quality is higher when the FP value of a successor is higher than that of the founder.

The relationship between the founder-successor FP value congruence and the successor's willingness to takeover the business is mediated by the quality of founder-successor relationship.

Findings

Data analysis supported the hypotheses proposed by the authors. The study found that FP value congruence was a crucial determinant of the successor's willingness to takeover.

Practical Implications

The study has significant implications for family firms. While selecting an appropriate successor the founders or incumbent leaders need to consider congruence between their family values and those held by the potential successor candidate. Early education in family values and frequent communication with potential successor(s) improves value congruence and strengthens founder-successor relationship. This improves the successor's willingness to take over the business and makes the succession effective.

Source: *Family Business Review (2019), Vol. 32, No. 3, pp. 259–276.*

ARTICLE SUMMARY

The Case for Humble Expectations: CEO Humility and Market Performance

- Oleg V. Petrenko, Federico Aime, Tessa Recendes, and Jeffrey A. Chandler

Humble chief executive officers (CEOs) are known to exert positive influence inside the organization through improved collaboration, information sharing and empowerment. However, the effects of CEO humility on external audiences have not been adequately examined. Using Videometric analysis of humility exhibited by 122 CEOs of US (S&P 500) firms, this study examines the effect of CEO humility on analyst expectations and market performance of the firm. This summary briefly presents the study and its implications.

CEO Humility and Earnings Expectations

Financial analysts are one of the most important external evaluators of a firm. They shape market expectations for the firm through public forecasts of its expected earnings. The authors argue that the CEO characteristics serve as important market signals and influence analysts' assessment of the firm's expected performance.

The authors further argue that since humble individuals are viewed to be lacking self-confidence and self-esteem, they are perceived as weak for leadership. Therefore firms with humble CEOs are affected by a performance expectation discount by the analysts. Hence, their forecasts for such firms are lower or more attainable compared to those of firms led by 'bold and strong' CEOs.

CEO Humility and Market Performance

Markets are known to reward firm performance relative to analysts' expectations. Firms with humble CEOs may not necessarily register better operational performance compared to that by firms with non-humble CEOs. However, everything else being equal, the firms with humble CEOs register better performance in the stock market because those firms are more likely to exceed analysts' expectations and beat the performance forecasts compared to that by the firms with less humble CEOs.

Findings

The statistical analysis of the Videometric data, the characteristics of the 122 CEOs, analysts' earnings expectations and firm's market performance measured by Abnormal Returns, Tobin's Q and Total Shareholder Returns, supported all the arguments that the authors theorized with regard to CEO humility.

Practical Implications

The study has important implications for the family firms. While appointing the CEO, family firms need to realize that CEO characteristics play an important role in shaping market perceptions and evaluation of the firm. The flamboyant, 'alpha' CEOs may reflect confidence in the firm but they also raise firm performance expectations.

In contrast, CEO humility helps a family firm in keeping the expectations lower among the analysts, and hence improves its chances to outperform in the market.

In leadership succession, family firms may perhaps do well not to discount the more virtuous and humanized leadership successor candidate.

Source: *Strategic Management Journal (2019), Vol. 40 No. 12, pp. 1938-1964.*

When More Is Better: Multifamily Firms and Firm Performance

- Patricio Duran and Marcelo Ortiz

The effect of family control on the financial performance of a firm remains debatable. While some studies find a positive effect on firm performance due to reduced agency costs, others argue that family control has a negative performance effect due to non-economic goals pursued by family owners. Besides, most studies are conducted in single family context, leaving firms with multiple owner families, under-examined.

Based on data from 80 publicly listed family firms in Chile, this study probes whether the presence of multiple and unrelated family controllers improve the financial performance of the firm. This summary presents the gist of the study, its findings and implications.

Family Control and Financial Performance

Family-owners have a higher incentive to more effectively monitor non-family managers and to manage the firm more efficiently. These measures improve firm performance.

However, family control may result in conflicts between majority and minority shareholders of the firm. Furthermore, family owners' pursuit of non-economic goals may lead to sub-optimal firm decisions regarding investments, compensation and/or top-level appointments. These may badly affect firm performance.

Multifamily Firms and Firm Performance

Multifamily firms involve different unrelated owner families. These families preserve their economic and affective endowments through monitoring of other family owners and managerial agents. This prevents the potential deviation of firm resources, which single family firms are prone to. Transparent decision -making also adds to the firm's unique control advantages. Hence, the multifamily firms outperform single-family firms.

Relatively equal distribution of ownership among the families ensures that bargaining power is not concentrated in a single family. Hence, outperformance of multifamily firms is greater when there is a greater balance of control among multiple owner families.

The performance advantages of multifamily firms begin to diminish as the number of owner families increase beyond a certain limit. This happens because of: reduced effectiveness of monitoring, increased competition for firm resources, weaker sense of belonging to the firm, decision paralysis due to increased bureaucracy and rise in conflicts.

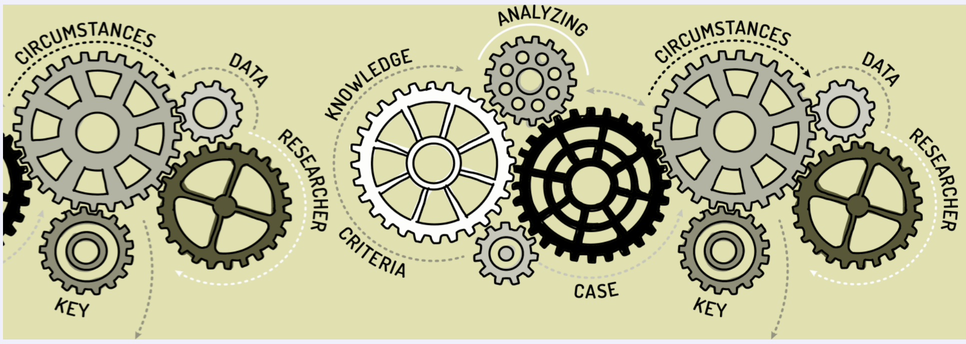
Findings

The statistical analysis supported the authors' hypotheses. Multifamily firms with near equal distribution of control outperform single family firms. This performance advantage maximizes when a firm has six (5.83) owner families.

Practical Implications

Adding unrelated owner families may help family firms in mitigating risks arising from resource tunneling and family conflicts that affect single family firms. Having multiple owner families with balanced ownership is likely to enhance firm performance through better monitoring and control.

Source: *Entrepreneurship Theory and Practice (2019),*
DOI: 10.1177/1042258719851206.



CASE SUMMARY

The Survival Battle of the Deccan Chronicle

- Navneet Bhatnagar

Deccan Chronicle, an English newspaper publishing business, was setup as a partnership firm in 1938 at Hyderabad (India) by M. N. Jaisoorya and his associates. Over the years, its operating costs kept rising and debts piled up. In 1977, a local businessman, T. Chandrashekhar Reddy, bought Deccan Chronicle. He had two sons, who joined subsequently and managed the newspaper. They modernized the printing machinery and launched several new editions. The Reddy brothers continued to grow the business after their father's demise in 1993. By 2000, Deccan Chronicle had become the tenth most circulated newspaper in India.

The Reddys aspired to grow bigger. They restructured Deccan Chronicle into a public company and bought an initial public offer of shares in 2004. Abundant funds helped them expand the newspaper business in south India during the next five years. However, they also made huge investments in various unrelated businesses, like an airfreight business, a chartered flight service, a bookstore chain and a cricket (sports) team franchise of the Indian Premier League. Their next generation family members were brought in top leadership roles at huge salaries.

However, the Reddys had little expertise in managing these unrelated diversifications. They incurred huge losses in these ventures. Adding to their troubles, the newspaper had come under severe financial stress due to rising input costs, growing competition and a risky circulation-dependent growth strategy.

In addition, the Reddys' extravagant lifestyle, misplaced priorities, and incoherent strategic decision-making, gradually led Deccan Chronicle into a debt trap. In order to fuel growth and later, to remain afloat, the Reddys had mortgaged most of its assets including the printing machines.

They had also pledged their stake in Deccan Chronicle to multiple banks and financers. Financial mismanagement ultimately led the firm to bankruptcy. Insolvency proceedings uncovered several unethical deeds of its management. The Reddy brothers were arrested in 2015 for defrauding banks.

One of its lenders, the Kolkata-based SREI Infrastructure Finance, had converted its debt into equity and had become the largest shareholder in Deccan Chronicle. SREI had made an offer to takeover Deccan Chronicle. The committee of creditors, who had given loans to Deccan Chronicle, was to meet in December 2018, to discuss and accept or reject the offer.

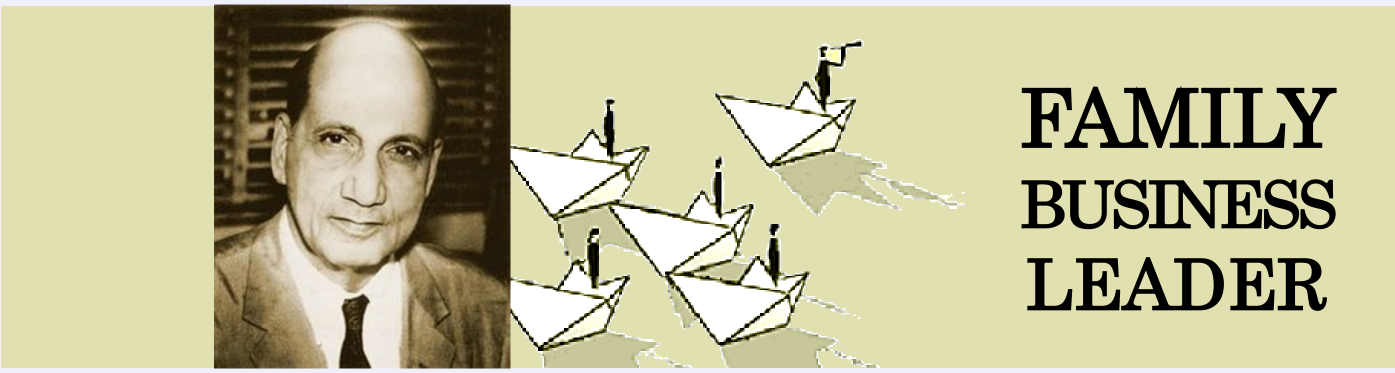
Learnings for Family Businesses

This case highlights the importance of robust family business governance mechanism. It underscores the significance of calibrating family business growth aspirations with the available resources and capabilities.

The case emphasizes the importance of:

- clear priorities for growth and sustained focus on the core business
- building adequate management capabilities
- refraining from irrational exuberance, and
- developing and grooming the next generation family members into capable and focused leaders, possibly with the help of expert external mentors.

Source: *Sage Business Case Collection: Family Business Series (Forthcoming).*



Kailash Chandra Mahindra

(1894-1963)

Kailash Chandra Mahindra (KC) was born in Ludhiana, Punjab and was second of the nine children in the family. KC attended the Government College, Lahore, where his scholastic aptitude shone through. His father died early. His elder brother Jagdish Chandra Mahindra (JC) sent him to study at Cambridge. At Cambridge, he earned Honours, played hockey, and took a keen interest in rowing. After graduating, he joined Messrs. Martin & Company, where he edited the monthly magazine INDIA and, briefly, the Hindustan Review.

In 1942, KC was appointed the Head of the Indian Purchasing Mission in the United States. On returning to India in 1945, he was appointed the Chairman of the Indian Coal Fields Committee of the Government of India and also of the Automobile and Tractor panel. His contribution to developing strategic coal policies and applying the latest methods of coal mining in India helped shape the industry. His Coal Commission Report became a seminal document in the industry. During those years, he also wrote the definitive biography of Sir Rajendranath Mookerjee, a pioneering engineer and entrepreneur of Bengal.

KC moved to Bombay in 1946 to co-found Mahindra & Mohammed with JC and Malik Ghulam Mohammed. After the partition of India, Ghulam Mohammed relocated to Pakistan and Mahindra & Mohammed subsequently changed its name to Mahindra & Mahindra.

Post the sudden demise of his brother JC in 1951, KC stewarded Mahindra & Mahindra into a major Indian industrial house that had a presence in several sectors. He remained the Chairman of the company for 13 years until his demise in 1963.

KC also served as a Director of the Reserve Bank of India, Air India, and Hindustan Steel.

What began as a steel-trading venture seven decades ago, steadily turned into a global brand, spanning nations and industries. Keshub Mahindra, son of KC, became the Chairman of Mahindra & Mahindra in 1963 and steered the group for nearly five decades before handing over the oversight and operations of the group to JC's grandson, Anand Mahindra.

Mahindra group is now a US$20.7bn diversified business house operating in 22 key industries, across 100+ countries. The group has 150+ companies and 250,000+ employees. The innovation driven, professionally managed Mahindra group is renowned for its high standards of governance.

KC also founded the K.C. Mahindra Education Trust (in 1953) with the objective of promotion of literacy and higher learning in the country. The group continues to follow on the path shown by him and spends a lot of its corporate social responsibility money on education, apart from many other areas of social welfare.

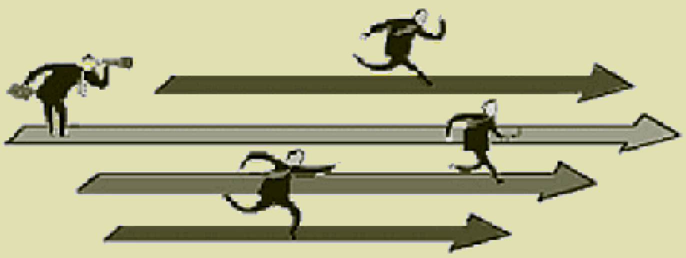
Source: https://en.wikipedia.org/wiki/Kailash_Chandra_Mahindra

https://en.wikipedia.org/wiki/Jagdish_Chandra_Mahindra

https://www.mahindra.com/about-us

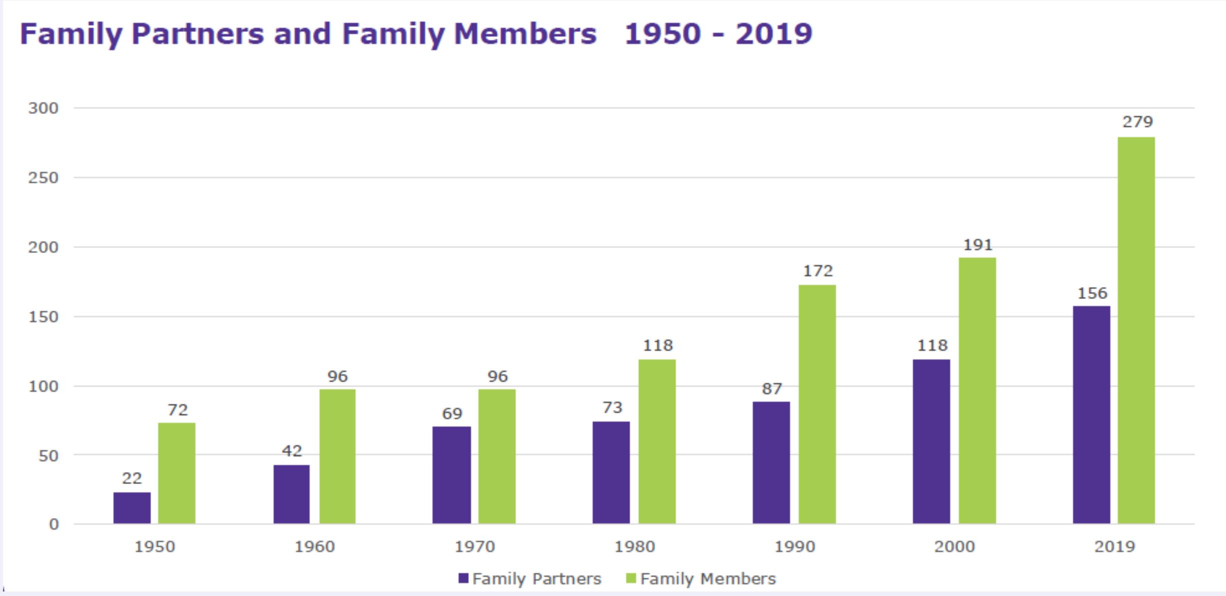
https://www.mahindra.com/resources/pdf/about-us/mahindra-group-presentation-FY19-20-arial.pdf

https://www.kcmet.org/who-we-are.aspx



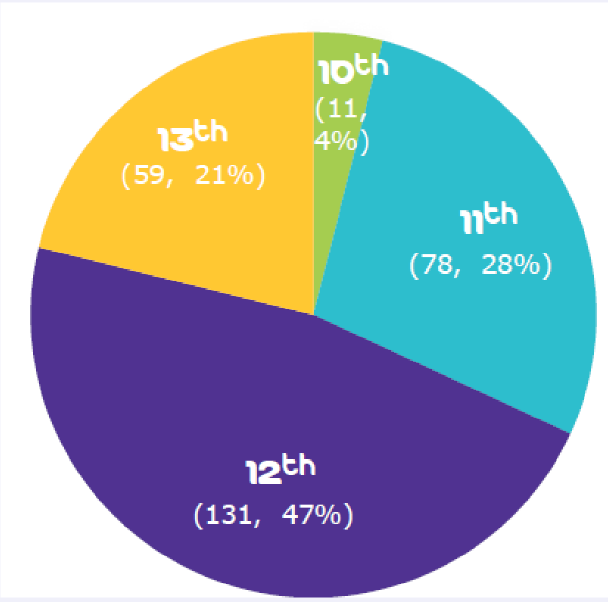
BENCHMARKING LEARN FROM THE BEST

Merck– A 350 years old family business, has 279 family members out of which 156 are partners in the holding company E. Merck KG. E. Merck KG owns 70 percent of Merck KGaA, the publicly listed arm. The family exercises influence on the business via the corporate governance structure. The family has had sophisticated governance mechanism for over 100 years now.



Family Members– 10th –13th generation

279 Family Members



The family and the company have survived for 13 generations, due to the following reasons:

- The interest of the company is given precedence before the family and its members
- A strong culture of ownership as trustees for future generations
- Modesty of the family (as a whole)
- History of unity, not of quarrelling
- Trust on management and staff
- Robust Family Business Governance
  - External managers at top level from 1920 onwards
  - Family members not entitled to work in the company
  - Strict separation of operational management and ownership
  - Family does not interfere with day-to-day business
  - Education program for family members
  - Democratically elected family board members

Source: Merck, Frank., 350 Years of Merck Family Business – Family and Corporate Governance, presentation at the 7th Asian Invitational Conference on Family Business, Indian School of Business, February 2-3, 2019

DO YOU KNOW?

During the post-independence and license raj era, although India had its share of family businesses in manufacturing, the number was small, and the size of the firms was small too. In fact, this happened to the extent that the average manufacturing firm in India in 1990 was 10 times smaller than its counterpart in the US. In spite of this, it was only in the late 1980s that the growth in services picked up (due to multiple internal and external factors) and prior to that, manufacturing was the natural way to go for most of the Indian businesses.

In terms of net sales, market capitalization and assets, there was a clear gap between the two sectors (manufacturing and services) in 1991, with services accounting for just 28, 17 and 25 percent of the total assets, market capitalization and net sales of the family firms, respectively. The advent of opportunities in services due to domestic policies and global demand narrowed the gap significantly in all respects.

	Total Assets			Market Capitalization			Net Sales		
	1991	**2018**	**CAGR**	**1991**	**2018**	**CAGR**	**1991**	**2018**	**CAGR**
Family Firms									
Manufacturing %	**72%**	**47%**		**83%**	**54%**		**75%**	**71%**	
Manufacturing	570,794	29,895,464	16%	305,162	39,218,315	20%	485,938	19,041,904	15%
Services	217,748	34,142,352	21%	63,450	33,193,492	26%	166,256	7,760,120	15%
Services (excluding bank-ing & financial services)	138,945	17,458,017	20%	34,813	23,230,721	27%	103,322	7,741,668	17%
Non-Family Firms									
Manufacturing %	**20%**	**7%**		**87%**	**39%**		**86%**	**73%**	
Manufacturing	587,620	11,312,069	12%	133,176	19,493,590	20%	625,355	14,110,051	12%
Services	2,363,935	159,498,150	17%	19,521	30,581,130	31%	105,584	5,218,929	16%
Services (excluding bank-ing & financial	312,433	11,441,729	14%	17,958	12,026,851	27%	103,014	5,216,207	16%

The dominance of State-owned enterprises in the banking and financial services sector (where these firms have had a traditional advantages due to monopoly and a large asset base) makes it imperative to remove the banking and financial services firms from the sample and then analyze the data for family and non-family firms. We find that today, family firms dominate non-family firms on all three fronts (total assets, market capitalization and net sales) in the remaining aggregated services sector.

Source: Bang, N. P., Ray, S., Bhatia, N. & Ramachnadran, K., "Family Businesses: The Industrial Evolution, 1991 - 2018", Thomas Schmidheiny Centre for Family Enterprise, Indian School of Business, Forthcoming.

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 sixteen 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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