Disintegrating Family Firm:
How Well Are You Prepared For The Ultimate?

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Many of you will recognize Hermes – one of the most exquisite luxury brands associated with women's handbags, jewelry or perfume. Few will know that Hermes is also one of the oldest family owned and managed firms in France. Founded by Thierry Hermes, a harness-maker, in Paris in 1837, Hermes until 2004 was alike most family managed firms - controlling the family stake and grooming leadership from within the family to retain control over firm's strategic direction. From 1978 to 2004, it was led by Jean-Louis Dumas great-great-grandson of Hermes, and credited for expanding into new crafts and establishing a global network of Hermes stores. With Dumas's death in January 2006, Patrick Thomas became the first non-family manager in Hermes 169 year history to take the position of CEO. Hermes, however, continued to be tightly controlled family firm and exhibit its family heritage:

"Hermes has continued to grow while remaining a family firm with a uniquely creative spirit that blends precision manufacturing with traditional craftsmanship."
[Hermes 2009 Annual Report]

In a surprise announcement on 23rd October 2010, LVMH-another French luxury conglomerate led by Bernard Arnault, famously known as king of the luxury jungle – claimed that it had accumulated a 17.1 per cent stake in the Hermes. Though about 20 percent of Hermes capital had been floated in 1993 to fund its expansion into retail, rest around 73 per cent was still controlled by the family. The identity of the seller was shrouded in mystery. No institutional shareholders were involved in the sale and rumors centered on a dissident member of the Hermes founding family.

The announcement led family to issue a statement claiming that the '*family was united*' and has a takeover bulletproof structure and numerous poison pills to thwart Arnault's attempts. Hermes however is facing the inevitable fate most extended or multigenerational family firms face: With more than 40 family members holding majority stake, Hermes had become too big with too many family members, some of whom perhaps were willing to cash out.

It is natural that as Indian family firms evolve, they are likely to face similar challenges of keeping the firm within the family and guarding family interests for the next generation. For more than twenty years, Professor Ramachandran has been studying how Indian families grow their business beyond three generations. He points out that as part of their evolution, other than business, families too must transform their family management capabilities.[1] In our recent joint research[2], Professor Ram, myself and our colleague Professor Joseph Lampel have concluded that in order to prolong their longevity, family firms need to proactively manage their family economic, expertise, reputation and attachment agenda (EERA).

Let me turn my attention to four questions you may want to reflect on and check if your family is paying attention to fostering family EERA?

(A) What is your family's long-term economic agenda? – In most family firms, the market and financial rationale for strategic decisions must be consistent not only with the strategic position of the firm, but also with the wealth they can generate for the family. Family firms can positively leverage this fusion of family and firm economic agenda to pursue growth initiative. However most family firms have their wealth tied up in the business, and as the families evolve and grow the need to put in formal mechanisms to preserve and nurture family's economic wealth and prevent family conflict over wealth multiplies. Sustaining family firms actively manage family wealth and take steps to loosen the coupling between family and business wealth.

(B) What is your agenda to nurture family expertise? – Firms invest in expertise as a means to improving strategic position. Sustaining families managing their family business, by contrast, are also intensely interested in investing in expertise of family members as a long-term effort to enrich the family's human capital. However, most have not perfected the approach to nurturing family expertise. At the one end, there are family firms where family members are groomed from a very young age. At the other, there are family firms, where family member end up pursuing careers outside the family firms since the family had no approach towards proactively nurturing family talent.

(C) Are you working toward extending family's reputation? – Research suggests that firms see reputation as primarily an asset with market and financial implications. Family firms must remember that sustaining families, by contrast, see reputation more broadly as having impact on the social and political standing of the family with significant impact on the family's ability to forge alliances and influence the political environment.

(D) Have you put formal and informal governance mechanisms to instill family affiliation? – Firms are usually concerned with psychologically and socially binding employees to the organization. For sustaining family firms the need to bind family members to the business is even stronger. As family firms evolve from being founder-controlled to sibling partnership to cousin consortium, the pressure to maintain ties grows. To counteract ownership fragmentation and go-it-alone opportunism as may be emerging in Hermes; families must reinforce mechanisms that bind the family to the firm. Formal consultation and a family charter are commonly used to achieve this, but senior family members will also reinforce ties by encouraging family celebrations and get together.

Though LVMH has been able to acquire substantial stake in Hermes, and Hermes family is in spotlight, it is without doubt an example of sustaining family business. For six generations, Hermes like Indian Muruguppa Group managed to sustain the family EERA, and may be able to ride over the current turmoil. After all it benefits from being an SCA, or Societe en Commandite par Actions, a French corporate structure enabling family that owns a business to keep control of decision-making even if they become minority shareholders. Having said that it will need to revisit how it embeds EERA agenda in the family to retain it as a true family firm.

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[1] Ramachandran, K. (2010) Indian Family Businesses: Survival Beyond three generations. Indian School of Business (ISB) Working Paper.

[2] Bhalla, A. Lampel, J. and Ramachandran, K (2010). Resource Allocation and New Venture Creation within Indian Family Firms. Indian School of Business (ISB) and Cass Business School Working Paper.