ISB | Thomas Schmidheiny Centre for Family Enterprise

Family Business Briefs

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Welcome!

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

- *Summaries of research articles with practical implications on **Managing Identity and Strategic Change, New Venture Survival, and Firm Acquisitions***
- *Summary of a published family business case on **Emami***
- *Inspirations from the life of **B. M. Munjal***
- *Interesting insights on **Hilti Corporation***
- *Infographic on **Pledging of Shares***

We hope that you will find these interesting and inspiring.

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,
Professor & Executive Director,
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ARTICLE SUMMARY

Dealing with Revered Past: Historical Identity Statements and Strategic Change in Japanese Family Firms

- Innan Sasaki, Josip Kotlar, Davide Ravasi, and Eero Vaara

Businesses may need to periodically craft a new corporate philosophy, mission and strategy to remain relevant with times. A family firm rooted in traditional values and revered past has a strong historical identity. Therefore, changing strategies and identities that depart from their historical trajectory is very challenging for these firms but this phenomenon is not well-understood. Hence, to examine how family firms with strong historical identities accommodate strategic change, the authors studied 21 Japanese family firms. This summary presents the key findings and implications of the study.

Organisational Identity and Strategic Change

Vision, mission, core values and corporate philosophy are the strategic identity statements for a firm. These statements define the organizational identity in terms of who they are and the values they represent. In the family firm context these identities and values can be deeply embedded. However, businesses operate in a dynamic environment that evolves with time. This may require firms to implement strategic changes and adopt new identities relevant to their contemporary context. Managers face a decision tension in such situations: i.e., choosing between which identity/ values/ strategies to change and which of those to be retained.

Strategies to Manage Historical Identity and Change: Key Findings

The comparative analysis of 21 Japanese family firms revealed three distinct strategies that family firms may use to preserve a connect between their past identity and contemporary strategic context. These are the following:

1. Elaborating: This strategy is to maintain the continuity of historical identity by presenting the current strategic change as an update or development over the past. This is employed where the change in strategy is incremental in nature, ***2. Recovering:*** This involves formulation of new identity statements (divergent from previous ones) that support the strategic change. To establish legitimacy of the new strategic change, some historical references are retrieved and re-used to establish the connect with firm history, and ***3. Decoupling:*** This strategy is to have original identity statements along with the new identity statements that uphold different values or norms. The two statements co-exist and address different domains.

Practical Implications

The study has implications for family firm that plan to implement strategic change:

- While implementing change, family firms can retain their core values and identity. Link with past identity can be carefully calibrated according to the shift desired from the past.
- By adopting one of the three strategies suggested in this article, family businesses can resolve the tension between maintaining continuity and implementing change.
- These strategies help them develop and deliver coherent messaging about "who we are" to their target groups and retain their connection with the past.

Source: *Strategic Management Journal (2019), DOI: 10.1002/smj.3065.*

ARTICLE SUMMARY

Many Roads Lead to Rome: How Human, Social, and Financial Capital are Related to New Venture Survival

- Christian Linder, Christian Lechner, and Frank Pelzel

New venture creation is largely driven by the idiosyncratic convictions of the founders and their access to resources. However, the initial resource base that enables a founder to identify a business opportunity may not be sufficient to ensure the survival of the venture. This study analyzes panel data of 670 start-up ventures in USA and Australia to understand the resource base that a founder needs for venture survival. This summary succinctly presents the study and its implications for family entrepreneurship.

Forms of Capital and New Venture Survival

Subjectivist theory of entrepreneurship says that identifying and pursuing a business opportunity, i.e., new venture creation, depends on the founder's subjective preferences and the available resource base. However, founders may use or combine those resources sub-optimally. This may affect venture survival.

The authors posit that three forms of capital are required for venture survival: ***1. Human Capital (HC):*** It comprises the subjective skills and knowledge that leaders, managers and employees accumulate through training and experience, ***2. Social Capital (SC):*** It comprises the resources embedded in the founder's social relationships and networks that can be mobilized for the venture, and ***3. Financial Capital (FC):*** It is the capital available for the venture. However, it can also be converted into other resources.

The main objective is to determine what combination of these three capitals can ensure new venture survival.

Pathways to New Venture Survival

The statistical analysis of data from 670 ventures revealed the following pathways to new venture survival:

1. None of the three capitals (i.e., HC, SC, and FC) are singularly sufficient for venture survival, instead, venture survival requires specific resource-bundle configurations
2. Resources required to identify opportunity are not sufficient for its exploitation
3. Financial capital alone is not very useful at the initial stages of venture creation
4. High human and social capital and low competition is the configuration that contributes to venture survival, and
5. Multiple forms of human capital (i.e., a diverse set of capabilities) are essential for new venture survival

Practical Implications

The study has important implications for family businesses. Family entrepreneurs need to understand that the resource bundle required for opportunity recognition is different from the one needed for opportunity exploitation.

Only having financial capital is not sufficient for new venture survival. Strong social network connections and access to high quality human resources, enriched with a varied set of capabilities, are more critical resources for a new venture to survive.

The study also helps venture capitalists and start-up investors in assessing the strength of the resource bundle of a venture and its probability to survive.

Source: *Entrepreneurship Theory and Practice (2019), DOI: 10.1177/1042258719867558*

Firm Acquisitions by Family Firms: A Mixed Gamble Approach

- Katrin Hussinger and Abdul-Basit Issah

Family firms are known to be loss averse since they aim at preserving socioemotional wealth (SEW). Therefore, they are reluctant to undertake risky activities, such as, research and development and firm acquisitions. However, firm acquisition is a strategic option that may help them gain competitive advantage and long-term benefits. Based on 423 acquisitions made by 225 US firms during 1980-2010, this study examines how family firms manage the trade-off between SEW preservation and financial wealth creation and probes their post-merger performance. The study design, its findings and implications are briefly discussed in this summary.

The Notion of Mixed Gambles and Acquisitions

Family firm decisions involve two dimensions of value: ***1. Socioemotional wealth***, and ***2. Financial wealth***. Often, the gains on one dimension are associated with losses on the other. Strategic decisions by family firms, like, firm acquisition, turn into "mixed gambles," i.e., gamble with outcome of gains and losses. Acquisition in an unrelated area is considered risky because of unfamiliarity. However, acquisition in related business area promises synergies and familiarity with know-how. Hence, in related acquisitions, the potential gains and losses of both SEW and financial wealth are amplified. This increases the salience of mixed gamble scenario and helps in gaining a better understanding of strategic considerations driving family firm acquisitions.

The Mixed Gamble of Related Firm Acquisitions

The authors posit that the following strategic considerations shape family firm acquisitions:

1. Related acquisition complements the family firm's core business capabilities and provides SEW gains, which non-family firms do not account for. Hence, ***family firms are more likely to make related firm acquisitions than non-family firms***.

2. Acquisitions require large funding hence, ***financially healthy family firms are more likely to make related firm acquisitions than family firms in a financial deficit***.

3. Due to their desire for control and superior willingness for long-term gains ***family firms with healthy performance are more likely to make related firm acquisition than well performing non-family firms***, and

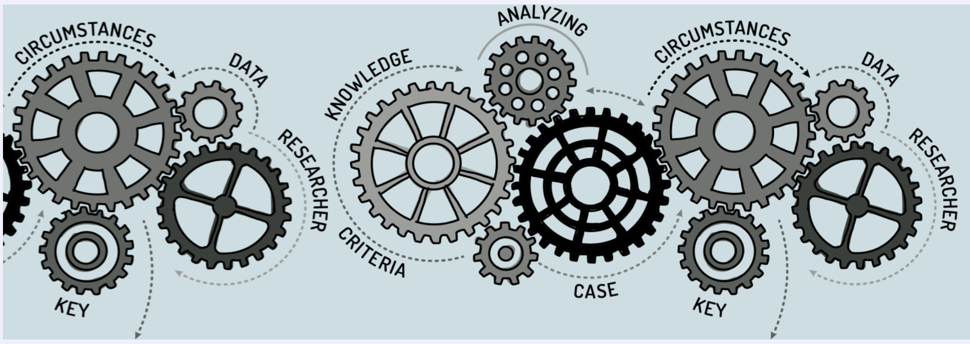
4. Family firms strengthen their core business and value and benefit from long-term SEW gains, while non-family firms put less emphasis on long-term financial and SEW benefits. Hence, ***well-performing family firms are more likely to make higher performance gains from the merger than well-performing non-family firms or poorly performing family firms.***

Data analysis supported all these hypotheses.

Practical Implications

While making acquisitions, family firms need to carefully weigh the short and long-term SEW and financial benefits. Especially for related acquisitions the potential short-term losses can be compensated with long-term gains. Hence, family firms need to assign more weight to long -term SEW gains in their acquisition decisions.

Source: *Family Business Review (2019), DOI: 10.1177/0894486519885544.*



CASE SUMMARY

The Emami Mission to the Next Orbit

- Navneet Bhatnagar and Kavil Ramachandran

The two founders of Emami Limited, Radhe Shyam Agarwal (Mr. Agarwal) and Radhe Shyam Goenka (Mr. Goenka), had guided the company from its humble beginnings in 1974 with an initial investment of INR 20,000 to become one of India's leading FMCG firms in 2013-14 with a sales turnover of INR 1.8 bn. The two co-founders shared a common background and bonding since childhood. They had complementary skill sets and an entrepreneurial zeal that became the potent mix for Emami's success. Mr. Agarwal was the chief strategist and aggressive go-getter whereas Mr. Goenka was the level-headed execution specialist and provided the financial knowhow to the organization.

The company started in the area of cosmetics and personal care beauty segment and later diversified into ayurvedic formulations, nutraceuticals, paper, real estate and constructions through inorganic growth strategy. Though the personal care industry was dominated by foreign brands, Mr. Agarwal and Mr. Goenka identified huge potential among middle income consumers in the urban and rural markets who could not afford the expensive foreign brands. Emami launched products in small pack sizes to cater to the needs of price-sensitive buyers. They invested in laying down an extensive rural marketing and distribution network. They adopted the then innovative marketing strategy of celebrity endorsements to increase penetration in these underserved markets.

The founders were cognizant of the need to groom the next generation for continuity of the business across generations. The next generation of both the co-founders shared strong bonding and camaraderie through shared childhood experiences. They were groomed and inducted into the business early on. The next generation worked with a shared leadership model, where one member of each family worked together on key verticals. Emami professionalized business operations, hired non-family professional experts and asked them to lead key business functions. It also hired external advisors and independent directors on the board.

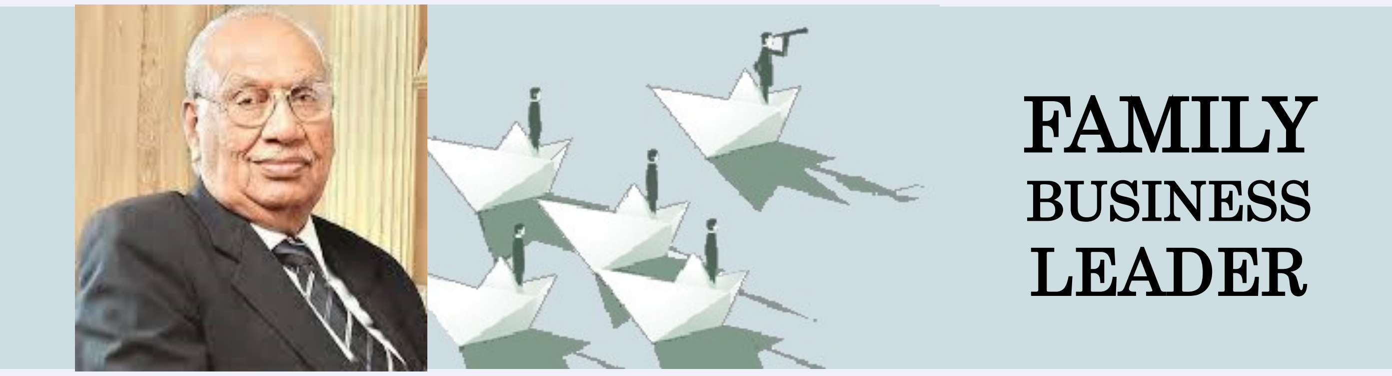
However, the founders were now faced with two critical decisions: 1. successor planning and selection, and 2. institutionalization of family and corporate governance mechanisms to ensure long-term sustenance. Succession decision was challenging since all the next generation members were equally qualified and had proven leadership capabilities.

Learnings for Family Businesses

This case describes the challenges family firms face in managing growth and succession planning. More so, when next-gen members are all equally capable. Key takeaways:

- It is crucial to manage growth challenges through professionalization of operations.
- Timely succession planning is critical for family firms. The incumbent leaders may adopt a shared leadership model, especially when there are multiple contenders with similar experiences and capabilities.
- Family governance mechanisms such as, the family council and constitution are likely to aid in family business sustenance.

Source: *The Emami Mission to the Next Orbit (2020), Sage Business Cases, Authors: Navneet Bhatnagar and Kavil Ramachandran*



Brij Mohan Lall Munjal
(1923 - 2015)

Born in simple middle-class Arora / Khatri family to Bahadurchand Munjal in Kamalia, Lailpur district (part of Pakistan before independence), Brij Mohan Lall Munjal (BML) was married to Santosh Munjal. They had four sons and one daughter.

After completing formal education at the age of 20, BML moved to Amritsar along with his family. He started working at the Ordinance Factory. Thereafter, he started a bicycle components business along with his four brothers. Later, the company successfully bid a tender announced by the Government of Punjab to manufacture bicycles. They got the license to make bicycles. With own capital and Rs 6 lakhs given by government, the group started making cycles under the brand name “Hero”. Hero Cycles soon became a name to reckon with and Munjal and his brothers helped create an entire cycle manufacturing ecosystem in Ludhiana.

By 1975, the Hero group became India’s largest bicycle brand and by 1986 it became world’s largest bicycle maker. In 1984, the company started a joint venture with Honda Motor to manufacture motorcycles and soon overtook market leader Bajaj Auto to become India’s biggest two-wheeler manufacturer. BML’s story is that of an entrepreneur who dreamt big and didn’t flinch from taking risks. As an entrepreneur he believed in his dreams and went on to nurture them.

In 2011, Hero parted ways with Honda to chart its own course. “Our primary goal was never profit, but total devotion to the customer”, he said. Munjal remained the guiding force for the top management for a few more years before handing over the chairmanship of the company to his son Pawan Munjal, 62. In mid-2015, he stepped back to become chairman emeritus.

A self-educated entrepreneur, BML repeatedly built businesses that went on to become world leaders in their respective segments. He believed that success inevitably follows if one works hard and treats people well. The management practices he followed made him popular among employees, dealers or vendors.

He was a highly respected businessman not only for building a large business empire but also for valuing each person he met. His rise from manufacturing bicycle components to making bicycles and then entering the big league with the Honda joint venture to produce motorcycles and scooters, is legendary.

BML received the Padma Bhushan in 2005, ranked 27 on Forbes Asia’s 2015 India Rich List and won the Forbes India Leadership Award for Lifetime Achievement in 2014.

His competitors too adored him. Bajaj Group Chairman Rahul Bajaj, for instance, called him his ‘guru’ and looked up to him for his wisdom and common sense. He was, indeed, a hero in every sense of the word.

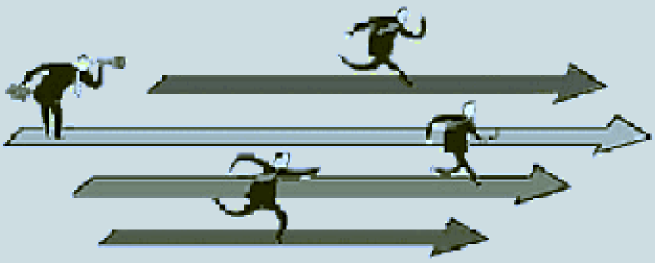
Source: *https://www.bhaskar.com/news/life-journey-and-interesting-stories-about-hero-motocorps-brijmohan-lall-munjal--5450870-NOR.html*

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

https://www.outlookindia.com/magazine/story/brijmohan-lall-munjal-1923-2015-pawan-kant-munjal-hero-group/298648

https://www.entrepreneur.com/article/252426

http://www.forbesindia.com/article/india-rich-list-2016/remembering-brijmohan-lall-munjal-the-value-creator/44679/1



BENCHMARKING LEARN FROM THE BEST

The Hilti Corporation was founded by Martin Hilti in 1941 in Liechtenstein, a Central European country. Starting as a fastener manufacturer, Hilti was a market leader in power tools, anchors, drills and laser products. It was completely privately held. Martin Hilti established the Martin Hilti Family Trust in 1980 and transferred all the family shares to the trust. Family members, the beneficiaries of the trust, also signed a heritage document stating that they would never inherit the shares but would only benefit from the financial results and performance of the trust. The idea was to make sure that the family members were well protected financially, but that the company was also protected from ownership-related disputes. The trust ensured continuity, not just for the family but also for the company

Early 1960s	• First consideration within testamentary clauses
1967	• Formation of a foundation with the aim to become active in case of death of Martin Hilti Sr.
1980	• Formation of a trusteeship (Martin Hilti Family Trust) with the aim to become active in case of death of Martin Hilti Sr.
1980-1990	• Phase 1: Formation of Trust and stand-by
1991-1996	• Phase 2: Making Trust operational
1990	• First general revision of the trust certificate
1996	• Review I: Fundamental revision & restatement of the trust certificate (family constitution and policy)
1997- Ongoing	• Continuous adaption of trust deed to dynamics within Hilti Family/ Hilti AG/ environment (trust deed today over 60 pages)

Since the entire stake of the family in Hilti Corporation was held in shares by the trust, governance and safeguarding of the trust were of utmost importance to the family. Hence, they devised a dual governance structure. At the first (top) level were the protectors, who were appointed by the family, and at the second level were the trustees, who were appointed by the protectors. There were clearly laid out rules for protectors and trustees with respect to their appointment, retirement, voting rights, benefits and expectations. Protectors and trustees were very well qualified and capable people. Some notable features of the two-level governance system were:

- Trustees operated the trust, developed the trust policy and benefits distribution policy
- Protectors ensured trustees acted in accordance with the trust deed
- There was a maximum age limit of 70 for independent trustees and 75 for beneficiary trustees

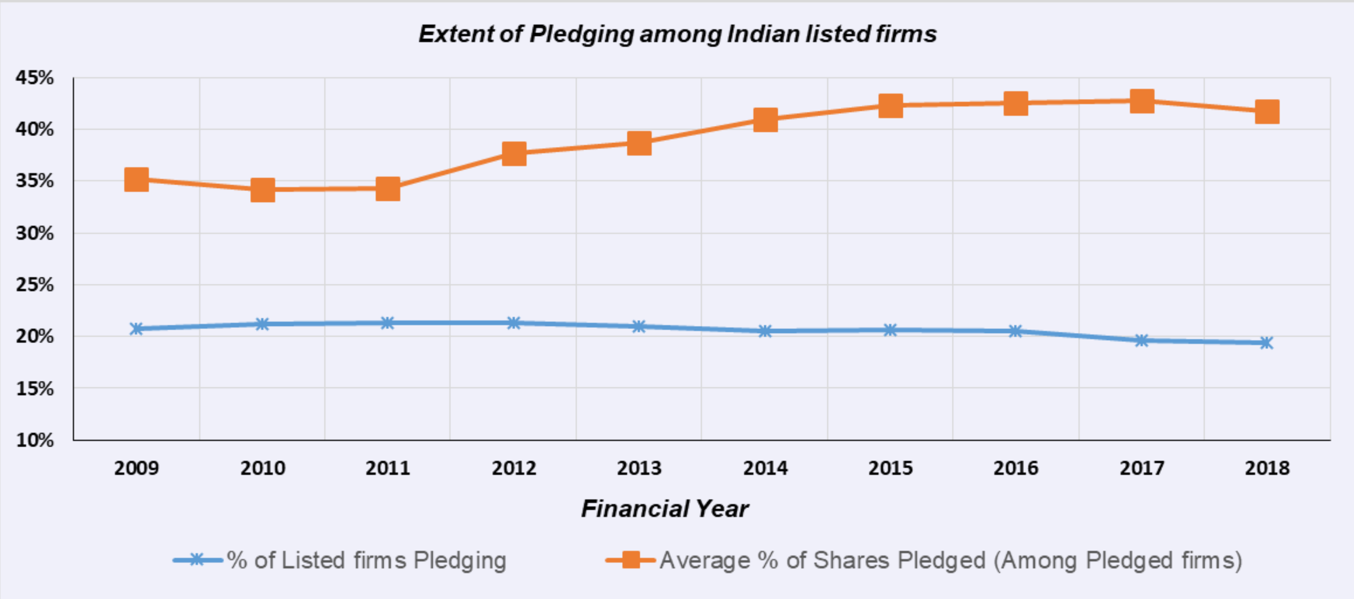
The trust was continuously improved to adapt to the changing times and environment.

Source: "Hilti - Leadership and Ownership Transition in a Culture-Rich Company", (Kavil, Ramachandran & Bang, N.P.), ISB Case Series, Harvard Business Publishing, ISB167-PDF-ENG and ISB168-PDF-ENG, August 2019, 15p https://hbsp.harvard.edu/product/ISB167-PDF-ENG?Ntt=&itemFindingMethod=Search

DO YOU KNOW?

The shareholding of a particular firm when offered as a collateral to avail of a fixed-maturity loan for personal or business reasons is known as pledging of shares. Essentially, pledging enables corporate insiders to avail the value of their stock, which is otherwise tied up as equity in the firm, without foregoing the possession of those shares and without losing the voting rights.

Post the pledging of shares, if the share price goes down, and the collateral value is no longer greater than the maintenance amount for the loan, a margin call would be made to the shareholder. If the borrower does not respond to the margin call, the lender would invoke the pledge and sell the shares in the market to recover the loan amount, leading to a downward pressures on the price of the stock.



Data Source: *CMIE Prowess Database; Graph made by the team of TSCFE, ISB*

While the occurrence of pledging has roughly remained constant, the percentage of shares pledged has risen in the past decade. As per the Reserve Bank of India's Financial Stability Report (June 2019), the exposure of Indian institutions (banks and financial institutions) as well as mutual funds to pledged shares has seen a considerable jump in the past five years. The aggregate exposure to pledged shares stood at approximately ₹2.25 trillion (~ $ 32.3 Billion) in March 2019. As on 31st March 2018, promoters of more than 18% of listed Indian companies (on the national bourses) had pledged their shares. Among the firms in which the promoters had pledged their shares, the average level of pledging stood at approximately 42%cof the shares of the promoters as collateral for loans.

Pledging shares has become an easy option to raise funds, even for many well-known business families. Unfortunately, they do not seem to visualize scenarios where the optimistic assumptions about future performance may not always materialize. Right from the Satyam Scandal in 2009 to Essel and Reliance ADA Groups in 2018, pledging has contributed to the loss of promoters' control on multiple Indian listed firms. While the RBI has outlined that pledging of shares could become an infectious disease for the Indian economy if left unchecked, Securities and Exchange Board of India (SEBI) has been actively introducing additional regulatory disclosures for pledged shares.

Source: Compiled by the team of TSCFE, ISB as part of on an ongoing research project.

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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