



Family Business Briefs

Issue 56 / October 2019

Welcome!

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

- *Summaries of research articles with practical implications on **Market Performance, R&D Strategy, and Non-Family Managers of Family Business***
- *Summary of a published family business case on **Hilti***
- *Inspirations from the life of **K. C. Mammen (Kunju) Mappillai***
- *Infographic on **Changing demographics and intentions for transgenerational succession***
- *Interesting insights on **STEP Project's Global Family Business Survey, 2019***

We hope that you will find these insightful and invigorating.

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

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ARTICLE SUMMARY

Family Firms and the Stock Market Performance of Acquisitions and Divestitures

- Emilie R. Feldman, Raphael Amit, and Belén Villalonga

Corporate strategy literature views shareholder returns of acquisitions and divestitures from the limited perspective of the focal (acquirer/divesting) firm. The authors argue that investor assessment of value creation in these transactions is also based on whether the counterparty (i.e., the target firm in case of acquisition or the buyer firm in divestiture) is a family or non-family firm. They test this possibility using data comprising 6,504 acquisition transactions in the USA between 1994 and 2010.

Family Versus Non-Family Firm Acquisitions and Divestitures

Acquisitions and divestitures have high potential for agency conflicts, especially in case of non-family firms having dispersed ownership. For instance, self-interested managers may make costly acquisitions not backed by sound strategic rationale. Family firms are likely to be more diligent about the strategic fit, risk assessment, bargaining, and secure external financing, while making acquisitions. Similarly, in divestitures, family firms are likely to be more selective and careful about identifying the 'right' business to divest, deciding the selling price, avoiding disruptions, resolving interdependencies and overseeing the separation of the business.

Expected Shareholder Returns

There are four firm-pairings possible: (1) Acquirer and divester: Both non-family firms, (2) Acquirer: non-family firm; Divester: family firm, (3) Acquirer: family firm; Divester: non-family firm, and, (4) Acquirer and divester: Both family firms. Shareholder return expectations are likely to be the following:

- **Acquisitions:** Acquiring firm's shareholders

expect family firms to: be strongly governed, bargain harder, and negotiate more effectively compared to non-family firms. Therefore, among all pairings, return expectations are likely to be highest when the acquirer is a family firm and the target is a non-family firm.

- **Divestiture:** Divesting firm's shareholders expect that weaker governance in non-family firms will lead them to negotiate the deal less effectively compared to family firms. Hence, among all pairings, return expectations are likely to be highest when the divester is a family firm and acquirer is a non-family firm.

Key Findings

Confirming the hypotheses, the study found that in acquisitions and divestitures, investors expect performance advantages to accrue to the family firm if the counterparty in the deal is a non-family firm. However, these advantages are expected to get dissipated if the counterparty is also a family firm, since 'familiness' no longer remains a unique resource in the transaction. Hence, stock market performance and investor returns are higher when the acquirer or divester is a family firm and the counterparty in the transaction is a non-family firm.

Practical Implications

Family firms can achieve better stock market performance and shareholder returns if they divest-to/acquire a non-family firm. Since investor expectations have a direct bearing on market returns of acquisitions/divestitures, family firms need to take measures to manage investor perceptions of their counterparties in those transactions.

Source: *Strategic Management Journal* (2019), Vol. 40, No. 5, pp. 757-780.



ARTICLE SUMMARY

The Contact-Hitting R&D Strategy of Family Firms in the Japanese Pharmaceutical Industry

- Shigeru Asaba and Tetsuo Wada

Family firms are considered risk-averse and more conservative since they are known to invest less in innovation and research compared to non-family firms. Therefore, an underexplored question is: while investing less in innovation, how are family firms able to compete with their non-family peers in research and development (R&D) intensive industries. Addressing that question, this study examines data from 39 firms in the Japanese pharmaceutical industry and identifies distinct R&D strategies followed by family and non-family companies. This summary briefly describes the study, its key findings and their implications.

R&D and Family Firms

Research on innovation and R&D activities in family firms reveals mixed findings. One view finds family firms less innovative since they invest less in research and innovation compared to non-family firms. Another view suggests that even though family firms invest less on R&D, their productivity is higher than that of non-family firms because they utilize the R&D resources more efficiently. However, no consensus exists on the reasons for higher innovation/R&D productivity of family firms.

Innovation Productivity and Strategy of Family Firms

Innovation can be low versus high value (return) or radical versus incremental. The authors hypothesize that family firms have two strategy options to survive and compete in R&D intensive industries:

1. Low-Value Focused R&D Strategy: Since family firms avoid making large R&D investments, they may undertake low-value

(low-return) R&D projects. These innovations need small investments and have higher productivity and probability of success. Thus, family firms may invest in multiple low-value innovations to be more R&D productive than non-family firms.

2. Contact-Hitting R&D Strategy: Family firms may undertake incremental innovations that may not require new technology and competencies. Instead, such innovations require deep internal search and recombining of existing knowledge and competencies, which are the strengths of family firms. Being close to their traditions these family firm innovations have a high probability of success (hits). Thus the high 'hit-rate' is likely to increase the family firm's innovation productivity.

Key Findings

The authors found that family firms follow contact-hitting R&D strategy. They enhance R&D productivity by developing several incremental innovations using their signature moves of recombining new and existing resources and competencies.

Practical Implications

It is crucial for family firms to find a niche market where they can apply their signature moves and strategically invest in R&D projects that help them fill that niche. Family firms in R&D intensive industries that do not want to risk investing in radical innovations can increase their competitiveness and innovation productivity by undertaking multiple incremental innovations.

Source: *Family Business Review*, (2019). Vol. 32, No. 3, pp. 277–295.



ARTICLE SUMMARY

Bounded Rationality and Bounded Reliability: A Study of Nonfamily Managers' Entrepreneurial Behavior in Family Firms

- Josip Kotlar and Philipp Sieger

Managers' ability and willingness to identify and exploit entrepreneurial opportunities are critical to long-term performance and survival of family firms. However, divergent views exist on non-family managers' entrepreneurial behaviours and their motivations. While agency theory views non-family managers as opportunistic agents that operate in self-interest, the stewardship theory argues that they have natural incentives to act in the interest of the family firm. Based on survey responses from 296 senior managers of Swiss and German family firms, this study identifies the factors that influence non-family managers' entrepreneurial behaviour.

Entrepreneurial Behaviour: Family and Non-Family Managers

Transaction cost economics (TCE) emphasizes the unique contracting relationship between owners and managers. It introduces two core micro-foundations of managerial behaviour:

- 1. Bounded rationality:** It suggests that managers have inherent cognitive limitations. For family managers, early socialization and tacit knowledge reduce problems of bounded rationality. However, non-family managers are unable to pursue entrepreneurial opportunities because they fail to understand the wide array of economic/noneconomic goals of family firms.
- 2. Bounded reliability:** It suggests that non-family managers are more likely to engage in re-prioritization of commitments. They are more prone to assigning low value to future outcomes and overcommitting themselves. They may also face identity-issues, especially when their identity is in conflict with their commitment to fulfill family goals.

Therefore, non-family managers are likely to exhibit lower entrepreneurial behaviour than family managers, especially when the founder has left the business.

Heterogeneity of Non-Family Managers' Entrepreneurial Behaviour

The authors argue that non-family managers' entrepreneurial behaviour is likely to vary based on the family firm governance of human capital, and bounded rationality and reliability issues. Non-family managers are likely to engage more in entrepreneurial behaviour when: their monitoring is high, they own shares in the firm, their pay is performance-based, they occupy top management position, perceived distributive justice is high, and perceived control over their job is high.

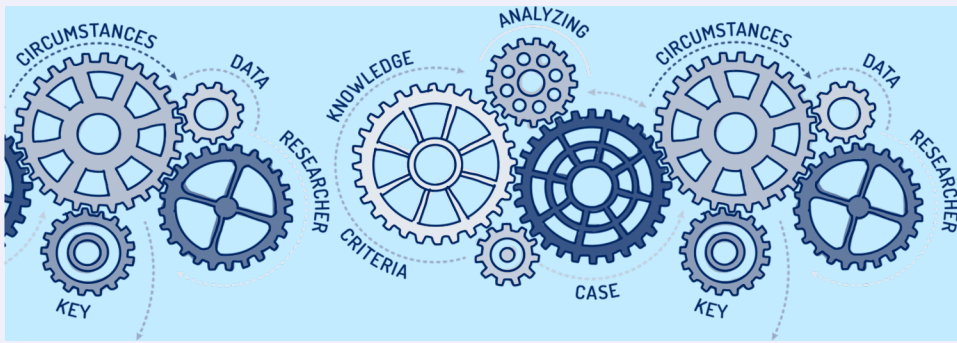
Findings

All the above factors, except performance-based pay and share ownership, were found to positively contribute to the entrepreneurial behaviour of non-family managers.

Practical Implications

Family firms aiming to promote entrepreneurial behaviour among non-family managers not only require monitoring to curb managerial opportunism but must also employ positive motivators. A work environment that gives significance to organisational justice, fair participation, and delegation will encourage entrepreneurial behaviour among non-family managers.

Source: *Entrepreneurship Theory and Practice* (2019), Vol. 43 No. 2, pp. 251–273.



CASE SUMMARY

Hilti - Leadership and Ownership Transition in a Culture-Rich Company

- Kavil Ramachandran and Nupur Pavan Bang

The year 2018 was to witness a momentous transition in the history of Hilti, a privately held family-owned business in Liechtenstein. For the first time, a non-family member was going to occupy the leadership position on the company board and family trust management. Hilti was established in 1941 by Martin Hilti and his brother to manufacture fasteners. Later, it diversified into areas such as power tools, anchors, drills and laser products. In 1990, Martin's son, Michael took over as the Chairman of the executive board. Since then, Hilti had grown into a global manufacturing and engineering business with a turnover of CHF 5.6 billion and 28,000 employees.

The uniqueness of Hilti was in its innovativeness and culture which was embedded in the company DNA. It had high standards in people practices, commitment to quality, ethics and governance. Martin defined the company values as – team, commitment, integrity and courage. These values remained unchanged even as the business transitioned through different generations and leaders. The Hilti values were deeply intertwined with business issues such as strategy, change management, and customer satisfaction. The company made efforts through special programs, “culture program” and annual board meetings to ensure that the executives were actively involved at the ground level in their interactions, understanding, and commitment to the employees, customers, and partners.

The company placed great importance on the continuity and sustenance of the business and family. It prepared contingency plans covering all possibilities and scenarios in case of a crisis. Michael Hilti was instrumental in

institutionalizing the strong culture, ethics, professionalization in the organization. In 1980, Martin set up the family trust and transferred all the family shares to the trust. All family members were beneficiaries of the trust and were financially protected. However, the family did not have the rights to sell the shares. This protected the company from family disputes.

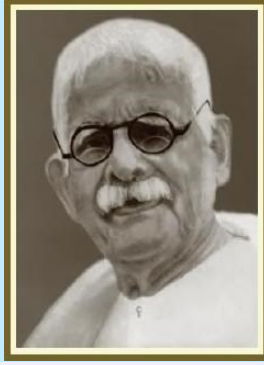
The Hilti family through its leadership and stewardship were able to build a long-lasting institution. The leaders believed the three pillars of the organization were the leadership, ownership and family. Hilti continuously tried to align these through good governance practices at the trust and the board to ensure growth and sustenance.

Learnings for Family Businesses

The case aims at showcasing the traits and best practices for a long-lasting family-owned business. The key takeaways for other family businesses are:

- **Strengthen organization culture** – for the overall integrity and cohesiveness of the business and family
- **Manage the board effectively** – both at the company and family level
- **Professionalize** – with clearly defined roles and a contingency plan
- **Safeguard the interests** – of the family and business to ensure perpetuity

Source: *Hilti – Leadership and Ownership Transition in a Culture-Rich Company (2019)*, Case Authors: Kavil Ramachandran, Nupur Pavan Bang



FAMILY BUSINESS LEADER

K C Mammen (Kunju) Mappillai (1873-1953)

Born in Tayyil family, Niranam, Central Travancore in South West India in 1873, Kandathil Cherian Mappillai Mammen Mappillai (KCMM) was the eldest son of Kandathil Cherian Mappillai and Mariamma and was an Indian Syrian Christian. He was married to Kunjandamma (Modisseril family) and had eight sons and one daughter.

KCMM completed his BA from Madras Christian College and wanted to join the Mysore Civil Service. On insistence of his uncle, Varghese Mappillai, founder of Malayala Manorama, he came back to Kerala and became a school teacher at M D Seminary High School and ultimately became its headmaster.

He was a voracious reader and had a flair for journalism. He also had varied business interests. He was an agriculturist, planter, industrialist, trader, banker, writer, editor, social reformer, political philosopher, and crusader for social and political justice. Above all, he was seen as a good man in the real sense of the term.

Following the demise of his uncle in 1904, KCMM became the editor of Malayala Manorama. During his time Manorama became a bi-weekly in 1918 and Daily in 1928 and became a powerful instrument of change. KCMM became the longest serving editor of Manorama. Manorama benefitted because of the traditions set during his long stewardship.

The publishing group now produces the largest circulating vernacular weekly magazine, and popular magazine for women and children. Its English Language Weekly has been growing in circulation since its introduction in 1982. The

group also publishes the largest selling Indian Year Book in both English and Malayalam.

KCMM was a member of the Sree Moolam Popular Assembly. He started the Travancore National Bank which was later amalgamated with Quilon Bank and became the largest private banking institution in Kerala.

He used Malayala Manorama to popularise cultivation, particularly rubber. Rubber eventually became backbone of Kerala midlands and continues to be so. KCMM was the chairman and managing director of the Madras Rubber Factory. He triumphed over the severest of adversities with unprecedented courage and supreme equanimity.

He helped build a modern and resurgent Kerala. It is no wonder that he won the admiration and adoration of the people in Kerala. As a mark of respect to his departed soul, the Chief Minister of the then Travancore- Cochin, Sri A J John and his cabinet ministers led the funeral procession when he passed away in 1953.

Source: https://en.wikipedia.org/wiki/K._C._Mammen_Mappillai

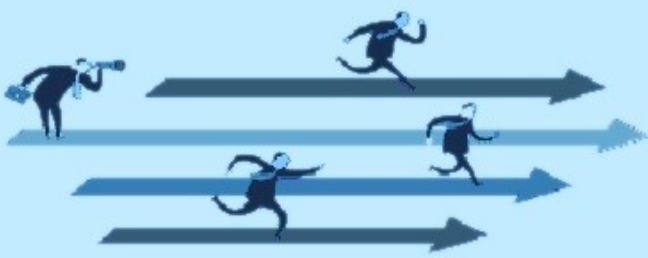
<https://www.mmfamily.in/>

<http://koti.netplaza.fi/~jmatthan/granddad.html>

<http://keralaletter.blogspot.com/2007/09/biography-of-k-c-mammen-mappilai.html>

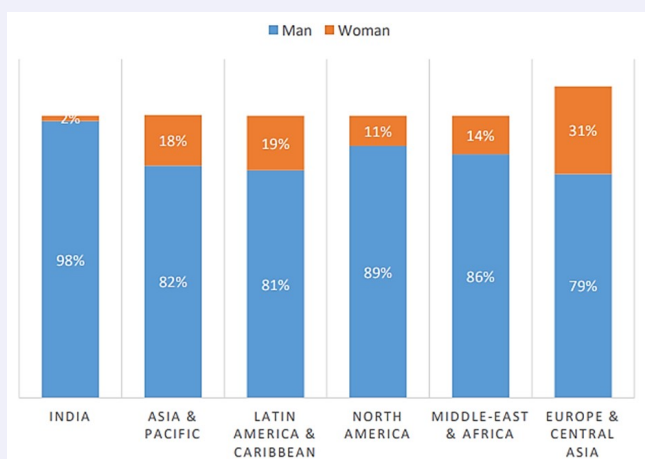
<https://www.thehindu.com/todays-paper/tp-features/tp-metroplus/the-man-the-tyre-and-the-legend/article28404627.ece>

BENCHMARKING LEARN FROM THE BEST

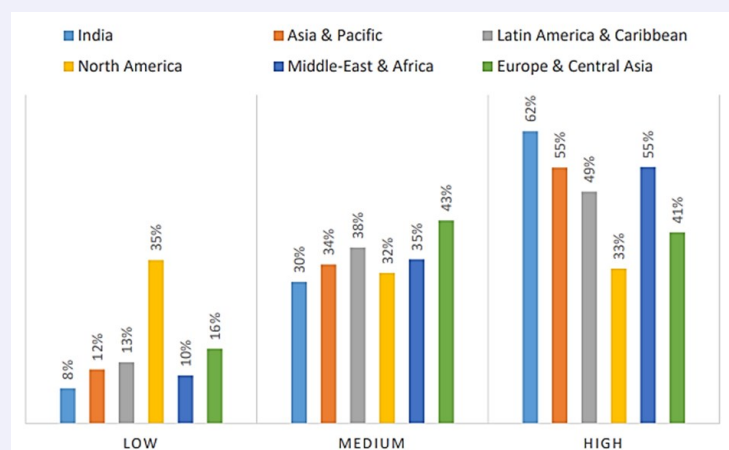


With people living longer, increasing demographic and societal changes, family businesses in different parts of the world are exposed to new challenges. Their traditional methods of succession and governance are no longer appropriate. Globally, 48 universities conducted a survey across 33 countries, covering over 1,800 family businesses, under the umbrella of STEP (Successful Transgenerational Entrepreneurship Practices) Project, to reflect upon the changing demographics and how they impact the family business governance, succession, entrepreneurial orientation and performance. Thomas Schmidheiny Centre for Family Enterprise, Indian School of Business, being the only member from India, conducted the survey in India. A few findings from the survey, in comparison to the other regions, are presented below.

Gender of the Current CEO



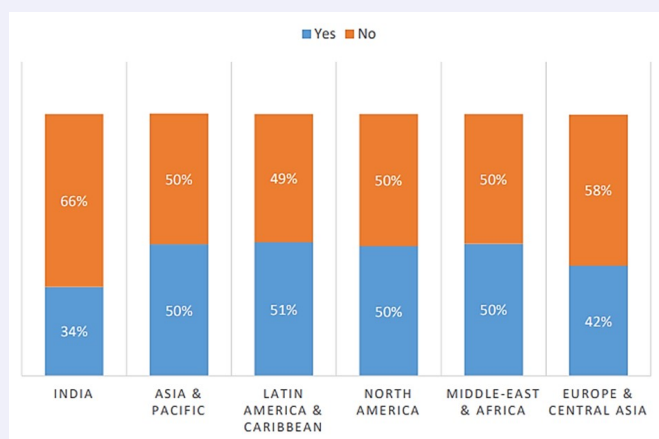
Likelihood that the Family Business will be passed on to the next generation



India has the lowest percentage (2%) of women CEO's and the highest likelihood of the family businesses being passed on to the next generation of the family, when compared to all other regions in which the survey was conducted. It is also highly likely that the next CEO will be from the family, in India.

At 34%, the percentage of incumbent leaders who have a retirement plan in place is the lowest in India.

Retirement Plans



Source: Global Step Project Benchmarking report (2019), http://blogs.babson.edu/entrepreneurship/files/2019/06/Benchmarking-report_India_final_.pdf



DO YOU KNOW?

The STEP Project's global family business survey, 2019, finds that more than half of global family CEOs do not have a formal retirement plan and 70% of global family businesses do not have a formal succession plan. However, Millennial CEOs are ready to take over. The survey offers some interesting findings:

- **Generational Outlook:** Millennial family business leaders (39%) have the highest level of education, have lower tenures as CEOs, plan to retire by their fiftieth birthday and family firms led by CEOs from 'Generation X' and 'Millennials' perform better.
- **Retirement Plan:** Global family CEOs plan to retire between the age of 61-70. However, more than half of global family CEOs do not have a formal retirement plan and about one third of global family CEOs do not plan to spend time in business activities after retirement. There is a need for family businesses globally to implement CEO retirement plans.
- **Succession planning:** 70% of global family businesses do not have a formal succession plan. Though 47% of global family businesses have a succession plan in case of unexpected events. While this is good, it is not enough to ensure the long-term sustainability of family businesses. Successors' self-commitment and competence are the key criteria to select the next CEO. It is necessary that family businesses globally consider that the next leaders will be Millennials and implement formal succession plans resulting from a process taking into account business, family needs, and the Millennials' perspective.
- **Family governance and corporate governance:** There is a perceived need for change of family businesses' existing family governance structures. Family businesses wanting to strengthen family members' identification with the firm need to implement more than one family governance tool. Adopting more than one family governance tool leads to higher degrees of entrepreneurial orientation and firm performance compared to the ones which adopt only one.
- **Effect of gender and societal change:** More female CEOs are not just needed but are also beneficial to the family business. Family businesses with female CEOs have less autocratic leadership than male CEOs, the female CEOs plan to retire at a younger age than their male counterpart and decisions and succession take place earlier if the next senior family business leader is female.
- **Entrepreneurial orientation, performance and main concerns:** Availability of talent is the main concern of family business leaders globally. Family businesses which are led by leaders belonging to Generation X and Millennials have higher level of firm performance than family businesses led by older demographic cohorts. Hence, it is time to 'pass the baton' to Millennial CEOs to boost family business performance. Moreover, to sustain competitiveness it is also important to continuously look for talent. Family businesses globally, should reflect on how to strengthen their branding as an employer.

The report concludes that changing demographics, differences in generational outlook and societal changes are rendering the traditional methods of retirement, succession and governance redundant. Proactively planning to tackle the challenges of succession, retirement and governance, while keeping changing society and generational outlook in mind, will go a long way in perpetuating family businesses.

Source: Calabrò, A & Valentino, A. 2019 Global Family Business Survey: The impact of changing demographics on family business succession planning and governance (<https://cdm16793.contentdm.oclc.org/digital/collection/stepsumrep/id/31/rec/1>)



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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