ISB | Thomas Schmidheiny Centre for Family Enterprise

Family Business Briefs

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Welcome!

*I am delighted to share with you the next issue of our bimonthly publication, '**Family Business Briefs**.' This issue contains some thought-provoking ideas, facts and figures about family businesses that you may find noteworthy. The Briefs has the following sections:*

- *Summaries of research articles on **Family Firm Innovation, International Entry Modes,** and **Financing Business Expansion***
- *Summary of a family business case on **Lupin Limited***
- *Inspirations from the life of **Govindram Seksaria***
- *Interesting insights on **Single Family Offices***
- *Infographic on the **Gender Diversity in Firms***

We hope that you will find these interesting.

As always, 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
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ARTICLE SUMMARY

Does Knowing "Who Knows What" Matter for Family Firm Innovation? Insights from Transactive Memory System Theory

- Kristen Madison, Joshua Daspit and Emily Garrigues Marett

Innovation is crucial for transgenerational success of family firms. Extant research has largely focused on firm-level factors affecting innovation, such as, successor capabilities, resource allocation and strategic controls. At the family level, innovation is viewed from the theoretical lenses of entrepreneurial legacy, imprinting, and socioemotional wealth. However, in this study, the authors investigate the interdependence of family and non-family employees, their communication process and knowledge structures to comprehend the process of firm innovation. For this, they conducted a survey of 93 respondents comprising CEOs, and family/non-family employees of 31 US family firms. This summary briefly describes the study.

Family Firm Innovation

Family firms differ from non-family firms in multiple ways. They have distinct goals, behaviors, orientations, resources and governance structures that can influence innovation process and outcomes. Common culture, shared goals and cooperation in family firms aid innovation. Human and social capitals are essential inputs that foster innovation. Non-family employees supplement family employees of the firm through their diverse knowledge and expertise. Hence, family firm innovation is dependent upon the individual and group-level dynamics that enhance the contribution of resources.

Transactive Memory System (TMS)

TMS helps us understand how information is gained from external sources and converted into knowledge that directs our actions. There are two core components of TMS, namely the *cognitive process* and a *cognitive structure*.

The *cognitive process* comprises knowledge that was collectively encoded and stored before performing a task. This primarily happens through communication. The *cognitive structure* refers to the repository of knowledge gained through everyone's unique knowledge. It depicts the "*understanding of who knows what*."

Cognitive Process, Structure and Innovation

Communication (*Cognitive process*) is essential for efficient operations, increase in productivity and overall well-being of the organization. Regular communication fosters sharing of knowledge between employees which facilitates firm innovation. Hence, the authors hypothesize that communication between family and non-family employees enhances innovation in family firms. The presence of knowledge resources alone is not sufficient to realize the maximum innovation potential. The shared "*understanding of who knows what*" (*Cognitive structure*) is crucial for firm innovation. Therefore, the authors hypothesize that shared understanding of knowledge resources among employees facilitates firm innovation. Data analyses confirmed the authors' hypotheses.

Practical Implications

- Family businesses need to understand the factors that foster or impede firm innovation.
- Communication is the key: Leadership must promote shared understanding of knowledge resources among family firm employees.
- Understanding the cognitive processes and structures would help family business leaders in strategically leveraging the resources essential to foster innovation at the firm level.

Source: *Family Business Review, (2021), pp. 168-192, Vol:34, No:2*

The Ownership Structure Contingency in the Sequential International Entry Mode Decision Process: Family Owners and Institutional Investors in Family-Dominant versus Family-Influenced Firms

- Kai Xu, Michael A. Hitt and Stewart R. Miller

Internationalization is crucial to business growth and expansion. *International Business* scholars have studied the factors affecting the entry mode choices of firms. However, such studies with respect to heterogeneous family firms remain unexplored. In order to address this knowledge gap, the authors examine how family firm ownership structure shapes entry mode decisions in their internationalization. For this, the authors studied 63,932 foreign subsidiaries in 51 different countries and regions over a period of seven years. This summary briefly explains the study.

Entry Mode Choice: Sequential Decision-Making

The entry mode choices are made through the assessment of returns and risks. Each entry mode such as contracts, Joint Ventures, Partially-Owned Subsidiaries (POS) and Wholly-Owned Subsidiaries (WOS), have their own risks/returns. The authors theorize that family businesses unbundle this complex process using ***sequential decision-making***. In the first stage, family firm decision-makers select a focal criteria and eliminate the options that do not meet it. In the second stage, tradeoffs are considered and a satisfactory entry mode is chosen from rest of the options.

First Stage of Entry Mode Decision

In firms where family ownership is the largest *(i.e., family-dominant firms)*, family goals supersede the financial goals. Family goals emphasize family values and preservation of the family's socioemotional wealth (SEW). These firms are also sensitive to financial risks as family leaders mostly use internal resources to fund their major investments. Hence, the family-dominant firms prefer entry mode choices that have lower financial risks. The authors hypothesize that in the first stage, family dominant firms choose POS than WOS. In contrast, firms in which institutional investors are the largest shareholders and family share-holders are second-largest *(i.e., family-influenced firms)*, profit-maximizing strategies are encouraged. The institutional investors are relatively risk-neutral as they diversify their investment portfolios. Their motivation to maximize earnings drives them to choose full equity ownership. Hence, the authors suggest that family-influenced firms are more likely to choose WOS compared to POS.

Second Stage of Entry Mode Decision

In family-influenced firms, institutional investors are more willing to compromise in second stage, when their focal criteria of financial returns is met in the first stage. Family owners being the second-largest shareholders can accommodate their SEW goals as a secondary criteria. As acquiring a business reduces the threat to SEW, the authors hypothesize that family owners influence institutional investors thereby selecting *acquisition* as the entry mode choice. The statistical data analysis confirmed the hypotheses made by the authors.

Practical Implications

- Family firms must understand the critical role of ownership structure and family goals in determining their internationalization process.
- Two-stage sequential decision-making based on focal and non-focal criteria can help family firms optimize their entry mode choices while ensuring institutional investors' support.

;***Source:*** *Journal of International Business Studies (2020), Vol. 51, No. 2, pp. 151-171.*

ARTICLE SUMMARY

Family Business Group Expansion through IPOs: The Role of Internal Capital Markets in Financing Growth while Preserving Control

- Ronald W. Masulis, Peter K. Pham and Jason Zein

Firms choose different ways to finance their expansion. In developed markets, firms sell shares through seasoned equity offerings (SEOs), while emerging market businesses launch initial public offers (IPOs) to fund investment opportunities of their divisions or subsidiaries. Though SEOs are extensively studied in extant literature, knowledge about funding choices that create a business group structure, remains limited. In that pursuit, this paper examines why a Family Business Group (FBG) chooses IPOs over SEOs as a funding option. To study this, the authors use data of 12,793 IPOs from 44 countries over a span of 10 years. This summary succinctly describes the study and its implications.

SEOs versus IPOs

SEOs are issued to fund a new project that is a part of an existing public enterprise. In contrast, IPOs are issued for a new public firm, distinct from the existing business entity. If SEO is issued by a family firm, it results in proportionate dilution of family control over the business. In contrast, when the expansion is implemented by creating new firms, which are funded through IPOs, a large amount of equity can be raised without loosing family control rights. Minority investors prefer IPOs as they are benefitted by intangible, family-specific assets such as networks, and reputation. However, in order to secure investors, IPOs need to be backed by cash flows. Also, emerging market investors only prefer IPOs of large firms with high levels of insider control.

Control Retention of FBGs

Family business groups seek control over their firms as they aim to deploy their family values over a long period of time and nurture transgenerational leadership succession. However, as the need to fund business growth surmounts, family firms look for options that help them retain control over the business. Funding options such as, debt and non-voting shares have higher costs. Therefore, the authors suggest that FBG firms are more likely to launch IPOs (than SEOs) when they wish to expand the business without loosing control.

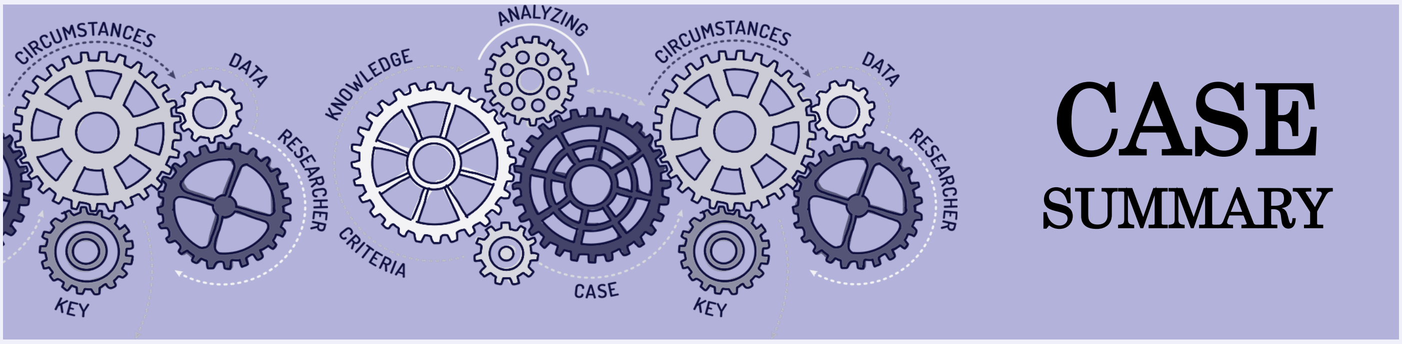
Internal Capital Market of FBGs

Minimizing the conflict between loosing control and reducing the costs of an IPO requires internal capital markets. The groups can utilize their internal capital to incubate high-risk projects. Once these businesses reach a substantial size and begin to generate cash flows, FBGs can take those to the market and seek public funding. Backed by FBG support and credible performance record, investors are more likely to be ready to fund these firms. Hence, the authors hypothesize that FBG firms with higher internal capital are more likely to be active in taking their firms public. Data analysis confirmed the authors' hypotheses.

Practical Implications

- Family firms must gain in-depth understanding of all the alternatives available to fund their investment opportunities with external equity.
- Understanding the pros and cons of SEOs and IPOs enables family business leaders to make appropriate strategic funding choices.
- It is crucial for family business leaders to know when to use internal capital to incubate FBG projects and how to strike a balance between family control and business growth.

Source: *Management Science (2020), Vol. 66, No. 11, pp. 5191-5215.*



Nurturing the Transgenerational Growth of Lupin Limited

Lupin Limited is a major pharmaceutical company in India. It was established by Desh Bandhu Gupta at Mumbai in 1968. DB Gupta was a professor of Chemistry at Birla Institute of Technology and Sciences (BITS), Pilani, Rajasthan. He moved to Mumbai in 1960s with an intention to start his own enterprise and to utilize science for his country by improving healthcare. Lupin had modest beginnings. DB Gupta borrowed 5,000 INR from his wife, as seed money to start the company.

Later, with financial support from banks, they started manufacturing folic acid tablets for the women and children welfare programme of the Indian government. Subsequently, Lupin began to make anti-Tuberculosis (TB) drugs. Within a short span, it was counted among the world's largest anti-TB drug makers. This drug category constituted 36% of Lupin's annual sales. In 1988, the Lupin Human Welfare and Research Foundation was founded for the development of under-privileged communities.

Lupin established a joint venture in Thailand in 1989. Since then, the company's focus remained on expanding its global operations. Lupin made several acquisitions aimed at strengthening its strategic position in both, branded drugs and generics segments of the global pharmaceutical market.

In its growth journey, Lupin faced numerous challenges. The largest pharmaceutical market, i.e., the USA, was highly competitive and regulated. Hence, the company focused on product differentiation and entered only with four products. For a long time, Lupin only focused on one anti-TB drug, Rifampicin, which had low profit margins due to regulated pricing. There were failures in diversification strategies. These lead the company into huge debt. In 2003, DB Gupta professionalized the company and appointed an experienced non-family professional at the leadership position. He revived Lupin's corporate governance mechanisms and drafted a succession plan.

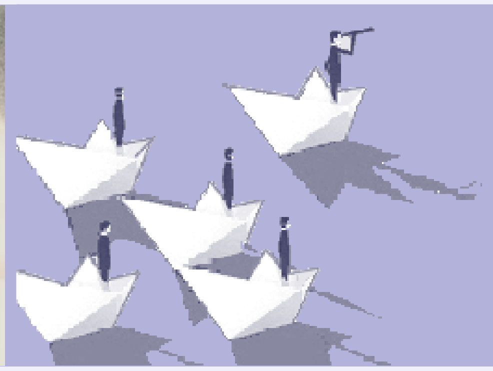
In 2017, DB Gupta passed away five years after handing over reigns to his eldest daughter Vinita Gupta and son Nilesh Gupta. Presently, Lupin is professionally managed under the leadership of Vinita and Nilesh. Vinita manages the overseas operations, while her brother takes care of India operations. Vinita is an MBA from Northwestern University and Nilesh has an MBA from the University of Pennsylvania in USA. Vineeta played a very important role in globalization through acquisitions. She recalls that as a teenager, she thought of nothing else but to build the company globally based on her father's foundations. Now, Lupin is the 10th largest generic pharma company in the world, with presence in over 100 countries. Vineeta says that she already has a plan to steer the company on a fast growth track and as a family, they aim to achieve their father's dream of eradication of TB from the world.

Learnings for Family Businesses

The key takeaways from the Lupin case are:

- Family businesses must nurture strong foundation and self-belief as they develop a capable next-generation leadership.
- Family businesses should transform with the changing times but must remain deeply rooted in the core values of the founder.
- As family businesses grow, they must build on their strengths and carve a niche as they internationalize the business.

Source: *Lupin founder DB Gupta, a self made maverick who wanted to take TB out in India, dead, The Economic Times (June 27, 2017).*



FAMILY BUSINESS LEADER

Govindram Seksaria

(1888- 1946)

Govindram Seksaria was an Indian businessman born in 1888 into a Marwari family in Nawalgarh, Rajasthan. He lost his parents at an early age. Since then, he took the responsibility of his five siblings. In 1905, he moved from Nawalgarh to Bombay (now Mumbai). He started his career as an operator on the Bombay Cotton Exchange. Struggling through the British rule that did not encourage growth of indigenous businessmen, Seksaria continued to progress. Within a few years, the Cotton Contract Board accepted his membership and he became one of the initial members of the East India Cotton Association.

Following his success in cotton, Seksaria began trading bullion and other commodities. He also entered into the Bombay Stock Exchange and other stock exchanges across India. He became a founding member of the Indian Stock Exchange. In 1934, Seksaria became a member of the New York Cotton Exchange, which was a rare achievement for an Indian in those days.

Seksaria then turned from a trader to an industrialist. In 1937, he started manufacturing edible vegetable oil and later diversified into sugar, textiles, minerals, mining, printing, real estate, and banking. He founded the Bank of Rajasthan in 1943. He acquired several firms including large textile mills in Bombay. His trading activities complemented his industrial ventures. Due to his trading acumen Seksaria was able to secure low prices for inputs required by his factories. This ensured high levels of profit for his manufacturing businesses.

Seksaria remained rooted to his origins as an intuitive trader and speculator. Industry gave him added prestige and influence. The Oakland Tribune wrote about him, "*The Bombay Cotton Exchange is a colourful market loaded with speculators and…..Mr Seksaria is the most popular of the lot. He has the Bombay cotton market in the palm of his hand.*" Seksaria could track the prices across continents to clinch the trade, even though he could not speak English and there was no internet or analyst reports from research outfits in those times. A daily call from New York that provided trading updates and analysis from the East India Cotton Association, were his key inputs for deciding trade deals.

Seksaria donated liberally to the freedom movement of India. In addition to his industrial and trading empire, Seksaria also supported hospitals and educational institutions, which was continued by his son. The Govindram Seksaria Educational Society established Shri Govindram Seksaria Institute of Technology and Science and Govindram Seksaria Institute of Management and Research. He pioneered girls' education in an era when few others did. He was the principal donor in the establishment of the Bombay Hospital.

Known as the Cotton King of India, Seksaria was among the most successful industrialists of pre-independence India. He died in 1946 at the age of 58. As a tribute, all the major markets in Bombay, including the bullion exchange, cotton exchange and stock exchange remained closed on his death. Sekhsaria did not speak English or Hindi and hailed from the tiny village, yet he managed to awe the sophisticated traders in Liverpool and New York Cotton Exchanges. His life exemplifies entrepreneurial risk-taking ability, keen eye to spot the right opportunity and employing profits for societal welfare.

Source: *Merchant, M. (2019). Govindram Seksaria: The Untold Saga of an Emipre-Builder, Amaryllis-Manjul Publishing, New Delhi.*

BENCHMARKING

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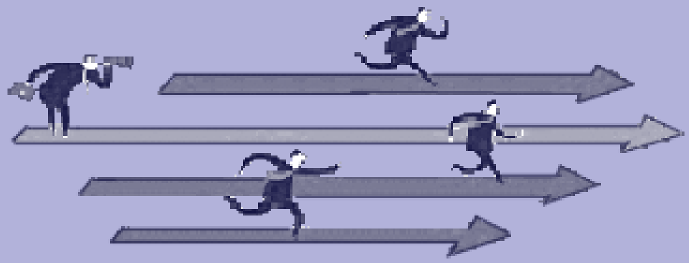
FROM THE BEST



Single Family Offices and Common Mistakes

"Family offices are becoming more common in India as business owners and serial entrepreneurs understand that their hard earned wealth needs a mix of protection and opportunity for further growth. Besides investing, family offices also help the family/UHNWI in areas like succession and family governance, estate planning, philanthropy and social impact investing."…. Munish Randev, Founder & CEO, CERVIN Family Office & Advisors.

An e-book released by Cervin Family Office & Advisors in July 2021 shares the learnings from the Indian Single Family Offices, especially the common mistakes many families make while structuring or managing their family offices. Among others, some of the mistakes that stand out from the e-book are as follows :-

Mistake 1: *Lack of comprehensive planning*: "*Speed to market*" and lack of clarity on the expectations from the family office.

Mistake 2: *Lack of adequate resources to support the family office*: Co-opted teams (with employees from the corporate office) and inadequate experience in many areas of investment management.

Mistake 3: *Human resource mismatch*: Mismatches in skills, expertise and experience can be disastrous for the family office.

Mistake 4: *Trying to in-house most of the investment classes*: Family offices should think of themselves as wealth allocators and not fund managers.

Mistake 5: *Lack of deep due diligence capabilities*: The biggest error made by many offices is to have a very superficial approach to product due diligence which lacks depth and hence the necessary understanding of the risks, fitment and performance measurement and attribution.

Mistake 6: *Not having a robust risk management system*: Lack of importance given to the risk intelligence and analytical function often leads to portfolio loses or periods of sharp volatility and distress.

Mistake 7: *Choosing the wrong advisors*: Working with a wrong advisor can really harm the family's well-being.

Mistake 8: *Entering an asset class without any plan or strategy*: Inadequate planning for each asset class can often lead to a reactive portfolio just made up of random opportunities.

Mistake 9: *Not structuring the office to satisfy all the family members*: The mistake that some families make is to have just one central family office pool which is managed using one policy and without any specific adjustments suited to the needs of individual family members.

Mistake 10: *Not having a succession plan for the family office*: A family office is built to ensure family's financial sustainability and hence needs to have its very own continuity plan.

These common gaps have been witnessed by the CERVIN team while advising 85 large family offices over the last 7 years. While this list is not exhaustive, it will help the growing ecosystem of family offices, which is an important support for continuity in family businesses and serial entrepreneurship.

Source: *Single Family Offices – Common Mistakes, Cervin Family Office & Advisors Private Limited, 2021.*

DO YOU KNOW?

Gender Diversity is an important goal for businesses across the globe. Many countries require corporate entities to appoint women directors on their boards. Few other countries nudge the firms or have suggested the firms to have gender diversity policies. In the tables below, we see the share of female managers and women on boards in the largest publicly-listed companies in some of the major economies across the world. We find that while the percentage of women on boards of large firms has improved over the years, the share of female managers have remained more or less stagnant for most countries. Hence, there is a long way to go for the trickle down effect of gender diversity to happen, across all levels of the organisation. Though women's participation has increased in recent years, family firms need to proactively improve their gender mix.

Share of Female Managers (%)

Country | Year >	2011	2012	2013	2014	2015	2016	2017	2018
France	38.7	38.7	35.4	32.1	31.1	32.4	32.9	33.8
Germany	29.7	28.2	28.5	28.6	29.0	29.1	29.2	29.2
Italy	24.7	25.6	26.6	26.2	26.1	27.2	27.1	26.6
Luxembourg	23.8	17.8	14.6	22.1	17.9	17.5	18.2	24.0
Norway	32.9	33.6	34.2	35.4	35.9	37.7	38.1	35.4
United Kingdom	34.2	34.0	33.6	34.9	35.0	35.7	35.9	36.0
United States	38.3	38.3	37.9	38.0	38.5	38.8	39.5	39.8
OECD - Average	31.1	31.1	30.9	31.3	31.4	32.0	32.1	32.4
Non-OECD Economies								
Brazil	36.0	36.6	36.7	37.3	38.0	38.4	38.5	38.1
China	25.3	25.8	26.3	26.8	27.3	27.8	28.0	28.4
Costa Rica	33.9	28.6	36.3	31.7	27.9	31.8	34.7	32.0
India	12.0	12.3	12.3	12.4	12.5	12.6	12.7	12.7
Indonesia	23.2	22.4	24.9	26.9	25.8	26.5	27.1	27.7
Russia	43.0	42.6	41.7	41.4	42.1	42.0	41.3	41.8
South Africa	30.3	30.5	29.5	30.7	30.4	31.3	31.9	30.4

Female share of seats on boards of the largest publicly-listed companies (%)

Country | Year >	2011	2012	2013	2014	2015	2016	2017	2018
France	21.6	25.1	29.7	32.4	35.6	41.2	43.4	43.9
Germany	15.2	17.9	21.5	24.4	26.1	29.5	31.9	33.8
Italy	5.9	10.8	15.0	24.1	28.6	32.3	34.0	36.4
Luxembourg	5.6	9.7	11.3	11.7	12.1	12.9	12.0	13.3
Norway	41.3	43.7	42.0	37.6	38.8	42.6	42.1	40.2
United Kingdom	16.3	18.8	21.0	24.2	27.8	27.0	27.2	29.9
United States	..	..	..	..	..	20.3	21.7	23.4
OECD - Average	..	..	..	..	..	21.2	22.3	23.7
Non-OECD Economies								
Brazil	..	..	..	..	..	5.8	8.4	8.0
China	..	..	..	..	..	8.5	9.7	11.1
India	..	..	4.9	5.5	12.6	12.8	13.8	14.0
Indonesia	..	..	..	..	..	2.8	3.3	3.3
Russia	..	..	..	..	..	6.8	7.0	9.2
South Africa	..	..	..	..	..	18.7	21.4	24.6

Source: *Data extracted on 09 Oct 2020 06:15 UTC (GMT) from OECD.Stat*

Indian School of Business

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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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