

International Journal of Management Cases

ENTREPRENEURIALISM IN CIRCUMVENTING THE ENVIRONMENTAL CONSTRAINTS: A CASE STUDY OF ROSEMARY'S POULTRY FARM

THE NOVA GROUP CASE STUDY: FAMILY DYNAMICS IN A MULTIGENERATIONAL FRENCH FAMILY BUSINESS

ORGANIZATIONAL CULTURE, ENTREPRENEURIAL ORIENTATION AND GROWTH IN FAMILY FIRMS. A CASE STUDY FROM A MATURE INDUSTRY

THE APPLICABILITY OF THEORY PERSPECTIVES TO UNDERSTANDING GOVERNANCE IN SMALL TO MEDIUM SIZED FAMILY FIRMS

A LONGITUDINAL CASE RESEARCH OF A LARGE FAMILY FIRM: SAPUTO INC.

KEY STRATEGIC DECISIONS THAT GOVERN TRANS-GENERATIONAL FAMILY BUSINESS CONTINUITY: THE CASE OF EXOR-FIAT

FACTORS DETERMINING THE INVESTMENT STRATEGIES OF FAMILY WEALTH: CASES FROM WESTERN EUROPE

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Guest Editors Commentary

The Entrepreneurial Development of Family Businesses and Business Families

Panikkos Poutziouris PhD, David Sola, PhD, and Khaled Soufani, PhD

This special issue is organized in conjunction with 9th Annual IFERA World Family Business Research Conference - Global Perspectives on Family Business Developments: Theory-Practice-Policy, that took place in Cyprus in 2009. The thematic topic, entrepreneurial development of family businesses and business families is open in order to capture the inter-disciplinary dynamics that shape the transition of families in business as they evolve across the personal – family – enterprise life cycle.

As the field of family business entrepreneurship gains legitimacy in academia and more business schools teach and research the multi-disciplinary topic of family business entrepreneurship, specific in depth case studies are essential, not only to add to the expanding body of research, but also to help towards the orchestration of better impacting educational- teaching, outreach and training initiatives.

This collection of case studies provides useful insights about new research methodologies addressing topics such the environmental constraints around family businesses, the family dynamics of multigenerational businesses, the organizational structure and the entrepreneurial growth, governance, longevity, and the strategic decision making process for family business continuity. They contribute to theoretical advancement and illuminate us about best practice.

More specifically, this issue contains a series of seven cases from a global perspective, focusing on the development of family enterprises and enterprising families across the spectrum.

N. Juma and J. Sequeria offer an in depth case study about the entrepreneurial odyssey of Rosemary's Poultry Farm. This case outlines developments from the stage of opportunity recognition to a successful business launch, to the

reconfiguration of the business model and strategy after market competition emerges.

R. Labaki, building on a systems perspective, presents the case of large French food distribution group where family relationships weaken over the life cycle and result in an agency problem epitomized by increasing conflicts of interests between active and non-active family shareholders which jeopardize family continuity in the business.

F. Visintin and D. Pittino build a conceptual model that integrates the organizational culture, entrepreneurial orientation and growth in the context of family firms, which they then apply in a Italian manufacturing firm.

T. Lou and D. Caspersz explore the concept of relational governance in family business using social capital theory and demonstrate through an Australian construction firm how the presence of relational governance as an 'informal control mechanism' enables the owner-managers to balance the interplay of family values and business objectives. Moreover, they highlight that the family's shared vision about an agreeable succession plan facilitates the establishment of a board which consequently enables trans-generational succession and safeguards the long-term survival of the family firm.

B. Ibrahim et al examine longevity of multi-generational family firms, and offer an longitudinal account of the trans-generational development, over three generations, of a large family business in Canada, Saputo Inc. This case study is part of a large study by the research team to examine factors contributing to longevity in family firms.

B. Bertoldi, R. Quaglia, and R. Demastro, examine strategic decisions that govern the trans-generational family business continuity of Exor-Fiat., which is controlled by one of the

oldest industrial families in business in Europe - the Agnelli dynasty. The analysis expounds the guiding principles which constitute the DNA of the trans-generational entrepreneurial spirit, namely: long-term planning perspective, multi-dimensional governance structures and support for the nurturing of talented management.

T. Tse, D. Sola, and R. Gheorghita via the prism of multiple case studies, propose a framework that encapsulate the factors which influence the development of wealth investment strategies, namely : (i) family mission; (ii) family characteristics; and (iii) macroeconomic and asset class performance.

These case studies can be used for teaching and training as they illustrate best practice in terms of managing and governing family firms as they develop across generations . We are grateful to participating family business entrepreneurs., for sharing their experience , as they help to enlighten other owner-managed family firms on how they can engineer the survival , growth and development of their families in business across generations .

We would like to offer our gratitude to authors for their ceaseless dedication to research and publish and to our reviewers who provided valuable support both to the authors and the editorial team. On

behalf of IFERA, authors, reviewers, and editorial team of IJMC enjoy and employ the knowledge incorporated in this collection of family business case studies, which contributes towards building bridges between theory and practice. Hopefully it will also provide an inspiration for your quest to continue the learning, both from the bright and dark side of family business entrepreneurship.

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ENTREPRENEURIALISM IN CIRCUMVENTING THE ENVIRONMENTAL CONSTRAINTS: A CASE STUDY OF ROSEMARY'S POULTRY FARM

NORMA JUMA
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Abstract

This case outlines an entrepreneur's journey from opportunity recognition to a successful business launch. The entrepreneur details how she acquired her seed capital and initial market through a women's group. She has a lot to be proud of including a lifestyle she sought. However, a large scale commercial farmer just moved into town and her business model is severely threatened by the new player's low price strategy. The entrepreneur invites a local Small Business Consultant to her farm to help her redefine her business model. According to the entrepreneur there are just two options: either increase her operation to a much larger scale or find a way to drastically cut her costs in order to breakeven at the competition's prices. The case stops shy of the consultant's recommendation(s). The students are asked to assume the role of the consultant and come up with alternative solutions and recommendations.

Key Words: Women entrepreneurs, Financial Capital, Environmental Constraints.

Introduction

The cool breeze gently blew through the gigantic mango trees on a warm Saturday morning. Two ladies sat under the mango tree enjoying some fresh homemade lemonade. Achieng, a young small business consultant visited with one of the local women entrepreneurs, Ms Rosemary. Ms. Rosemary is a retiree in her late fifties and is relatively new at her current trade although she is no stranger to entrepreneurial ventures. Achieng marveled at the development at Rosemary's rural homestead. She wondered what Ms. Rosemary

could possibly want to talk about. The details of her request for a personal visit were rather vague. According to ancient tradition younger people always waited for the elder persons to call a meeting to order. But times have changed, even in Africa life has taken on a faster pace. As they say cultures evolve with time. After a respectful pause, Achieng ventured to inquire indirectly of the purpose for the visit. 'Ms. Rosemary, tell me your story. What I mean is how did it all begin? How did you, a professional woman, turn into a successful farmer after retirement? How did you make the change from an eight to five high power personal secretary to a successful poultry farmer?' Rosemary was a little surprised that Ms. Achieng was interested in the genesis of her business. Most consultants are always on the clock. They want to quickly identify the problem(s), throw in some so called professional advice and be on their way with their hefty fee safely tucked in their briefcases. Ms. Rosemary smiled and asked the house help to refresh their drinks, a clear indication that they were in for a long journey to the beginning of time. 'It all began with the Victory Women's Group' Rosemary calmly began her tale.

In order to fully appreciate Rosemary's business model it is imperative that we have a glimpse at the poultry industry in her country and a brief overview of her operation.

Industry Overview

Agriculture is the mainstay of Kenya's economy, accounting for 23% of the gross domestic product (GDP) while manufacturing accounts for about 19% and service accounts for 58% (World Group, 2008). Poultry farming for both domestic and

regional consumption is an under-exploited and under studied area. The Kenyan Government is in the process of compiling data and possibly introducing laws to regulate the poultry sector (www.worldpoultry.net). Currently it is estimated that approximately 90% of the rural population keep poultry either for subsistence or commercial purposes (Nyange, 2000).

In Kenya, chickens are the most important class of poultry. Kenya has an estimated poultry population of 29 million birds, with chickens forming the largest proportion. Over the last decade or so the poultry industry has developed tremendously due to the demand for meat and eggs, particularly in the urban areas (Export Processing Zones Authority, 2005). Even with this growth in the sector, commercial poultry processing is almost under a monopoly with Kenchic being the main player and larger commercial producers enjoying an oligopolistic competition.

Firm Overview

Rosemary is a retiree and a serial entrepreneur. During her career days she was an administrator in a government office. She also owned and leased farms for commercial sugarcane farming in addition to freelancing as an office administrator for small businesses. Rosemary's love for business dates back to her childhood. She is the firstborn to an entrepreneur who was a pioneer in his time. Her father taught her the significance of having financial freedom and the flexibility that comes with it. As a young mother she operated a part time business designing and tailoring children's clothing while she held a fulltime corporate job. Later in life she operated a catering service from her home. Certainly, Ms. Rosemary is no stranger to wearing multiple hats. She presently owns and operates a poultry farm. The farm has done relatively well but its competitive environment is drastically changing. Although the business has been profitable, for the most part, it is not certain if this is sustainable or if growth is even a possibility. Ms. Rosemary invites a small business consultant to revisit her business model and help her navigate the evolving competitive environment.

In the next section Ms. Rosemary recounts the genesis of her business idea as well as how she raised her seed capital.

The Genesis of the Business

Ms. Rosemary narrates her story and Ms. Achieng, the consultant, dutifully records the conversation and jots down significant comments about which she would like further clarification or additional information on.

You know my dear, there is nothing quite like good friends, Ms. Rosemary began her tale. I mean friends who have a sense of direction and purpose in life. I am one of the founding members of Victory Women's Group. This is not the first group I have participated in but this group is very different I can assure you. First and foremost all the members are or were professional women. Most of the founding members are retirees now. We have lawyers, bankers, secretaries, administrators, teachers, businesswomen, etc. From this group we have members who are or were holding full time jobs while engaged in commercial farming or some other part-time business. I was one of those women during my career days. I learnt about commercial sugarcane farming from my father. My father loaned me the seed capital plus a lease of his land. (Rosemary pauses and smiles.) My father was too radical for his time. You know back in those days women were not allowed to inherit property from their parents. My father made sure that he gave me property while he was still living so nobody could dare take it away when he was gone. Anyway, I introduced two members of our women's group to commercial sugarcane farming. This paid great dividend years later when I decided to quit sugarcane farming and move into something less strenuous after retirement. I wanted to engage in something I could monitor without leaving my compound and yet make some sensible or worthwhile return. Whereas I was the teacher to members who wanted to invest in commercial sugarcane farming years back, it was now my turn to be a student of poultry farming.

Members of Victory Women's Group are each other's keeper, mentor and cheerleader. For instance, the lawyer in the group is entrusted with the legal issues of the group. She counsels the group on corporate issues as well as personal issues. And if necessary she gives members referrals. The banker advises the group about the various financial instruments as well as the best interest rates offered by various banks on Certificates of Deposits (CDs) and money market accounts. So each member brings something to the table. But let us get back to my story and how I arrived to

this place in my business. You see, most of my friends from the Victory Women's Group retired a couple of years or so before me. Most of them started businesses within their profession. For instance, Mrs. Otieno, a retired school principal, established a private preschool and elementary academy. Mrs. Odhiambo, a retired administrator, continued with her late husband's retail business, etc... Inevitably, I toyed with the idea of operating a business center, but the idea of keeping regular office hours defeats the purpose of retirement. I also knew for a fact that sugarcane farming was way too strenuous for a retiree. The bright idea came to me during a friend's retirement party. I asked an old friend, who owns a chain of hotels and restaurants in town, who his poultry supplier was and other details about the poultry business. I then told the Victory Women's Group that I wanted to get into the poultry business. The support was overwhelming. Some offered to teach me about bookkeeping, and some taught me about delegating responsibilities to the employees and holding them accountable in this type of business. Some gave me contracts to supply their businesses or referrals to friends and family. After gathering momentum my poultry is always sold out even before maturity. Of course, it took a while to build my clientele but once that was established, I relied solely on word of mouth. However, I am afraid that this may have to change in the near future.

Ms. Achieng probed further on the profile of Ms. Rosemary's clientele and sources of sales. In summary, about 70% to 80% of Ms. Rosemary's production is sold to restaurants and hotels. Most of these clients have either written contracts or a long term relationship with Ms. Rosemary. Most of the hotels and restaurants expect deliveries to be made to their premises. Some hotels and restaurants also expect credit sales. Ms. Rosemary gives about 20 days grace period for the accounts receivables. She tries to be selective on whom she extends credit to in order to avoid bad debt and liquidity issues. About 10 to 15% of the sales are farm gate sales. All gate sales are made on a cash basis. This group of clients consists of both individual consumers and a few local restaurants and hotels. Less than 5% of the sales are attributable to slaughter houses and butcheries. Ms. Rosemary does not give credit sales to slaughter houses and butcheries. Ms. Rosemary has a few slow accounts but there are no bad debts so far. Her sales are not what they use to be and therefore she is considering reevaluating

her credit policy. However she does not think she can afford a more liberal credit policy.

Ms. Achieng probed Ms. Rosemary to talk about her source of seed capital, growth capital and working capital. In the next section Ms. Rosemary narrates about the challenges she faced in regards to raising capital.

The Funding

You see my dear, as you may already know, most African women are hard working but they lack seed capital. That is the greatest hindrance to most women entrepreneurs. Traditionally, women are greatly disadvantaged among our people. For instance, until 1978, women in Kenya were not paid a house allowance by the government. The assumption was that the women either lived with their fathers or their husbands. In fact, the current law requires married women to prove that they are the sole or primary bread earner in order to be awarded a house allowance. Even to date women in many communities in Kenya still do not inherit property from their parents. Not to mention that not all family are willing or able to educate their daughters. Given the limited access to both proper education and property rights, most women end up with no means to acquire collateral for possible bank financing. That is where a group such as ours can be instrumental in financing a business. For most of our members, the group has been a source for affordable financing. Our country's financial market is still underdeveloped and the interest rates charged by the commercial banks are not supportive of small businesses to say the least.

When I decided to start the poultry business I had some personal savings and my retirement package. After building the structures for the poultry and placing the first order, I quickly realized that I would need more capital. Since I had not established the business and I had no clientele to speak of, approaching a commercial bank was out of the question. I turned to Victory women's group for a loan. I was able to borrow a substantial amount at a fraction of the prevailing commercial rates. Occasionally, I access the bank overdraft when in need of a bridge loan. More importantly, the women's group ensured that my business took off. You see if the business fails chances are the loan will go unpaid. Therefore, whenever the group advances a loan to a member, every member of

the group has an interest in the success of the business. They will root for you not only as a sister but they will also root for you as your investors. Borrowing funds from the women's group did not only give me a source of affordable capital, it also gave me clients and business advisors. Most of our rural or even urban women do not have access to such funding. True, there are many women's groups all over the country. But very few of them have the kind of financial capital that Victory Women's Group has accumulated over the years.

Achieng felt that it was important to understand a little more on how this women's group accumulated its capital. In any event most consultancy sessions always concluded with the questions of possible sources of additional funding or how best to pay back a loan during hard economic times. She politely interrupted Ms. Rosemary. 'Ms. Rosemary, how did Victory Women's Group accumulate such a colossal amount of capital?'

Good question my dear. You see we wanted to leave a legacy for our children. So we realized that while having chai and madazi (tea and doughnuts) is an important part of socializing we needed to have bigger dreams. We are fairly well educated women and in most cases we either had a second source of income or a husband. We all paid our monthly dues as well as our membership dues. The money was then invested in bonds, CDs and real estate. Members were also loaned money at a rate lower than the prevailing market rate. We ploughed back into the group the interest earned from all of our investments.

Achieng marveled at the discipline exercised by the team. She knew it could not have been easy. So after a thoughtful pause she interjected, 'Ms. Rosemary, do you mean you never received any dividend or cash bonus during all those years?' Rosemary chuckled, 'Of course, we each got a check once a year at Christmas time. But that was it. We focused on long term investment'.

This approach was ingenious of the women. One cannot overstate the significance of affordable financing in a developing economy like Kenya. Moreover, given the exorbitant interest rates and the restrictions that come with bank financing, using the informal sources of financing is not only prudent but may well be the difference between making it and failing in this environment. In the next section we detail how women entrepreneurs circumvented these environmental challenges.

Rosemary's case mirrors the techniques used by most women entrepreneurs.

Circumventing Environmental Constraints

It is momentous to understand the environmental constraints that women entrepreneurs in Kenya have to overcome in order to start and sustain a successful business. The most crucial ones are funding and human capital. In January, 2003 the Kenyan government implemented the Free Primary Education Policy, which opened up opportunities for many disadvantaged and marginalized children who had never enrolled in school or had dropped out because they simply could not afford the costs. This has huge significance to the girl child in Kenya. However, the challenge remains for high school and college education. When confronted with limited resources, most families educate the boy child and the girl child has to forgo formal education. The structure of Victory Women's Group is an example of how women circumvent and bridge the knowledge gap. Women's groups are a great source for the technical and managerial skills needed to run a business. Women's groups can also be a valuable source of human capital. The women have learnt how to leverage their skills by sharing their talents.

Financing is a major challenge faced by most new ventures but more so for women owned ventures. The situation was even more challenging for women entrepreneurs who are in most cases still highly marginalized in regards to property ownership. A solid source of collateral is still vital to obtaining any form of debt financing in Kenya. The traditional practices, which largely deny women the right to inherit property from either their parents or husbands, greatly inhibited the growth of women entrepreneurs. However, it is important to distinguish between traditional practices and legal rights. According to the Law of Succession passed in 1972, both the male child and the female child have equal rights of inheritance. The widows and widowers also have equal rights with the exception that a widow's right to her deceased's husband's immovable property is terminated when she remarries. Nonetheless, women still face an uphill battle when it comes to inheritance. The financial institutions are not always willing lenders to small and medium size ventures. Historically, most financial institutions tend to be prone to nepotism, tribalism and favoritism, not to mention the exorbitant interest

rates. Women entrepreneurs in general and Ms. Rosemary in particular circumvent these problems by borrowing money from informal sources such as women's groups and relying on bootstrapping techniques for funding.

In the next section Ms. Rosemary details her business model and highlights some of her bootstrapping techniques as the consultant probes for specifics.

The Business Model

'Rosemary, so through the Victory Women's Group you garnered your initial clientele and seed capital, but how about the actual operation of your business?' Rosemary reflected for awhile and then took a deep breath before continuing with her narration.

This is a tough business. The pricing of poultry is more or less fixed by the prevailing market prices. One has to manage the cost of operation if she/he intends to make any profit from the business. Poultry is a commodity product. The hotels and restaurants can differentiate their offer because they sell more than just chicken or eggs. They sell entertainment, ambience, convenience, etc... The suppliers of the poultry on the other hand have very little room to differentiate their offer.

I keep my costs down by employing only two workers who care for the chickens. I use my personal driver to deliver the orders to the various hotels and restaurants as well as get whatever supplies we need from town. I have also learnt to delegate most of the responsibilities to the workers, that way I am left to tend to other issues besides supervising the routine activities at the farm. I am primarily responsible for ensuring that there is market for the chicken as they mature as well as managing the financials. I make sure that the pay roll is made. I pride myself in the quality of my chickens and therefore I price my chickens and eggs at the upper range of the narrowly predetermined market price. I would term the business as fair. I get what I intended to get from it...a supplementary income. Plus it keeps me busy and engaged during my retirement years. What I like about it most is the fact that it is not strenuous as long as I can afford the help. I do get help from my nieces and nephews during school holidays. My concern is I need some assurance about the sustainability of the business and if

possible some nominal growth. At the moment I am experiencing some delay in selling the entire stock upon maturity. This can be costly since I have to keep feeding the chickens until they are sold off.

The Operation

With the exception of the indigenous chicks I buy chicks from a hatchery in town. I normally buy about 250 chicks at a time. I keep four different breeds of chicken: hybrid layers, the White Leghorn; hybrid broilers, White Cornish and Kenbrew; and indigenous chickens. I keep layers mainly for eggs, the broilers mainly for the meat and the indigenous chickens for both eggs and meat. However, the indigenous chickens have lower productivity and I keep them mostly for family consumption and a niche market. Kenbrews also yield a fairly good production of eggs in addition to good quality and quantity of meat. Their egg production is not as high as the White Leghorn but they mature faster thus, can be sold for meat after a relatively shorter period. They are also cheaper to maintain because I can use organic feed after the first four weeks.

When the chicks arrive, they are tiny and they need to be kept warm. During the first five weeks we keep them in a special heated shed, known as a brooder. I keep the brooder warm using heat lamps (one infrared lamp for every 250 chicks). The lamps consume a lot of electricity but it is safer than using a jiko. Besides warming the brooder we also equip the brooder with a water trough and a feeder. Each breed is kept separate since they require different feeding regimens and also for bio security reasons.

Layers need three different types of feeds during their life span. I start them off with chick mash from when they are a day old to about 8 weeks. This is then followed by grower mash from 9 weeks to 18 weeks. Finally from 19 to about 75 weeks we feed them on layer mash. The feeds are specially manufactured and are bought commercially. Rearing layers or hybrid broilers on any other feed than those specified will not work. These chickens lay the first egg at 18 weeks. Each hen lays about 280-300 eggs per year. After about one year the layers go through one month of molting where they lose feathers and the egg production drops. Generally they remain productive for about two years after which they are sold for meat.

The broilers are fed broiler starter for the first four weeks. Each chick consumes 1.2 kg of this starter mix during this period. From week 4 to week 8 they are given broiler finisher. Each chicken consumes about 3.5 kg of the mix during this period. I strictly follow this regimen for the White Cornish but not for the Kenbrew. I often make a complete switch to organic feed or a mixture of organic feed and manufactured feed after four weeks in the case of the Kenbrew. Kenbrew seem to do better with more greens in their diet. Whereas both White Cornish and Kenbrew are kept in similar, though separate, confinement as layers, they are never provided with laying boxes because they mature within 6-8 weeks. The target weight is 2 kg live-weight or 1.5 kg dressed weight at 6-8 weeks.

The indigenous chickens are bred on the farm. We always try to make sure that there is one cock for every 8-10 hens. We also introduce new cocks every two years to avoid inbreeding. Unlike most farmers I do not let my indigenous chickens out in the open. The chickens are kept in an enclosed area with adequate room for them to move around freely. This ensures that I limit the possibility of my chicken picking up infections. I feed them with Machicha (dregs from fermented millet), Omena (fishmeal), and millet meals chaff and maize meals chaff.

Family Involvement

This business has meant a lot to me and my family during my retirement. My children are grown and have separate lives and interests, thus are unlikely to continue this business. However, I am responsible for more than ten orphans due to the loss of a number of family members on both sides (my husband's siblings and my own siblings). I use some of the income from this business to assist my nieces and nephews with their schooling. Moreover, having some of the children here at the farm during the holidays is a good thing since they assist me in the business. I train the children in bookkeeping, account collections and other administrative aspects of the business. The older children, who are at the college and university level, often meet with hotel or restaurant managers to take orders and collect account receivables. They also work on generating new accounts with individual customers as well as hotels and restaurants. The younger children help with other farm chores such as picking eggs and

cleaning up the chicken shelters. I believe that the children are learning transferable skills and their experience in the business exposes them to entrepreneurship. I also believe that it is important to equip children with strong values and viable skills. However, each individual child should determine its own destiny when it comes to career choices and investment decisions. I do not look at this business as a long term investment. If my extended family is interested in getting involved in the poultry business I would be more than happy to introduce them to the trade.

In the next section we will turn our attention to the competitive environment now that we have a better understanding of Rosemary's business operation and personal vision. It is imperative to have a general understanding of marketing and general pricing policies in this industry.

Marketing Approach of the Poultry Industry in Kenya

There are two distinct groups of poultry farmers; those who farm exclusively or prominently indigenous poultry and the commercial poultry farmers who tend to farm hybrid poultry. Typically, indigenous poultry farmers sell about 30% of their eggs, spent hens and broilers directly to the end users such as individual consumers and local hotels. These sales are referred to as gate sales since they typically occur at the farm or at a nearby local market. However, about 70% of the sales are made through middlemen. Farmers who keep indigenous chickens typically do not have a planned marketing regime. They tend to make sales whenever their chickens exceed their holding capacity or whenever they need money for subsistence. This makes them more susceptible to the lower prices offered by the middlemen. It is estimated that the price differentials typically double while the poultry produce is in its unprocessed form as they move from the gate sales or village to the urban market. Figure 1 summarizes a typical distribution channel and the pricing structure. These prices fluctuate widely depending on season, region and other variables.

Commercial farmers tend to have a more formal approach to marketing. This is inevitable given the substantial investment on chicken feed and other inputs. Commercial farmers often establish contracts with hotels, restaurants and even

butchers and if they are large enough they may supply the supermarket chains. As stated earlier, commercial poultry processing is almost under a monopoly with Kenchic being the main player while larger commercial producers enjoy an oligopolistic competition. The ability of larger commercial producers to drive down their cost structure or negotiate bigger contracts with supermarket chains and other institution buyers is phenomenal given their sheer economies of scale and oligopolistic power. Whereas Ms Rosemary has prudently avoided the middlemen in her business model, she has to contend with much larger commercial farmers in a largely unregulated industry and fairly ill-defined market structure. In terms of the legal and regulatory framework there are a few government laws and regulations that either directly or indirectly impacts the poultry industry. These include the Animal Diseases Act, the Co-operative Act and Hatchery Rules. As stated earlier, the Kenyan Government is in the process of compiling data and possibly introducing laws to regulate the poultry sector (www.worldpoultry.net). Until such a time when the market structure is well defined and the industry pricing structure becomes public knowledge the small and medium scale farmers will continue to be faced with a skewed playing field. This is particularly dire given that currently approximately 90% of the rural population keep poultry either for subsistence or commercial purposes (Nyange, 2000).

Exhibit 3 depicts the price differentials between Rosemary's product lines and her most recent competitor. In the following section Ms. Rosemary expresses her fears and seeks counsel.

The Changing Competitive Environment and the Crossroad

Ms. Rosemary took a long reflective pause, then in a very somber tone she continued her narration in almost a besieging tone. I am afraid my simple business model may not be sustainable in the long run. In fact we may be talking about five or so years. Now, Ms. Achieng this is my reason for seeking your counsel. I need to find a way to make this business self sustaining. I recently lost two very lucrative accounts to a large scale commercial farmer. I cannot afford to compete at their prices. My current clients know about the new supplier and I know they are still keeping my account for old times' sake. However, I am not sure that they

will continue to do business with me when there is a much cheaper alternative in town, especially if the pricing gap continues to widen. The way I see it, I must either increase my operation to a much larger scale or find a way to drastically cut my costs in order to breakeven at my competitor's prices. Chicken feeds constitute about 80% of the cost of operation (see exhibit 1). I have no control over the pricing of feeds. If I decide to increase my scale of operation, where will I get the additional funding? I have already borrowed to my limit in the women's group (see exhibit 2(a) and 2(b)). I cannot possibly afford the high interest rates charged by the commercial banks. Remember, this business is meant to generate a modest source of income during my retirement years. I really do not want to deal with a partnership at this stage in my life. Please, help me save this business.

You be the consultant. What advice would you give Ms. Rosemary?

Discussion Questions

Financial Capital

1. Calculate liquidity, profitability and debt management ratios for Rosemary's Farm. Do a trend analysis of each ratio. Is Rosemary's farm financially healthy?
2. Is Ms. Rosemary in a good position to raise external investment? What questions would an investor ask Ms. Rosemary?
3. What general lessons about venture financing can one draw from this case? Give specific examples from the case.
4. List viable sources of funding for Ms. Rosemary should she choose to expand her business. List the pros and cons for every source suggested.

Social Capital

1. Given the socio-economic challenges faced by women in Kenya, why has Victory Women's Group done so well?
2. How did Rosemary tap into the social capital of Victory Women's Group?

Decision Points: Future Direction

1. Evaluate the options that Ms. Rosemary is considering at this time (at the end of the case).
2. What advice would you give Ms. Rosemary for positioning her business for the future?

Teaching Notes

Introduction

Ms. Rosemary is a retired professional woman turned entrepreneur. This case outlines her journey from opportunity recognition to a successful business launch. She details how she acquired her seed capital and initial marketing through a women's group. She has a lot to be proud of including a lifestyle she sought. However, a large scale commercial farmer just moved into town and Rosemary's business model is severely threatened by their low price strategy. Ms. Rosemary invites a local Small Business Consultant, Ms. Achieng, to her farm to help her redefine her business model. According to Rosemary she has just two options: either increase her operation to a much larger scale or find a way to drastically cut her costs in order to breakeven at the competition's prices. The case stops shy of the consultant's recommendation(s). The students will have to assume the role of the consultant and come up with recommendations. Most of the case is written in first person account as told by the entrepreneur.

Key Issues and Discussion Points

The learning goals related to this case include the identification of the resourcefulness of women entrepreneurs in developing nations, and recognition of the significance of social capital and human capital. The central theme and challenge posed to the readers is a chance to analyze an existing strategy which proved successful for a number of years but is now threatened by new competition.

Potential Audience

The case is intended for undergraduate students in Entrepreneurship, International Business and Strategic Management courses. It is a fertile ground for courses that cover cultural diversity of entrepreneurship, family business/small business management, cultural issues in international business, the dynamics of evolving external environment and the inevitable realignment of the internal structures and strategies of a firm. The purpose of the case study is to provide the students with a real-life example of issues facing women entrepreneurs in developing nations.

Suggested Teaching Approach

The case can be taught using either of these approaches.

1. The instructor can begin the discussion by asking students to identify the sources of Rosemary's success. Some of the likely responses may be centered on her social capital or network (she was able to obtain affordable seed capital through the women's group, she obtained a substantial amount of support on marketing of her outputs through group members' referrals, etc...) as well as human capital (the management expertise, legal advice, etc...). The instructor can then divide the class into teams of four to five students each and ask each team to brainstorm on the possible solutions to Ms. Rosemary's predicament. The instructor should monitor the groups to answer questions, but not to determine the direction of the discussion. The instructor can encourage the teams to identify as many potential courses of action as they can and the consequences of each action. The instructor can then have the class decide on one recommendation.
2. Alternatively, the instructor may ask students to address these specific questions either in groups or as individuals depending on class size. Questions addressing specific aspects of the case can also be used to facilitate a class discussion. Some of these include:

Financial Capital

a. Calculate liquidity, profitability and debt management ratios for Rosemary's Farm. Do a trend analysis of each ratio. Is Rosemary's farm financially healthy?

Liquidity Analysis

Current Ratio

The current ratio shows how many times over the firm can pay its current debt obligations based on its assets. The formula is the following: Current Ratio = Current Assets/Current Liabilities.

| | 2006 | 2007 | 2008 |
|--------------------------|------------|------------|------------|
| Current Assets (CA) | 149,045.00 | 183,980.00 | 156,930.00 |
| Current Liabilities (CL) | 140,000.00 | 110,000.00 | 183,000.00 |
| Current Ratio=(CA/CL) | 1.06 | 1.67 | 0.86 |

Interpretation

This means that Rosemary's farm was unable to meet its current (short-term) debt obligations in 2008, hence the bank overdraft. However in 2006 and 2007 it was able to meet its current obligation 1.06 and 1.67 times over respectively. In order to stay solvent, the firm must have a current ratio of at least 1.0 which means it can exactly meet its current debt obligations. So, Rosemary's farm was solvent in 2006 and 2007 but not 2008.

Quick ratio or acid test

The quick ratio is a more stringent test of liquidity than is the current ratio. It looks at how well the company can meet its short-term debt obligations

without having to sell any of its inventory to do so. It tells us how many dollars of liquid assets the firm has per dollar of current liabilities. The higher the number, the more liquid the firm and the better its ability to pay its short-term bills. Service firms such as educational institutions, which tend not to carry too much inventory, will see no significant difference between the current and quick ratio. In the case of Rosemary's Farm, there is no inventory reported in their financial books.

Net Working Capital

A company's net working capital is the difference between its current assets and current liabilities: Net Working Capital = Current Assets - Current Liabilities.

| | 2006 | 2007 | 2008 |
|---------------------------|------------|------------|------------|
| Current Assets (CA) | 149,045.00 | 183,980.00 | 156,930.00 |
| Current Liabilities (CL) | 140,000.00 | 110,000.00 | 183,000.00 |
| Net Working Capital=CA-CL | 9,045.00 | 73,980.00 | -26,070.00 |

If a company's current assets do not exceed its current liabilities, then it may run into trouble paying back creditors in the short term. The worst-case scenario is bankruptcy. Rosemary's farm faced a tough situation in 2008. This shortfall explains the bank overdraft. This may also explain Rosemary's anxiety about the future of her farm. A declining working capital ratio over a longer time period could also be a red flag that warrants further analysis. From this calculation, the students should be able to see the relationship between the company's net working capital and its current ratio.

2007 data this does not appear to be a chronic condition.

We acknowledge the fact that to truly analyze this firm's financial health, we need to look at data for the industry (poultry industry in Kenya). However, the data provided in this case is adequate for introducing students to financial ratio analysis. Fortunately we have three years of data for the firm, thus we can look at the trend in the ratios.

In summary, Rosemary's farm faced liquidity problems in 2008 but looking at the 2006 and

Debt Management Analysis

Debt to Assets Ratio

The debt to assets ratio shows how much of the firm's asset base is financed with debt. The key thing to remember is that if 100% of the firm's asset

base is financed with debt, the firm is bankrupt. The debt to asset ratio should be in line with the firm's industry. It is important to watch the historical trends in the firm and its ability to cover its interest expense on debt.

The debt to assets ratio is: Total Debt/Total Assets

| | 2006 | 2007 | 2008 |
|-----------------------------|--------------|--------------|--------------|
| Total Debt (TD) | 140,000.00 | 110,000.00 | 183,000.00 |
| Total Assets(TA) | 1,566,545.00 | 1,482,230.00 | 1,333,455.00 |
| Debt to Assets Ratio(TD/TA) | 8.94 | 7.42 | 13.72 |

Rosemary's farm does not carry any long term debt. In order to get total debt, you have to add current debt (current liabilities) plus long term debt. As mentioned in the case, loans of more than a five year term tend to attract exorbitant interest rates, often in excess of 35%. It is not uncommon to see most small to medium size businesses being funded wholly by equity and short term debt in Kenya. These ratios are very low by any standard and that may be a good thing in this environment. Most of Ms. Rosemary's debt is from the women's group, accounts and accrued expenses. All these sources have much lower interest rates if any at all. That is not bad compared to the prevailing interest rates for long term debt which can be as high as 35%.

Interpretation

The debt to assets ratio for Rosemary's farm in 2006 is 8.94% this means that 8.94% of the firm's assets are purchased with debt.

As a result, 91.06% of the firm's assets are financed with equity or investor's funds. Of course the students don't know if this is good or

bad as they don't have industry data to compare it with. But they can do a trend analysis. Is the debt burden increasing or decreasing over the 3 year time period? A drop in the debt to assets ratio in 2007 may be a good thing, but we need more information to analyze this adequately. The instructor should point out that the entrepreneur should not forgo investment opportunities with the sole objective of reducing the debt burden. Even when Rosemary faced liquidity problems in 2008, her debt to assets ratio remained under 14%.

Debt to Equity Ratio

A firm is financed by either debt or equity (money invested by owners) or a combination of the two. The debt to equity ratio measures how much debt is used to finance the firm in relation to the amount of equity used. Debt financing is riskier than equity financing especially in markets with a high cost of debt capital and high inflation rates. As the proportion of debt financing goes up, the risk of the firm also goes up.

The formula of Debt to Equity Ratio is: Total Debt (Liabilities)/Shareholder's Equity

| | 2006 | 2007 | 2008 |
|-----------------------------|--------------|--------------|--------------|
| Total Debt (TD) | 140,000.00 | 110,000.00 | 183,000.00 |
| Total Equity (TE) | 1,426,545.00 | 1,372,230.00 | 1,150,455.00 |
| Debt to Equity Ratio(TD/TE) | 9.81 | 8.02 | 15.91 |

A debt to equity ratio greater than 100% is considered a very risky investment. Rosemary had debt to equity ratio below 10% in 2006 and 2007. This ratio went up to 15.91 in 2008. This may have made Rosemary a little concerned but it is still a relatively low ratio. Unfortunately the

students have nothing to compare it to except to talk of a spike in the debt level in 2008.

Like any other ratio, students need comparative data in order to know if this is good or bad. The case does not provide industry data but we can calculate the 2006 and 2007 debt to equity ratio.

This may be an indication that Rosemary's fear may be founded but we need more of a trend rather than a single data point.

Profitability Analysis

Every firm is most concerned with its profitability. One of the most frequently used tools of financial ratio analysis is profitability ratios which are used to determine the company's bottom line. Profitability measures are important to company managers and owners alike. If a small business has outside investors who have put their own money into the company, the primary owner certainly has to show profitability to those equity investors. Profitability

| | 2006 | 2007 | 2008 |
|--------------------------|--------------|--------------|--------------|
| Net Income (NI) | 304,625.00 | 1,339,612.86 | 496,300.00 |
| Total Assets (TA) | 1,566,545.00 | 1,482,230.00 | 1,333,455.00 |
| Return on Assets (NI/TA) | 0.19 | 0.90 | 0.37 |

Interpretation

A higher percentage means that the company is doing a good job using its assets to generate sales. The ratio was lowest in 2006, the year Rosemary acquired a new vehicle for business use plus she made expansions on the chicken sheds and made substantial investment in fixtures and fittings. The farm also had to buy a fresh stock of layers. In 2007 the farm did not invest in buying a new stock of layers and therefore the expenditures were greatly reduced (she did not have to buy Chick Mash and Growers Mash). Rosemary's business cycle will also have heavy investments every other year as long as she continues to invest in layers.

With these levels of ROA, the students may express fewer concerns with the liquidity issues. The students may want to know how to interpret an ROA of 90% because it is not a common occurrence. ROA is a function with many implicit variables such as the level of capitalization. For instance in mid 2006, the software industry in the USA experienced an average ROA of 13.1 with Microsoft enjoying a whopping ROA of 20.1. During the same time period the Auto industry averaged an ROA of a dismal 1.1 with GM suffering a negative 1.8.

Generally speaking, firms with relatively lower capital intensive investments will tend to enjoy a higher ROA relative to those with higher capital intensive investments. Capital intensive firms such

ratios show a company's overall efficiency and performance.

Return on Assets (also called Return on Investment)

The Return on Assets ratio is an important profitability ratio because it measures the efficiency with which the company is managing its investment in assets and using them to generate profit. It measures the amount of profit earned relative to the firm's level of investment in total assets. The return on assets ratio is related to the asset management category of financial ratios.

The calculation for the return on assets ratio is: Net Income/Total Assets.

as equipment manufacturers, auto manufacturers, an airlines, etc...will require substantial assets simply to keep their operation going. Whereas firms such as fashion designers, ad agencies, and software firms, etc... may require only minimal capital equipment and will thus produce a higher ROA. Rosemary's farm falls in the latter category. It seems that Rosemary's farm is in better shape than she thinks.

It is important for the instructor to point out the limitations of using ROA as a sole determinant of a firm's profitability or performance. It is important to note that ROA includes total assets and not net assets. For instance, if the cash in the bank (a current asset) is borrowed then it is balanced by a liability (short term debt or long term debt); account receivables are current assets but they are balanced by accounts payables, a liability, etc...Therefore ROA is often of little interest to investors but management are often interested in it in order to assess the use of all money put to work.

Return on Equity Ratio

The Return on Equity ratio is perhaps the most important of all the financial ratios to investors in the company. It measures the return on the money the investors have put into the company. This is the ratio potential investors look at when deciding whether or not to invest in the company. The calculation is: Net Income/Stockholder's Equity.

| | 2006 | 2007 | 2008 |
|---------------------------|--------------|--------------|--------------|
| Net Income (NI) | 304,625.00 | 1,339,612.86 | 496,300.00 |
| Stockholder's Equity (SE) | 1,426,545.00 | 1,372,230.00 | 1,150,455.00 |
| Return on Equity (ROE) | 21.35 | 97.62 | 43.14 |

In general higher percentages are an indication of better performance. It shows that the company is doing a good job using the investors' money. However, there are important exceptions to this rule. While highly regarded as a profitability indicator, the ROE Ratio does have a recognized weakness. Investors need to be aware that a disproportionate amount of debt in a company's capital structure would translate into a smaller equity base. Thus, a small amount of net income (the numerator) could still produce a high ROE off a modest equity base (the denominator). This is not a concern in the case of Rosemary's farm. Overall she holds very low levels of debt. However, we need more data to determine a more consistent trend for Rosemary's ROE. She had a large capital investment in 2006 (purchased a vehicle) while in 2007 she had a break in terms of not restocking the layers. Rosemary is likely to end up with a spiked ROE every other year when she does not need to restock the layers.

In general, financial analysts in developed economies consider return on equity ratios in the 15-20% range as representing attractive levels of investment quality. The expectations in developing economies are much higher. This tends to be a function of the industry as well as country specific factors among a host of other factors.

b. Is Ms. Rosemary in a good position to raise external investment? What questions would an investor ask Ms. Rosemary?

Ms. Rosemary runs a profitable business. Positive net income is a strong indication that she has a viable investment and external investors are likely to consider her proposal. However, the more pertinent question is, is it prudent given the information on the cost of debt? The entrepreneur has also indicated that she is not interested in a partnership and by inference she is not interested in other equity holders.

The students should tie their discussion to the financial ratios. They are all likely to agree that Ms Rosemary can raise external investments. They may even point out that she already does (short

term loans from the women's group and the bank overdrafts). The students may also point out that investors may ask for her cash flow statements, income statement and the business plan.

c. What general lessons about venture financing can one draw from this case? Give specific examples from the case.

Students' answers will vary. Some may point out that early stage financing is very restricted. Ms. Rosemary obtained her financing from the typical sources: personal savings, friends (the women's group) and bootstrapping (personal resources and resourcefulness)

d. List viable sources of funding for Ms. Rosemary should she choose to expand her business. List the pros and cons for every source suggested.

Debt: This term may be used to refer to all borrowed funds. Since all debt instruments are interest bearing, their greatest limitation would be the obligation to service them irrespective of firm performance. They must be repaid regardless of firm performance. Secondly, to obtain it the lenders usually require some business or personal assets to be used as collateral. The benefit is that the entrepreneurs do not have to give up ownership and control.

Equity: This term refers to invested funds such as stocks and retained earnings. Their value increases or decreases depending on firm performance. Their limitation is that the business founders must give up some ownership and control of the firm. The benefit is that the entrepreneur does not have an obligation to service the capital and the capital does not have a maturity date.

Social Capital

a. Given the socio-economic challenges faced by women in Kenya, why has Victory Women's Group done so well?

- The members are well educated , hence a high level of human capital

- The support in terms of financial capital, expertise advice and moral support... collectively we may call this social capital

Long term orientation of the members... 'leaving a legacy for their children'

b. How did Rosemary tap into the social capital of Victory Women's Group?

- Her marketing strategy is basically by word of mouth
- She gained a lot of expertise and advice from the group members. She talked of members helping her with the general administration/ management. A friend taught her the significance of delegating responsibilities to the workers, bookkeeping...

Decision Points: Future Direction

a. Evaluate the options that Ms. Rosemary is considering at this time (at the end of the case).

Students' responses will vary. The students may discuss the pros and cons of the two options suggested by Ms. Rosemary

b. What advice would you give Ms. Rosemary for positioning her business for the future?

Students' responses will vary. At the moment Ms. Rosemary is keeping four different breeds of chickens and each is housed separately. Each breed of chicken has unique dietary needs. Some students may suggest a focus strategy for Ms. Rosemary. Select the least capital intensive breed (the indigenous chickens and maybe Kenbrew) and forgo the rest. Of course the limitation of this suggestion is that these are not the most profitable breeds. The turnover may be high for Kenbrews in comparison to the layers but the layers are more profitable.

Some students may suggest a differentiation strategy. They may suggest Ms. Rosemary should concentrate on purely organic farming and market her produce as such. The large scale farmer may not be able to meet the needs of such a market segment. This suggestion has the same limitations as the first one.

Some may suggest that Ms Rosemary should closely reexamine the poultry industry and try and identify the underserved market segments. Look at the institutions...government, private,

non governmental organizations, etc... Are there institutions that support small businesses or women owned businesses? Reaching out to markets that are underserved or seeking out markets that are particularly supportive of her type of business may increase her prospects.

The instructor may want to introduce the 'Blue Ocean Strategy' or if this has already been discussed in class, some students may suggest this approach. This strategic approach basically advocates for entrepreneurial firms to reach beyond their current operations and markets in pursuit of new opportunities.

Firms that are willing to venture into market spaces where there is relatively limited competition, referred to as the blue oceans, often outperform those that limit growth to incremental improvements in competitively crowded segments, referred to as the red oceans.

Role of the Authors

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Exhibit 1 a: Income & Expenditure Statements

| Income and Expenditure | 2006 | 2007 | 2008 |
|--------------------------------|----------------------------|----------------------------|----------------------------|
| Sales | Ksh | Ksh | Ksh |
| Broilers | 495,000.00 | 517,500.00 | 525,000.00 |
| Layers | 48,000.00 | - | 59,800.00 |
| Kenbrews | 517,500.00 | 532,500.00 | 535,500.00 |
| Eqqs from Layers | 750,000.00 | 825,000.00 | 862,500.00 |
| Indigenous/organic Chicken | 216,000.00 | 225,000.00 | 231,000.00 |
| Indigenous/organic Eqqs | 554,400.00 | 579,600.00 | 604,800.00 |
| Gross Income | <u>2,580,900.00</u> | <u>2,679,600.00</u> | <u>2,818,600.00</u> |
| Expenditure¹ | | | |
| Stock (Broilers) | 75,000.00 | 90,000.00 | 97,500.00 |
| Stock (Layers) | 11,250.00 | - | 12,000.00 |
| Stock (Kenbrews) | 11,750.00 | 12,500.00 | 13,750.00 |
| Feed (Broiler Starters) | 90,857.14 | 90,857.14 | 90,857.14 |
| Feed (Broiler Finisher) | 275,000.00 | 275,000.00 | 275,000.00 |
| Feed (Chick Mash) | 151,428.57 | - | 151,428.57 |
| Feed (Growers Mash) | 785,714.29 | - | 785,714.29 |
| Feed (Layers Mash) | 487,350.00 | 487,350.00 | 487,350.00 |
| Feed (millet & maize meals) | 6,300.00 | 6,780.00 | 7,600.00 |
| Vaccines | 21,125.00 | 20,250.00 | 24,375.00 |
| Salaries & Wages | 96,000.00 | 108,000.00 | 120,000.00 |
| Security Services | 36,000.00 | 36,000.00 | 60,000.00 |
| Depreciation | 157,500.00 | 144,250.00 | 130,725.00 |
| Insurance | 15,000.00 | 15,000.00 | 15,000.00 |
| Telephone Charges | 30,000.00 | 28,000.00 | 25,000.00 |
| Electricity, water & cons. | 26,000.00 | 26,000.00 | 26,000.00 |
| Total Expenditure | <u>2,276,275.00</u> | <u>1,339,987.14</u> | <u>2,322,300.00</u> |
| Net Income | <u>304,625.00</u> | <u>1,339,612.86</u> | <u>496,300.00</u> |

Exhibit 1 b: Notes to Income & Expenditure Statements

| Currency | Feed | Stock | Layers: Gaps in Stock Purchase | Layers: Gaps in Feed Purchase |
|--|---|---|---|---|
| In Kenyan Shillings (sign: Ksh; code: KES) | Feed costs constitutes over 80% of the total cost of production | The mortality rate of poultry is relatively low at Rosemary's farm. She routinely writes off less than 1% of the stock. | Layers have a life span of about one and a half years. Therefore the stock is replenished every other year. | Layers feed also vary as follows: chick mash from when they are a day old to about 8 weeks; followed by grower mash from 9 weeks to 18 weeks; finally layer mash from 19 to about 75 weeks. |

Exhibit 2 a: Balance Sheets As on Dec/31st

| Balance Sheet | 2006 | 2007 | 2008 |
|--|---------------------|---------------------|---------------------|
| Assets | Ksh | Ksh | Ksh |
| Fixed Assets | | | |
| Property, Plant & Equipment ¹ | 1,417,500.00 | 1,298,250.00 | 1,176,525.00 |
| Current Assets | | | |
| Receivables and Prepayments | 129,045.00 | 133,980.00 | 140,930.00 |
| Cash & Cash Equivalents | 20,000.00 | 50,000.00 | 16,000.00 |
| | <u>149,045.00</u> | <u>183,980.00</u> | <u>156,930.00</u> |
| Total Assets | <u>1,566,545.00</u> | <u>1,482,230.00</u> | <u>1,333,455.00</u> |
| Long Term Liabilities | | | |
| Equity Capital | 1,426,545.00 | 1,372,230.00 | 1,150,455.00 |
| Long Term Debt | - | - | - |
| Current Liabilities | | | |
| Payables & Accrued Expenses ² | 60,000.00 | 50,000.00 | 78,000.00 |
| Bank OD | - | - | 30,000.00 |
| Short term Loan (Women's Group) | 80,000.00 | 60,000.00 | 75,000.00 |
| | <u>140,000.00</u> | <u>110,000.00</u> | <u>183,000.00</u> |
| Total Liabilities | <u>1,566,545.00</u> | <u>1,482,230.00</u> | <u>1,333,455.00</u> |

Note: Currency In Kenyan Shillings (sign: Ksh; code: KES)

Exhibit 2 b: Balance Sheets As on Dec/31st Cont.

| Notes: | | | | |
|--|-------------------|------------------|-------------------|---------------------|
| Property, Plant & Equipment ¹ | | | | |
| Year ended 31st December 2006 | | | | |
| Cost | Temporary Sheds | Fittings | Vehicles | Total |
| As at 1/1/2006 | 500,000.00 | 70,000.00 | 350,000.00 | 920,000.00 |
| Additions | 40,000.00 | 15,000.00 | 600,000.00 | 655,000.00 |
| Total Value | <u>540,000.00</u> | <u>85,000.00</u> | <u>950,000.00</u> | <u>1,575,000.00</u> |
| Depreciation(@ 10%) | 54,000.00 | 8,500.00 | 95,000.00 | 157,500.00 |
| Net Book Value as at Dec/31/2006 | <u>486,000.00</u> | <u>76,500.00</u> | <u>855,000.00</u> | <u>1,417,500.00</u> |
| Property, Plant & Equipment ¹ | | | | |
| Year ended 31st December 2007 | | | | |
| Cost | Temporary Sheds | Fittings | Vehicles | Total |
| As at 1/1/2007 | 486,000.00 | 76,500.00 | 855,000.00 | 1,417,500.00 |
| Additions | 20,000.00 | 5,000.00 | - | 25,000.00 |
| Total Value | <u>506,000.00</u> | <u>81,500.00</u> | <u>855,000.00</u> | <u>1,442,500.00</u> |
| Depreciation(@ 10%) | 50,600.00 | 8,150.00 | 85,500.00 | 144,250.00 |
| Net Book Value as at Dec/31/2007 | <u>455,400.00</u> | <u>73,350.00</u> | <u>769,500.00</u> | <u>1,298,250.00</u> |
| Property, Plant & Equipment ¹ | | | | |
| Year ended 31st December 2008 | | | | |
| Cost | Temporary Sheds | Fittings | Vehicles | Total |
| As at 1/1/2008 | 455,400.00 | 73,350.00 | 769,500.00 | 1,298,250.00 |
| Additions | 5,000.00 | 4,000.00 | - | 9,000.00 |
| Total Value | <u>460,400.00</u> | <u>77,350.00</u> | <u>769,500.00</u> | <u>1,307,250.00</u> |
| Depreciation(@ 10%) | 46,040.00 | 7,735.00 | 76,950.00 | 130,725.00 |
| Net Book Value as at Dec/31/2008 | <u>414,360.00</u> | <u>69,615.00</u> | <u>692,550.00</u> | <u>1,176,525.00</u> |

Note: Currency In Kenyan Shillings (sign: Ksh; code: KES)

Exhibit 3: Rosemary's Price Structure vs. the New Competitor

| Rosemary's Price structure as of 2008 | Ksh per Bird/Egg | Competitor's Price structure as of 2008 | Ksh per Bird/Egg |
|---------------------------------------|------------------|---|------------------|
| Broilers | 350.00 | Broilers | 320.00 |
| Layers | 260.00 | Layers | 230.00 |
| Kenbrews | 357.00 | Kenbrews | 340.00 |
| Eggs from Layers | 11.50 | Eggs from Layers | 10.00 |
| Indigenous/orqanic Chicken | 385.00 | Indigenous/orqanic Chicken | N/A |
| Indigenous/orqanic Egqs | 12.00 | Indigenous/orqanic Egqs | N/A |

Note: Currency In Kenyan Shillings (sign: Ksh; code: KES)

Figure 1: Typical Distribution Channel and Pricing Structure for Indigenous Chicken

| Rosemary's Price structure as of 2008 | Ksh per Bird/Egg | Competitor's Price structure as of 2008 | Ksh per Bird/Egg |
|--|-------------------------|--|-------------------------|
| Broilers | 350.00 | Broilers | 320.00 |
| Layers | 260.00 | Layers | 230.00 |
| Kenbrews | 357.00 | Kenbrews | 340.00 |
| Eggs from Layers | 11.50 | Eggs from Layers | 10.00 |
| Indigenous/organic Chicken | 385.00 | Indigenous/organic Chicken | N/A |
| Indigenous/organic Eggs | 12.00 | Indigenous/organic Eggs | N/A |

THE NOVA GROUP CASE STUDY: FAMILY DYNAMICS IN A MULTIGENERATIONAL FRENCH FAMILY BUSINESS

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Abstract

This case illustrates the evolution of family relationships in a multigenerational family business and its impact on performance. Building on a systems perspective, it uses the organizational finance, family therapy, and family business literatures to explain how and why family relationships in a large French food distribution group weakened over the life cycle and lead to increasing conflicts of interests between active and non-active family shareholders, thus to the loss of the family control over the business. The case highlights the role of values transmission across generations and governance mechanisms. Finally, it suggests key learning lessons for family businesses to strengthen their family relationships and ensure the family continuity in the business.

Key words: agency theory, communication, culture, corporate governance, family business, family relationships.

Introduction

Family businesses have been traditionally viewed as an ideal type of organization with outstanding performances stemming out mainly from insignificant agency costs (Ang, Cole, & Lin, 2000; Dalton & Daily, 1992; Jensen & Meckling, 1976). This monolithic vision is however biased and limited (Corbetta & Salvato, 2004; Sharma, Chrisman, & Chua, 1997) since it does not account for the families' heterogeneous characteristics, dynamics and performance (Dyer, 2006). Family businesses pursue dual performance objectives that relate both to the business system (e.g., transgenerational continuity) and to the family system (e.g., family health). Achievement of these objectives over time is a real challenge given the vulnerability of family businesses during succession, as shown

by the progressively higher rate of failure when the business is passed from the first generation to subsequent ones (Birley, 1986).

The scarce studies investigating family businesses from the perspective of family and business performance and dynamics restricted the analysis to quantitative sets of ratios and items assessing the business performance and family relationships quality (Anderson & Reeb, 2003; Cadieux, Lorrain, & Hugron, 2002; Lansberg & Astrachan, 1994; Lee, 2006; Sharma, 1997). Triangulation of methodologies through in-depth interviews and data analysis combined with a more exhaustive use of quantitative instruments from the family therapy field helps better understanding the family business dynamics and performance over time.

This case study addresses these deficiencies by presenting a twofold qualitative and quantitative analysis of the antecedents and outcomes of family relationships dynamics in a former large multigenerational family business. The Nova Group is a French food distribution and century-old business that encountered major family-based problems throughout its life-cycle. By bridging the family therapy, family business, and organizational finance fields, this case suggests explaining how and why the family relationships of the Nova Group weakened and lead to increasing conflicts of interests between active and non-active family shareholders, thus to the loss of the family control over the business. It also highlights the crucial role of the transmission of values across generations, as well as the advantages and disadvantages of the governance mechanisms set or ignored by the family. Finally, it presents key learning lessons for family businesses to help them strengthening the family relationships, preventing the loss of family control, and ensuring longevity.

Literature review

A systems-based view of the family business

A systems perspective of the family business helps understanding its holistically complex situations (Hollander & Elman, 1988) while viewing its problems and their resolution as an effect of the whole system's functioning (Dunn, 1999). The family business system comprises three open, dynamic and interacting subsystems - family, business and ownership subsystems (Gersick, Davis, Hampton, & Lansberg, 1997) which relate to the environment (Pieper & Klein, 2007). The premise of this view is that the success of the family business depends on the way these subsystems interact and relate to one another over time (McClendon & Kadis, 2004). Taking into account the characteristics of each subsystem and the stage of its life-cycle is hence crucial to understanding the family business evolution.

The family subsystem is an emotional and multigenerational unit where the functioning of its members is totally interdependent (Bowen, 1978; Kets de Vries, 1993; Zellweger & Astrachan, 2008). Family members are tied by blood, marriage or adoption relationships. Being viewed as multidimensional, family relationships are structured to satisfy the family members related needs that are emotional, informational, political and financial (Labaki, 2005). At the opposite of the predominant thoughts in the family business literature, family relationships are not static but progressively weaken over time. The family needs and the quality of relationships evolve along with the evolution of the ownership and business subsystems. In the family therapy field, family relationships can be assessed through their degree of cohesion and of adaptability to change (Olson, McCubbin, Barnes, Muxen, & Wilson, 1992).

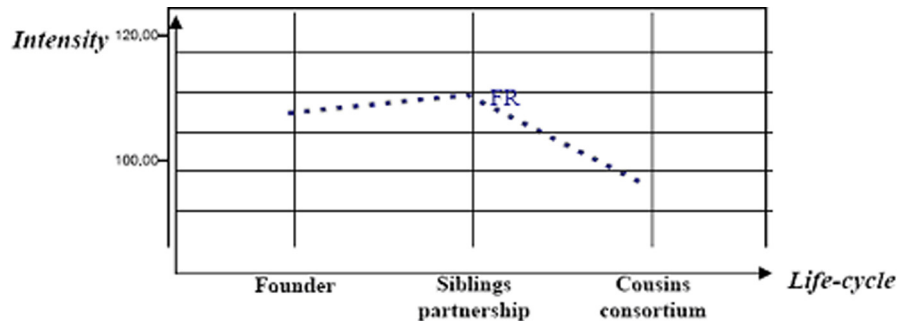
The ownership subsystem commonly tends to follow a predetermined path, moving from the founder's controlling stage to the siblings' partnership, then to the cousins' consortium (Gersick, Davis, Hampton, & Lansberg, 1997). During the first stage, family relationships have been reported as being healthy and balanced, thus providing the necessary conditions for the smooth start of the family business (Beckhard & Dyer Jr, 1983; Davis & Harveston, 1999; Kets de Vries, 1993). However, these favorable family relationships can become vulnerable during the subsequent life cycle stages where the complexity

of the family business system increases. The siblings partnership stage is considered by the literature as a fertile ground for rivalries that infect family relationships between the "newcomers" in the business sphere (Casson, 1999; Davis & Herrera, 1998), although recent research shows that on average a successful family business succession to the second generation strengthens the family relationships at the siblings partnership stage (Labaki, 2007). This situation worsens however with the multiplication of shareholders and managers belonging to different branches of the family structure, during the cousins consortium stage (Davis & Harveston, 1999; Gersick, Davis, Hampton, & Lansberg, 1997; Kets de Vries, 1993).

In addition, the business subsystem evolves from a start-up stage to an expansion, then to a maturity stage with different financial and strategic challenges. Family relationships are gradually affected (Casson, 1999; Smith, 1759) as the ownership and business life cycles evolve (Marcus, 1983; Sonfield & Lussier, 2004), with a sharp tendency to weaken at the cousins consortium stage (Labaki, 2007).

The family business and family therapy literatures suggest several family variables influencing family relationships, mainly the communication of cultural values across generations. According to Galvin, Bylund, & Brommel (2004, p. 49), "throughout the flow of patterned and meaningful messages, family members regulate cohesion and adaptability to develop a collective identity". The quality and frequency of communication between family members strengthen family relationships (Galvin, Bylund, & Brommel, 2004; Mustakallio, 2002; Poza, Alfred, & Maheshwari, 1997). Hence, if cultural values are properly conveyed and communicated throughout generations, they would favor strong family relationships (Astrachan & Karlsson-Stider, 2004; Dyer, 1986), whether these values are traditional (Barnes & Hershon, 1976; Hollander & Elman, 1988), ethical or spiritual (Delaune, 1998; Dunn, 1999; Kuratko, Hornsby, & Montagnano, 1993).

These insights highlight the role of cultural communication within and across generations in strengthening family relationships, which is crucial for the family business given that family relationships tend to weaken over time, especially in the cousins consortium stage.

Figure 1: Family Relationships (FR) Evolution Across the Family Business Life Cycle

Source: (Labaki, 2007)

An agency-based view of the family business

The traditional corporate finance's theoretical framework (agency theory) stressed the advantages of family businesses in terms of performance by viewing them as a homogenous group and a reference base for zero or insignificant agency costs (Ang, Cole, & Lin, 2000; Jensen & Meckling, 1976). These costs are lower in family businesses because of the trust that characterizes family relationships and the natural alignment of interests between shareholders and managers that reduce the need for formal monitoring and governance mechanisms. The families involved in business are also perceived as a cohesive and static unit. More recently, however, several family business researchers have argued that family businesses are heterogeneous with significant agency costs (Lubatkin, Lane, & Schulze, 2001; Schulze, Lubatkin, & Dino, 2003). Therefore, the evolution of family relationships quality over the life cycle may highlight the presence of agency costs and threaten the business performance.

Conflicts of interest represent a main traditional source of agency costs. In a family business, the interests between family members can be regarded as convergent or divergent depending on the quality of family relationships. The social bonds embedded in emotions and feelings may contribute to building a collectivist culture within the family business; for example, an organizational climate in which personal objectives are aligned with the objectives of the collective (Corbetta & Salvato, 2004; Handler & Kram, 1988; James, 1999a). Hence, strong emotional family bonds are associated with congruent interests that inhibit the agency costs.

Moreover, dynamics of political relationships play a significant role in the extent of the goals' alignment. As the business matures, new forms of problems and challenges occur (Davis & Stern, 1981). Power struggles may emerge regarding the control of the business (James, 1999b, p. 52). Power differentials can materially affect the content of principal-agent contracts and the structure of governance mechanisms policing those contracts (Hill & Jones, 1992, p. 135). Family members who have the decision power can make decisions and take actions that favor their own interests and not those of the family (Van den Berghe & Carchon, 2003, p. 173).

In addition, as the family business moves towards the cousins' consortium stage, there are relatively more non-active family members (Neubauer & Lank, 1998) whose views are often different from those of their relatives working in the firm (Dyer, 1994; Ward & Aronoff, 1994). Weak family relationships between active and non-active family members are more likely to occur, inducing agency costs related to conflicts of interests. Corbetta and Salvato (2004) suggest that agency costs arising from separation of ownership and management depend on the extent of owner-management relationship. Whenever the firm is managed by a sole owner, as most founder-based family businesses, agency costs may be non-existing. In contrast, managerial control by individuals owning a minority of shares (as in the siblings and cousins consortium) may raise related agency costs to the level of non-family businesses. According to Vilaseca (2000), progressive growth of the shareholders group, through the evolution of the generations or the transfer of certain shares to other shareholders,

makes the alignment between the various personal interests increasingly difficult.

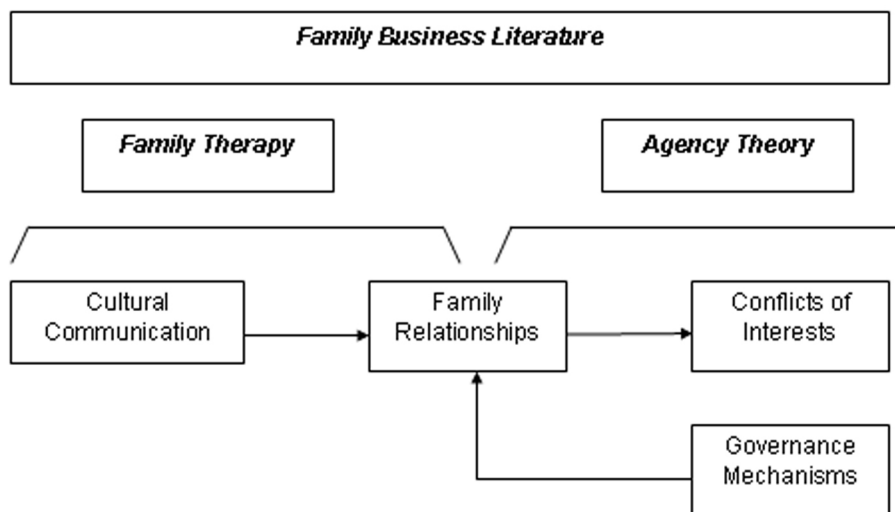
Furthermore, financial considerations of family members play a major role as the firm matures and the generations span. While the family seeks to satisfy one of its functions as a provider of security and comfort for its members, the business seeks to satisfy the financial investments in view of better performance, growth and continuity. Over time, the dual financial needs of the family and the firm evolve accordingly and tend to become conflicting. Issues of dividends distribution are crucial elements that may exacerbate weak relationships. Non-active family shareholders are generally less committed to the firm, have a larger emphasis on financial returns than active family members (Gersick, Davis, Hampton, & Lansberg, 1997; Vilaseca, 2002) and tend to be reluctant to reinvest profits in the business (Gersick, Davis, Hampton, & Lansberg, 1997; Neubauer & Lank, 1998). This situation often negatively affects family business performance (Donnelley, 1964; Lansberg, 1983) and leads to intense conflicts over strategic decisions of the family business (Ward, 1987). According to Astrachan (2003,

p. 569), “if the owning family disagrees about what its interests are, agency costs may actually increase as multiple disparate factions contract and monitor to make sure their varied interests are being attended to by family managers who have divergent interests”.

As the number of generations grows, many scholars stress the importance of setting family governance mechanisms (family holding, family council, family assembly, family constitutions) to help strengthening the family (Lansberg, 1988; Le Breton-Miller, Miller, & Steier, 2004; Mustakallio, Autio, & Zahra, 2002; Vilaseca, 2002). Astrachan (2003) notes that larger, older family companies have high degrees of family stability probably because they developed formal mechanisms for ensuring family health and maintaining family stability.

These insights highlight the role of governance mechanisms in preventing the deterioration of family relationships over time, which is crucial given that weak family relationships increase the potential for conflicting interests among family members in the family business.

Figure 2: Conceptual Framework Based on the Literature Perspectives



Research methodology

Based on the conceptual framework derived from the literature, this study tracks the family business dynamics of the Nova Group, a large publicly-listed and former multigenerational family business operating in the food retail industry in France. The evolution of the business, ownership and family subsystems implied a series of strategic, financial and family challenges, which were crucial in determining the path of the family business performance. Following Yin's (2009) approach, a case study is carried out through triangulation of quantitative and qualitative data in order to offer in-depth insights of the antecedents and outcomes of both the family and business performance over time.

Since family businesses are unique, their performance is bi-dimensional, referring both to the achievement of the family and the business

objectives (Chrisman, Chua, & Litz, 2004; Sharma, 2004). In order to gain a more accurate perspective of the family business performance beyond the commonly used quantitative ratios, this case takes into account their unique long-term objectives, mainly transgenerational wealth creation (Habbershon, Williams, & MacMillan, 2003) to maintain the family control, and socio-emotional wealth creation (Astrachan & Jaskiewicz, 2008; Gomez-Mejia, Haynes, Nunez-Nickel, Jacobson, & Moyano-Fuentes, 2007) to maintain strong family relationships over the life cycle. As suggested by Sharma (2004), family businesses are not always equally successful on both performance dimensions. Her dynamic matrix of family business performance shows that good performance on the family dimension indicates firms with high cumulative emotional capital whereas good business performance indicates firms with high cumulative financial capital.

Figure 3: Family Business Performance Matrix

| | | FAMILY DIMENSION | |
|--------------------|----------|---|---|
| | | Positive | Negative |
| BUSINESS DIMENSION | Positive | I <i>Warm Hearts</i> <i>Deep Pockets</i> High Emotional and Financial Capital | II <i>Pained Hearts</i> <i>Deep Pockets</i> High Financial but Low Emotional Capital |
| | Negative | III <i>Warm Hearts</i> <i>Empty Pockets</i> High Emotional but Low Financial Capital | IV <i>Pained Hearts</i> <i>Empty Pockets</i> Low Financial and Emotional Capital |

Source: (Sharma, 2004)

Building on these insights, the case analysis addressed the dynamics of the Nova Group performance along the family and business dimensions. Family managers and board members of the Nova Group (that is no longer family-controlled) accepted to collaborate in the analysis while being highly interested in the research question. In addition to self-administered questionnaires, semi-structured interviews were conducted to collect their experiences and perceptions, focusing on the family business evolution, challenges, role

of communication, conflicts of interests, and governance mechanisms.

In particular, the objective measures of business performance were complemented by the subjective perceptions by family managers of the business performance. Regarding the measures of family performance, questionnaires based on scales from the family therapy field were administered to gain an accurate view of the family relationships quality. The FACES (Family Adaptability and

Cohesion Evaluation Scales) instrument (Maynard & Olson, 1987; Olson, McCubbin, Barnes, Muxen, & Wilson, 1992) is designed to assess the family relationships along two dimensions: cohesion and adaptability. It offers a matrix of family types based on the levels of cohesion and adaptability (Circumplex Model of Family Systems). Moderate levels relate to balanced families whereas extreme levels relate to unbalanced and problematic families. By building on this matrix (Figure 5), it is possible to highlight the family relationships' quality across the life-cycle in the family business.

Other scales derived from the family business and organizational finance literatures complemented the analysis of the antecedents and outcomes of family relationships by assessing the degree of conflicts of interests, the degree of communication of cultural values, and efficiency of the governance mechanisms in the Nova Group.

Data analysis of the interviews and questionnaires was finally complemented by secondary sources of information such as a press articles' review, external and internal company documents, and financial data base. The findings derived from triangulating the different sources of data helped acquiring a wider perspective of the critical issues related to dynamics of family relationships, business performance and governance in the family business.

Presentation of Nova Group Case

Introduction to the case

With some nostalgia blended with bitterness, Christophe Duchesse remembers the founder's words reprinted in a book commemorating his family business' 100th anniversary:

"I am writing down in this notebook some reflections, some thoughts, some knowledge, and some recommendations that are designed to make you recall the sincere affection of your father, his desire that you keep alive his memory (...) and carry on - within the family - the principles of honesty, probity, and work, that we have learned, my dear wife and me, from our parents...". (Didier Duchesse)

While holding firmly the sacred book, Christophe stood up and watched from the window the giant

factories overlooking the view. He was one of the last active family members of Nova Group, the company founded by his grand father Didier Duchesse. Being part of the third generation, he just realized that the crucial decision he made in the last board's meeting is starting to blow up a wind of change on this successful international food retail business – while probably changing forever the family's fate in the business.

At the early stages of the business development, the family business was closely entwined with the founder's mark – personality, vision and values. It has nurtured generations of close family members through fundamental values and principles, making them part of the enduring success and development of the business. This is now part of the past history since the founder's shadow seems to finally fade far away from his expectations, leaving a scattered family out of the business.

Profile of Nova Group

Nova Group is a large French food distribution business. Founded over a century ago by Didier Duchesse, the business expanded rapidly, building on the innovative vision of the founder, the social actions and fundamental values he instituted. As the business activities developed, the founder's children were progressively involved in the business. However, the competitive environment started to be rude and the need for expansion and financial funds increased. As the business spanned many generations, the needs of family members became more important. In 1997, the family business was held by 220 family shareholders. Although the succeeding family managers had continuously set up a series of rules and governance mechanisms in order to avoid family-related problems, conflicts of interest arose in the subsequent generations, leading to a progressive loss of the family control. Whereas in 1960 the family controlled 60% of the voting rights, in 2007 only three family members remained actively involved in the business, controlling only 1.8% of the voting rights. However, Nova Group is still an international successful business with 150 000 employees and 36 billion Euros of annual sales volume.

What are the factors that influenced the family performance (e.g., family relationships quality)

and business performance (e.g., family control across generations) over time? This case study investigates this research question by analyzing the challenges the Nova Group faced from the first to the third generation, then make suggestions and recommendations for ensuring family continuity and unity in family businesses.

Challenges of the first generation in the family business

Starting up the business:

Didier Duchesse was born in a modest family in the Northern part of France. He first acquired his business experience in his parents' small grocery shop where he used to help after school. Whereas he wanted to pursue university studies in engineering, he brutally learned about the illness of his mother. Being raised with the family values of sacrifice and altruism, he first devoted full time to working in his father's business and postponed his university projects.

The death of his mother, shortly followed by his father's, was a very emotionally charged experience for Didier. He decided to enrol in management studies where he earned a degree in accounting and commerce in order to develop the family grocery shop, which was a symbolic heritage he was proud of. He then got the opportunity to start his own grocery shop by buying an existing one in 1892. Nova was the given name of the shop which was the business district name of the city where it was established. Didier's wife, Sophie Duchesse, naturally joined the business and helped him developing it while raising the growing family. The exceptional location of the shop, their hard work combined with a lot of sacrifice bare its fruits since the business rapidly evolved far beyond its original location along with the sales volume.

The founder was a charismatic and visionary man. He knew how to be persuasive to constantly get the necessary funding for his investments projects. The first branch store was thus established in 1898 with the financial resources of family and friends. Didier had increasing ambitions to develop the business while emphasizing the good quality of the products. He once stated: "At one point in time,

I was capable of targeting a sales volume increase despite business losses". He always insisted however that "Everywhere and always, the prices of our products reflect modest but reasonable benefits".

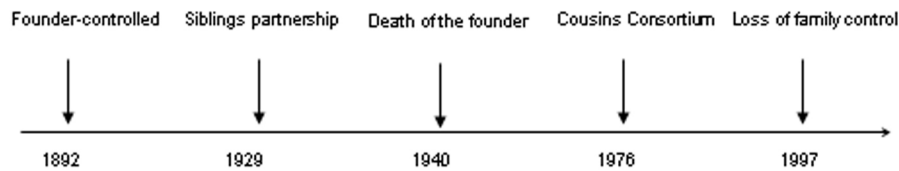
Expansion of the business: from commercial to industrial activities

After being the first historical small food retail shop in France, Nova opened new shops that quickly gained great popularity amongst French customers. Nevertheless, Didier soon realized that the growth of its business activities made him very dependent upon suppliers. Due to difficulties in getting the required quantity and quality of merchandise from the suppliers in due time, he decided to independently produce his own quality products. Nova's products range progressively increased (bread, chocolate, coffee, sweets, jam, wine etc.), leading to an exponential evolution of the shops number in the early 1900s, reaching almost 450 branch stores within a 15 years period.

Tradition of innovation and social values beyond contingency factors:

Not only the founder acted as a visionary man but he was always driven by innovation. Unlike other businesses in food retail services, he innovated continuously. First, by editing in 1901 the Nova Group Catalogue and a free Journal that contains information about the Nova products and prices. He was the first to progressively introduce publicity in this industry sector.

In addition, social values and actions were an integral and persistent part of the business philosophy that he has learned in his family and successfully transmitted to the business. He proposed many facilities for the employees since 1905: special allocations for the large families, establishment of a pension and life insurance fund for managers and employees, creation of a company providing pharmaceutical and medical services for employees, creation of a musical association, creation of a company that builds, sells and rents housing to employees...

Figure 4: Ownership timeline and key events of Nova Group

The founder also wrote: “I often abandoned the profits or salaries I had to get for the company’s sake. I preferred investing the money in developing the business. One should sacrifice his own interest for the general interest... My wife and I continued to live modestly despite the increasing profits of the business. This is anchored in a cautious strategy at the basis of our rule of behaviour”. This sacrifice spirit and long-term orientation was useful in overcoming upcoming crisis.

Despite hard economic times due to the advent of World War I, he managed to pursue his social, manufacturing and pricing commitments. He created a foundation for the war orphans and worked on extending the product range to soap and perfumes around 1918. In 1929, he introduced special training classes for the employees in different fields related to business activities such as œnology, grocery or retailing.

Financing growth while keeping family control

As the business grew, the founder became aware of the importance and need for continuous financing to keep on developing the business. The business was thus listed on Paris stock exchange since 1910. This allowed bringing in financing through several operations of capital increase or issuing obligations. The founder insisted however to distribute limited dividends to shareholders or to compensate them by free shares in order to invest the profits in long-term investments. He was also very concerned about preserving the family’s capital and control over the business. All family shareholders were asked to commit to keep their shares.

The Nova Group: For and by the Duchesse cohesive family

The family was at the heart of the founder’s preoccupations. Didier has been happily married to Sophie and always very strongly committed to his family. In 1918, the family consisted of 7 children: 5 boys (Marc, Jacques, Gérard, Bruno and Bernard) and 2 girls (Sabrina and Fabienne). Didier viewed the business as an extension of himself and of his family. His long-term view of the business was to be achieved through satisfying the family needs over generations on one hand, and maintaining the business management and control by a cohesive family on the other hand. According to Didier, “My very first satisfaction was the beginning of realization of the ultimate and initial goal: ensuring to my children a good situation and living”. In order to make his children united and committed to the continuity of the business, he initiated a tradition of sharing his thoughts and recommendations on ethical behaviour and values. Indeed, he used to grant each family member reaching his/her majority at 18 years old a booklet on the reflections, thoughts, knowledge he learned and acquired throughout his life experience. He believed that “To keep the family spirit, we must inculcate religious feeling, the spirit of tolerance, fairness, openness in relations”.

Challenges of the second generation in the family business

Passing the baton: The founder’s halo

Although Didier did not encourage the girls to be involved in the business, he was not reluctant to have their husbands join. He treated blood and alliance relationships equally. Since 1917, he started to integrate his sons Marc and Jacques progressively in the management activities. In 1929, he officially decided to retire from the business. The

managerial duties with nearly a thousand branches stores were thus delegated to his 3 sons Jacques, Gérard and Bruno and to his son-in-law Stéphane Bea. Despite his useless efforts to stay away of the business, Didier's retirement was unrealistic. He carefully kept an eye on the business during at least 10 years, while attending all the meetings, giving advice and sharing his experience with the active family members. Ensuring cohesion and adaptability in difficult times and avoiding conflicts among his children was a real preoccupation. Among the guidelines he gave to the second generation: "In any circumstance, the business interest rather than the personal interest should predominate. Harmony among you can only be maintained if you adhere to this perspective." He also kept taking care of the social activities of the business and developing them. Nearly before his death in 1940, he created a foundation for the support of large families.

Death of the founder: A pivotal and emotional event

The founder died in 1940 while the business was operating in nearly 1700 branch stores. His death not only affected the family but also all the employees. The latter expressed massively their attachment to this emblematic figure of the Chief, Le Patron, and to the business he developed throughout the years, as reported in numerous letters addressed to the family and in journal articles. The family members belonging to the second generation issued a communiqué:

"Our Father is not here anymore, but his teachings and his example remain. We will continue the work to which he devoted his life. Our existence will be dedicated to him. Our efforts will follow the same path and will pursue his efforts, backed by the same principles (...). The same methods of collaboration will be maintained with you, as well as the desire to keep the family character of the business".

Shortly after the death of the founder, the World War II started. Nova Group had to face again very hard times but the solidarity among the employees' families and the Duchesse family helped overcoming the situation. Many employees died from the bombings and many buildings were burned or destroyed. After the war, the renovations started surely but slowly due to a sharp increase in the prices of commodities.

After the death of the founder, Marc Duchesse became the CEO of the business supported by his brothers Jacques, Gérard, Bruno and Bernard as well as his brother-in-law who were the board members. The mother was also always present, providing support and supervising the business activities, although she was mainly focusing on the social activities, until she died in 1957. She was highly appreciated by the employees and known for her "indulgence and her capacity of listening to others".

Following the trace of the founder: The founder's shadow

Although the family board had to make difficult decisions given the critical economic situation after the World War II, it always acted in compliance with the values taught by the founder. The second generation pursued the innovative vision of the founder, like - among other innovations - a new concept in the late 60s, the self-service consumer foodservice based on Nova's Cafeterias. The business grew into supermarkets then into hypermarkets. The number of retail outlets kept on significantly increasing to reach nearly 2600 early 70s. The first internationalization efforts were made in the United States in the 70s by opening a chain of cafeterias.

Meanwhile, the Nova Group governance knew three evolutions within the same generation. The brothers peacefully agreed upon rotating the CEO leadership. After having Marc as the company's CEO, Bernard followed from 1960 to 1965, then Bruno from 1966 to 1976.

At that time, the family was holding the control of the business following the founder's wishes with almost 40 % of capital and 60% of voting rights.

Challenges of the third generation in the family business

Increased competition threatening business survival

The third managerial succession run smoothly following the same line of generational exchanges, while the number of family shareholders was significantly growing up. From 1976 to 1988,

the baton was officially passed on to the third generation. The son of Gérard, named Christian, was first appointed at the head of the business, after being actively involved since 1936. Christophe, another grand-son of the founder, came into the business in the late 80s. Deep changes followed, although he first tried to maintain the traditional values of the Nova Group. He was mainly driven by the diversification of business activities with lots of acquisitions and joint-ventures while keeping in mind the importance of the entrepreneurial spirit instigated by the founder. In the meantime, several other family members (such as sons or sons in law of the second generation) started holding key positions in the family business as associates and board members.

Progressive disappearance of the founder's influence

The coexistence of an increasing number of family members involved in the business and of non-active shareholders, along with an increasingly competitive environment at the end of the 80s, originated in a series of crucial challenges for the family business. Christophe recalls: "At that stage, it was clear that the leader who used to federate the whole family group was missing". In addition, the traditional practice that was instituted by the founder, regarding the transfer of his thoughts' book to each new family member, started to disappear. Family shareholders consisted mainly of cousins. "The moral authority that used to be represented by the founder who knew how to lead his boat and to motivate and unite the family has disappeared ... and with him the values that are now scattered". The founder's guiding principles related to sacrificing the personal interest in favour of the general interest were not followed. The business was progressively losing the ongoing mark of the founder and his values were vanishing towards more financially-oriented goals of the business. Christophe adds "We had to compete in order to survive. Competition was too fierce. We had to face it by seeking further business growth and diversification, which needed significant funds".

Progressive disappearance of the "affectio societatis"

In 1997, the family was represented by nearly 400 members, 220 of whom were shareholders. A large number of family shareholders were not active in the business. Most of them did not feel emotionally attached to the business neither motivated to join the business. One family shareholder observed: "There was a weakening of the "patriotic sense" of family shareholders, because of the progressive loss of the values the founder had set the stage for". Many family members lacked of interest and motivation to work in the business because they had various activities not related to the business activities. They were reluctant to keep their shares because of the high taxes that they were not able to pay given the low dividends they got. They were unable to meet these needs and consequently to maintain their shares. A significant number of shareholders sold their shares, leading to a significant decrease of the family capital in the business.

Managing the turmoil in the family and the business: weakening family relationships and increasing conflicting interests

In order to overcome the problems of dispersion of capital, the top family managers decided to set up a series of governance mechanisms. These were designed to strengthen family relationships on one hand, and to increase the emotional ownership of the family members on the other hand.

First, they created a family holding that was in charge of buying the stocks the family members are willing to sell. In addition, the managers suggested financial incentives to encourage family members to keep their stocks through very interesting and privileged dividend rates. Second, they created a family shareholder's agreement that binds all family shareholders. Regarding the terms of the agreement, shareholders were asked to inform the holding of any intention to sell their shares. Unexpectedly, these new governance mechanisms did not reach the desired goals.

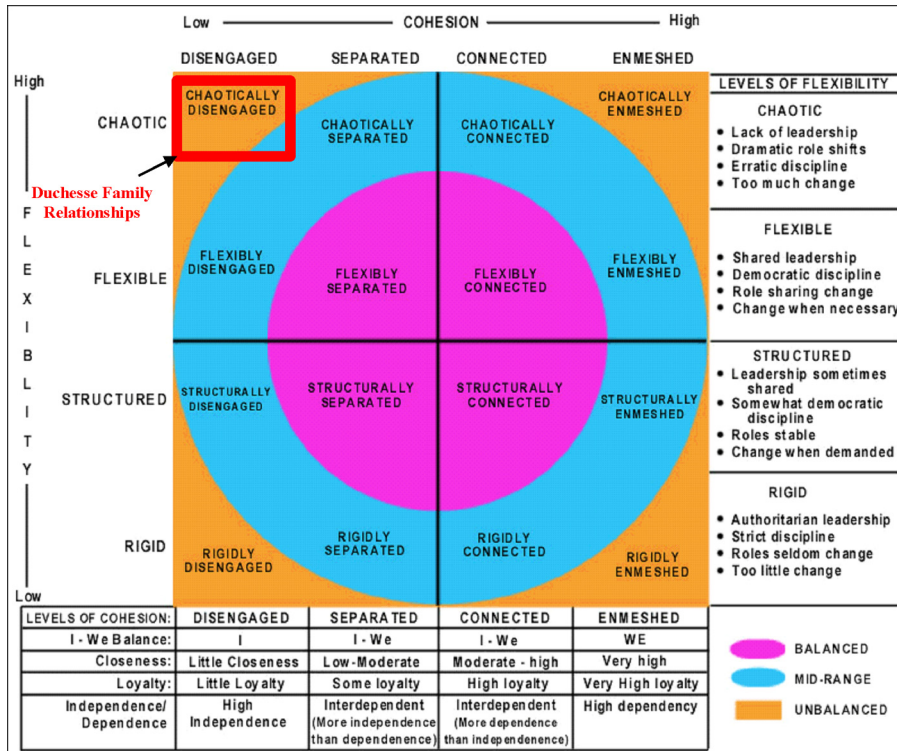
On one hand, many shareholders massively sold their shares to the family holding whereas the latter did not have enough liquidity to buy them while satisfying in the meantime the increasing business

financial needs to outcast competition. On the other hand, the family relationships appeared to be drastically weak. The family cohesion was disengaged and the family adaptability to the changing environment was chaotic. Conflicting interests emerged in the public arena among active and non-active family shareholders, who were split into rival “clans”. The shares ownership was perceived by the non-active shareholders’ clan as a “hurdle” since they had to pay high taxes. According to this clan, “We felt entrapped

or suffocated by this shareholders agreement (...) Two or three of us attempted a court trial...We won the court case since the other clan had to dissolve the pact and give us satisfaction....”

Building on the family typology derived from the FACES questionnaire (Maynard & Olson, 1987), the Duchesse family type is identified as chaotically disengaged, referring to extremely low levels of cohesion and high levels of adaptability, as outlined in the following matrix.

Figure 5: The Duchesse Family Relationships in 1997



Source: Adapted from Maynard & Olson (1987)

The denouement dilemma: Sacrificing the family control for the business health

On the business health side, the activities became increasingly diversified. The internationalization spread fast all around the world while the business size doubled from 1990 to 1995. In 2007, the business was one of the French leading food retail services companies. But these diversifications efforts were very expensive in terms of loss of family control. In 1992, the family controlled 26% of

capital and 30% of voting rights while in 1997 8% of capital and 15% of voting rights. More recently, in 2007 three family members were still shareholders owning only 1,8% of the capital and subsequent voting rights. Building on Sharma’s (2004) family business performance matrix (Figure 3), the Nova Group is hence positioned in Quadrant II with high financial capital and how emotional capital. It is characterized by business success but is tension prone while exhibiting failed family relationships.

Interpretation of the case study: Lessons learned

The case study offers several insights for family shareholders and managers to manage their relationships and build appropriate governance structures.

Family shareholders-managers relationships in a life-cycle perspective

Over time, there is a decreasing potential for the motivation and commitment of the family members to the business. Many family members choose not to work in the business and not to maintain their shares. Among the main reasons highlighted in the case study:

- Growing family and business needs across the life-cycle: The family managers used to favour investing business cash-flows in future long-term investments rather than distributing high dividends to family shareholders. By doing so, the managers overlooked the fact that many family members were relying mainly on the family business resources. The suggested dividends were not sufficient to satisfy their needs, which lead them to sell their business shares.

- Tax issues: The majority of family members was not able to deal with the high tax levels linked to the business ownership, which are specific to the French context. In order to avoid the tax hurdle for themselves and their heirs, many family members choose to sell their shares to outsiders rather than transmitting them to the new generation.

- Weakening of the “family spirit” and “emotional ownership” in later life-cycle stages: The professions and occupations of most of the new generation’s members were diverse and not linked to the business activities. In addition, the new generation was not affectively committed to the business. Whereas the young family members in the first generations used to receive at their majority a booklet outlining the reflections and values of the family business founder, this tradition disappeared across generations. The new members did not feel connected to the family values or to the history of the family business. This led to the weakening of the “patriotic sense” and the progressive loss of the values the founder had set the stage for in the early business years.

Family business governance structures

- Family shareholders agreement and family holding: The risk for conflicting interests between active and non-active shareholders increased with the evolution of the life cycle of the family business. The decision made by the family managers to set up a shareholders agreement in order to avoid the massive selling of family shares was not well-accepted by all family members. Unexpectedly, it led to conflicts among family members, which were translated into a court fight ending up by withdrawing the shareholders agreement from the family business. Moreover, the family holding which was mainly created to buy the shares of the family members was not efficient because it lacked financial funds and coordination with the group of non-active shareholders. Building on Sharma’s (2004) suggestion for this type of family business (Quadrant II), resolving the emotional capital problems is dependent on developing support mechanisms aimed at mending family relationships and moving toward Quadrant I of the family business performance matrix.

- The role of the founder or another leading family member is essential to federate the old and new generation’s family members around family values and motivate them to be committed to the business. The founder’s values must be transferred to next generations whereas the family governance structures or mechanisms must be established with a mutual agreement among the different family shareholders branches and managers. Other family governance structures such as the family assembly or the family council would facilitate family communication at the cousins consortium’s life cycle stage.

Conclusion

This case study demonstrates how a family business managed to survive during the first and second generation due to entrepreneurial, social, ethical and family-based values, as well as to balanced family cohesion and adaptability to face external and internal changes. It shows however that existing deficiencies regarding each of these factors were detrimental to the continuity of the family in the business at the third generation. It teaches us how the family business could master its ownership transition, business control and growth through setting up appropriate governance mechanisms that are chosen and developed with

mutual agreement among all family shareholders, active and non-active in the business. It can serve as a grid of analysis for managers to anticipate and prevent the critical issues during the later life cycle stages and, through appropriate collective decisions, to meet the family and business performance needs.

Teaching notes

Case synopsis

The Nova Group case describes the evolution of a French family business in the food distribution industry, from its founder life-cycle stage to its third cousins consortium's stage, with a particular emphasis on the determinants of its success and development into a large international group and of its failure by means of loss of family control.

It is intended to facilitate the analysis of the patterns of evolution of family relationships over time, the antecedents of their weakening and the conflicts of interests that arise and increase in the later life-cycle stages where the family spreads many generations. It investigates the role of family governance structures in hindering or expanding agency costs sources.

Through an agency theory and family therapy perspective, this case study illustrates how the quality of family relationships is a detrimental issue to the ongoing success and survival of family businesses. It underlines the need for responsible ownership, unity and tolerance for multigenerational family shareholders and managers who must strive to maintain balanced relationships for the family and business performance.

Key issues to be discussed

- Leadership and entrepreneurial characteristics of the founder, his declining and increasing influence across generations.
- Comparison of the contributions of the first, second and third generation to the development of the family business system.
- Analysis of the evolution of the family, business and ownership subsystems.

- Role of the family values for the family business survival in a competitive and uncertain environment.

- Family governance mechanisms: strengths and weaknesses.

- Family relationships challenges in terms of cohesion and adaptability over time.

- Family, business and ownership performance issues.

- Recommendations for family business managers and shareholders.

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ORGANIZATIONAL CULTURE, ENTREPRENEURIAL ORIENTATION AND GROWTH IN FAMILY FIRMS. A CASE STUDY FROM A MATURE INDUSTRY.

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Abstract

In this paper we present a case study to describe how organizational culture influences the growth processes of the family firm through its impact on entrepreneurial orientation and family firm's goals. The case shows that growth processes of family business may occur not through an holistic strategy aimed at the maximization of the overall value of the activities, but focusing on those activities that can have a positive impact on the family firm's identity, even through the pursuit of non economic goals.

Keywords in context

Organizational culture, Organizational identity, Growth processes, Entrepreneurial orientation, Goal setting.

Introduction

The study of growth processes of family firms is extremely important, since this class of enterprises plays a significant role as drivers of economic development and employment creation within several national and regional contexts, both in developed and developing countries (Astrachan and Shanker, 2003; Morck and Yeung, 2004, Zahra, Hayton and Salvato, 2004).

In the family business literature, growth processes have been examined mainly according to two approaches: the first one focuses on the process as a succession of phases (e.g., Gersick et al. 1997, Ward, 1987, 1991), in strict connection with

the general models of business growth through stages (e.g. Greiner, 1972; Churchill, Lewis, 1983; Scott, Bruce, 1987); the second one treats the topic in an indirect way, focusing on two related concepts: (1) the entrepreneurial orientation of the owning family as main determinant and "fuel" of the growth processes; (2) the identification of family goals and business goals as factors influencing forms and directions of growth.

In this study we embrace the second approach, describing the growth as the result of the interplay between entrepreneurial orientation and family firm's goals.

The relationship between entrepreneurial orientation and firm growth has been recognized and extensively studied within the field of corporate entrepreneurship (Delmar, Davidsson, Gartner, 2003, Davidsson, Delmar, Wiklund, 2002, 2006). With reference to family firms, Zahra (2003) among others observes that entrepreneurial activities increase the distinctiveness of the family firms' performance and therefore enhance their profitability and growth.

Following Lumpkin and Dess (1996), entrepreneurial orientation is defined by five behaviors: autonomy, competitive aggressiveness, innovativeness, proactiveness, and risk taking. Autonomy refers to the ability and will to be self-directed in the pursuit of opportunities; competitive aggressiveness is the propensity to directly and intensely challenge firm's competitors to outperform industry rivals in the marketplace. Innovativeness and proactiveness result in the tendency to support creative processes that may result in new

products, services, or technological processes and to continuously pursue new opportunities. Finally, risk taking propensity refers to the willingness to make investments and resource commitments that could lead to costly failures.

On the basis of this definition, a number of recently published studies has focused on the relationship between entrepreneurial behavior and growth in the context of the family enterprise (Kellermans et al., 2008, Zellweger and Sieger 2010, Moreno and Casillas 2008).

Growth processes in the context of family firms cannot be understood without considering the type of goals that characterize the family that owns the business (Sharma, Chrisman and Chua, 1997). It has been highlighted that family businesses generally do not follow the logic of shareholder value creation (Gallo et al., 2004; Ward, 2001; Nordqvist, 2005). This could mean that family owners do not pursue the maximization of stock value in the short term and also that family owners do not often behave as investors in a portfolio of activities: they tend to be committed to specific business entities acting as “families in business” rather than as “families as investors” (Habbershon and Pistrui, 2002). Tylecote and Visintin (2008) adopting a comparative perspective on national systems of capitalism show that family capitalism performs better in sectors that require high levels of firm specific expertise and long term commitment to the development of competitive resources.

It has been also observed that family firms pursue a wide set of “non economic” goals that go beyond the creation of financial wealth (Davis and Stern, 1988; Guzzo and Abbott, 1990; Riordan and Riordan, 1993, Westhead et al., 2001; Lee and Rogoff, 1996, Samuelsson, 1999; Sharma, Chrisman and Chua, 1997).

Both entrepreneurial orientation and company goals are influenced by the organizational culture and identity, which in turn are rooted in the culture and values of the controlling family. Some researchers have included these dynamics of influence in the concept of familiness (e.g. Chrisman, Chua, Steier, 2003; Habbershon, and Williams, 1999) highlighting that familiness may promote and/or constrain entrepreneurial activities thereby influencing family firms’ growth patterns.

In this paper we aim at describing the way in which organizational culture influences the growth

processes of the family firm through its impact on entrepreneurial orientation and family firm’s goals. Our aim is therefore to contribute to the growing stream of research that explores the determinants and consequences of entrepreneurial behavior in family business, trying to provide a dynamic and rich description of the effects of cultural variables, using the case study method.

The paper is structured as follows. In the first section we review the literature on the effects of culture on family firm behavior, in the second section we describe the method of the research, in the third section we present the case and in the fourth section we discuss the findings and conclude.

Family firm and organizational culture. Review and conceptual model

Both the entrepreneurial orientation and the type of organizational goals can be viewed as results of the family influence on the firm. This influence has been described through the concept of “familiness”, defined as the bundle of resources and capabilities that emerges from the complex interaction between family and business (Habbershon and Williams, 1999; Habbershon, Williams and McMillan, 2003). This pool of resources and capabilities may promote or constrain the growth of the firm, through the influence on firm’s goals and entrepreneurial posture (Nordqvist, Habbershon and Melin, 2008). For example, on the one hand, a centralized power structure with the overlap of ownership and management promotes greater responsiveness to external environment and innovative behaviors, that, in turn, foster the growth (Salvato, 2004, Moreno, Casillas, 2008); long term perspective and emphasis on transgenerational wealth creation may also contribute positively to the growth orientation (Nordqvist, Habbershon and Melin, 2008, Zellweger, Mühlebach, Sieger, 2008); on the other hand, there are traits of familiness that may prevent organizational growth, such as a greater resistance to change and a conservative and risk-adverse orientation (Naldi et al., 2007; Zahra, 2005).

A very important dimension of the familiness is related to the organizational culture. According to Schein (1992), organizational culture comprises the attitudes, values, beliefs, norms and customs of an organization; therefore, according to the resource based view (Barney, 1986, 1991) it

contributes in a crucial way to the development of the routines and strategic capabilities of the firm (Zahra, Hayton and Salvato 2004). As pointed out by Astrachan et al. (2002), culture is one of the key dimensions of family influence on the business: organizational culture of family firms can be shaped to various degrees by the culture and values of family owners.

A number of studies examines the relationship between family culture and organizational culture, evaluating also the impact of cultural variables on organizational behavior and performances (e.g. Zahra, Hayton and Salvato, 2004; Hall, Melin and Nordqvist 2001; Zahra et al. 2008; Sharma and Manikutty, 2005). Several studies have also analysed the antecedents and effects of family firm's culture focusing on the concept of organizational identity. Organizational identity is represented by shared views of what is central, enduring, and distinctive about the firm (Dyer & Whetten, 2006); thus organizational identity provides a frame of reference that guides strategic processes and decisions (Short et al., 2009).

Organizational identity is tightly related to the concepts of organizational image and organizational reputation. Organizational image is "what organizational agents want their external stakeholders to understand is most central, enduring, and distinctive about their organization" and organizational reputation is "a particular type of feedback, received by organizations from their stakeholders, concerning the credibility of the organization's identity claims" (Whetten & Mackey, 2002, p. 401, in Dyer and Whetten, 2006). Organizational identity influences the process of goal setting; in particular, if the family firm places great emphasis on image and reputation it is likely that its goals are influenced by the expectations of the internal and external non family stakeholders (e.g. employees, local community, interest groups and political groups, regional and national governments). Performance outcomes to satisfy stakeholder expectations are typically related to non financial and non economic goals and may include work conditions and job quality, job creation or preservation in areas with high unemployment rates, philanthropy, social or environmental initiatives, funding and support of nonprofit organizations (Zellweger and Nason,

2008). The relevance of these dimensions has been highlighted by the studies on family firm corporate social responsibility. According to these studies family firms are more socially responsible than non-family firms along a number of dimensions. Socially responsible behavior is especially due to family concern about image and reputation and is mostly focused on the narrow community (local, regional) (e.g. Dyer and Whetten, 2006, Gallo 2004).

We could employ the arguments presented to build a conceptual model that evidences the interaction between organizational culture, entrepreneurial orientation and growth in the context of family firms (Figure 1).

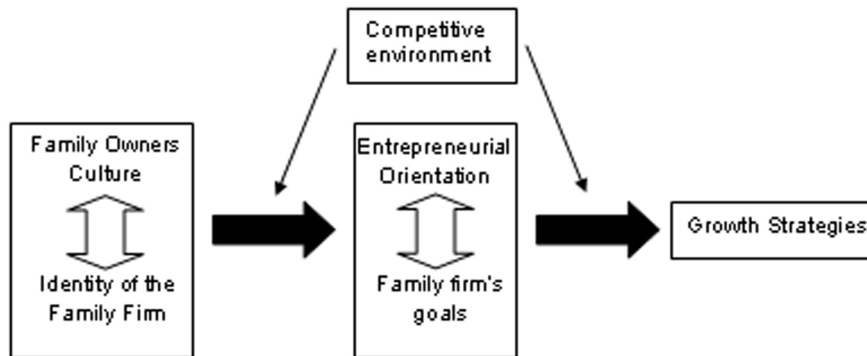
In particular, we assume that growth processes may follow a variety of patterns and these patterns are fostered or constrained by the interplay between economic and non economic goals of the family firm and by the "intensity" of entrepreneurial orientation. The interaction between these two dimensions may be in turn influenced to various degrees by the organizational culture of the family firm, whose main components can be identified in the values and culture of the controlling family and in the identity of the family firm among its main stakeholders. The relationships depicted are finally moderated by the effect of the competitive conditions in the firm's main industry.

In the following sections of the paper we empirically describe and discuss the relationships proposed in the model introducing and carrying out an in depth case study of a large family owned firm.

Method

In the empirical section we will illustrate the case study of an Italian group of firms, which we shall call Rossi (real name is not displayed for confidentiality issues) that realises and supplies turn-key plants for the iron and steel industry, offering a wide varieties of machineries from primary process management to production of the finished product. Examples of products are blast furnaces, steelworks for production of liquid steel; rolling mills, plants for steel forging processing and extrusion processing.

Figure 1. The conceptual model



The industry is very cyclical in nature and has undergone a progressive process of concentration among three global players. We will analyse company's growth strategies over the last 20 years and the type of relationships that the company carries out with its subsidiaries with a particular focus on the largest one, that is a Swedish company, Hopkins, once one of the fierce competitors of Rossi. The case study is based on a number of interviews carried out between 1995 and 2003. The analysis is also supported by secondary information found on local and financial newspapers and by statements made by the company managers during class presentations in Italian universities. The interviews were carried out over the years as the company was the object of several studies, from a PhD doctorate to a European TSER project on corporate governance and innovation. Most of the studies employed the "cascade method" whereby several interviews were carried out starting from the top management and going down to the employees. In this work, in particular, we report those sections of the interviews that deal with the topics covered in the paper. In 2000 we also had the opportunity to carry out a number of interviews in one of the Swedish subsidiaries. Overall, in this paper, we report parts of interviews with one of the family members, a financial director that was with the family since the second half of the 1970s, the current director of personnel, a middle manager and the CEO of the Swedish subsidiary.

We believe that the development of a case study is the method that better fits our research goals. As pointed out by Eisenhardt (1989) and Yin (2003) case study research strategy is particularly

useful when the research questions are aimed at explaining "how" a certain phenomenon takes place, rather than highlighting causal relationships ("why" questions). Our purpose is indeed to describe the processes through which the causal relationships between familiness, entrepreneurial orientation and growth may take place.

Among the various possible expression of company's growth we assume as relevant proxies in our case the expansion of the worldwide market share and the process of external growth through international acquisitions.

Case study: The Rossi Group.

In this empirical section we will illustrate Rossi's growth strategies over the last 20 years and the type of relationships that the company carries out with its subsidiaries with a particular focus on the largest one, that is a Swedish company, which we shall call Hopkins, once one of the fierce competitors of Rossi.

The leading company: Rossi

Rossi is a group of medium scale operating in a heavy engineering sector. It employs nearly 8000 people (3000 in headquarters and just above 3000 in the subsidiaries) and in the financial year 2008/2009 it had a turnover of 3,200 million euro. Its headquarters are situated in the North East of Italy. Subsidiaries are to be found in Italy, in various European countries, in the US and in China. The history of the group dates back to 1916 when two brothers founded the first embryo of the company

in Brescia, in the North-West of Italy, at the centre of the machine tools district. During the 1920s part of the company was transferred to the North-East, where, in a more or less artisan manner, it produced tools for forging steel and small auxiliary rolling machines.

During the 1950s, Livio, the son of one of the two founders, after graduating in engineering, started working for the family business. At this stage the company had 55 employees and was quite small for the sector (large for the Italian average). The strategy adopted was to service the needs of the small and medium Italian companies, which could not find on the market plants suitable and affordable for their limited size.

As early as 1964, Rossi produced the first turnkey plant abroad, in Eastern Germany. Its success continued to increase during the first half of the 1970s, thanks to the predominant importance given to R&D, which allowed it to improve the quality of the products and to produce important innovations.

During the end of the 1970s, as a consequence of a very serious crisis of the sector, the firm underwent a very difficult phase. The dramatic fall in production and orders could have led it to its complete crash if a major restructuring had not taken place. The new CEO, Angela Rossi, daughter of Livio, replaced a large part of the management and started a complete process of rationalisation of production.

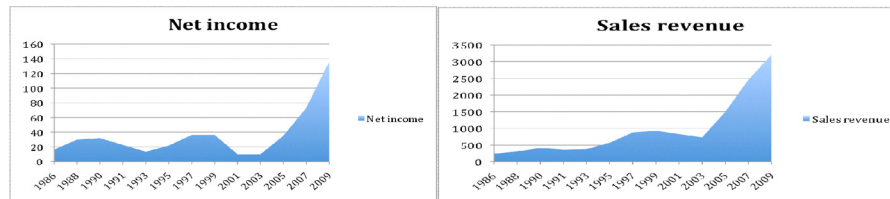
"in a family business the succession process is always tough. The employees and the other stakeholders tend to identify with the founder or the incumbent. A succession involving a young woman in a heavy engineering sector is even worse. I had to gain their trust. Luckily for me there was the crisis and I could show to everybody

what my priorities were, my family, my company and my employees. I chose a completely new top management and we started from there an important process of renewal. I had the support of the local employees. They worked hard because they understood that I was fighting also for them". (Angela Rossi, 1996)

With the aim of maintaining the employment and saturating the production plants in Italy, Angela started a campaign of acquisitions of companies with innovative technologies and a small to medium production capacity. A number of the production facilities of the acquired companies were shut down (particularly in those countries where the unions have a limited contractual power) and Rossi started producing and selling with the newly incorporated brands.

"we had no other option. There was excess capacity in the sector. Acquiring those companies was the only choice we had. Some of them were more efficient than us but our main goal was to preserve the interests of the headquarters. We were lucky because we have always pursued a strategy of high liquidity and could afford to buy them" (Financial director, 1996).

In the meanwhile, Mr. Paolo Virgili, the current CEO, who had been working for the firm since 1961, had become sales director. Thanks to the new managing board and the new growth strategy, turnover rose from 200 billion lira in 1980 to nearly 900 in 1990, particularly as a consequence of obtaining important orders from Ukraine and Byelorussia at the beginning of the 1980s and from the States, the USSR, North Africa and the Far East in the second half of the same decade. In addition, during the 1980s, the company was listed on the stock exchange.

Figure 2: The Rossi's group net income and sales revenue (million euro).

“it might sound odd but we have never had a ‘group’ vision. We had to treat the subsidiaries as our cash cows. They provided the technologies and the flexibility necessary to support the growth of the original Rossi. Sometimes we had to shut down some companies, other times we had to lay off large parts of their workforce. In many occasions it was not the best choice for the group, but we are not like any other multinational. We are a family business. We do not have external shareholders who ask for profits (or actually we do, but they are rather irrelevant), we have neighbours, friends, relatives who are all stakeholders of our company and exert strong pressures on us. After all this is our home and we want to enjoy a friendly and relaxed atmosphere around us. My family has always been active in the town. My father during the 1945-46 period was vice prefect of the local province, and until 1953 syndic of Rino (the town of 3000 people where the Holding has its seat). A large part of the inhabitants of Rino either work for Rossi or have relatives or friends who do so. In addition, the Group finances several of the community’s activities, such as the local basketball team, the restructuring of ancient buildings dear to the community, the local nursery and so on. In a number of occasions we even helped out our employees with the costs related to medical expenditures for treatments to be received abroad” (Angela Rossi, 1996).

“I feel lucky. I have grown in this company. My father worked for the company and I had heard stories about it since I was a kid. When I was younger I used to think I would do something different. However if you want to grow, professionally I mean, there are not many other options in the area. I started working here just after graduation. I worked hard. Here in Rossi they expect a lot from the employees but if you prove your commitment you can go far. I have been travelling a lot and I have acquired many competencies in the past 10 years. I was supported in following language courses and in gaining management skills that I was lacking. Yes,

I spent a few public holidays abroad. I would have certainly wanted to be at home with my girlfriend first and my wife later. But it is a price that I am willing to pay. What I give I get in return. As far as I know nobody has ever lost his job since the 1950s (unless deserved so) and those who have stayed for long have gone very up the hierarchy. (Middle manager, 2003).

The 1990s witnessed a new wave of acquisitions of both companies and new technologies. In 1995 Rossi entered the integrated plants market, through a joint venture with a Dutch company. In the same year, it acquired the patents for a technology which enables the production of more efficient plants and less severe depreciation costs. By the end of the decade the group had also acquired new subsidiaries in the UK, Holland, the US and Germany. At this stage the Group had achieved an international status with several subsidiaries in Italy and abroad and more than 95% of the turnover sold abroad and a leading worldwide position.

“the 1990s and the first few years of the new millennium have been rather stable. In the previous phase we had been growing and all our efforts were aimed at integrating the new subsidiaries in the overall growth strategy of the group. In the following period we chose the type of relationship we would have with the subsidiaries. They would not compete directly with us. They had to focus on those activities that were not part of our core business but in those activities they were let rather free. They are all too far to be directly monitored and controlled so we mainly look at the financial results. However we are not an ignorant outsider shareholder. We know the business and are perfectly aware of the evolution of the technology in the sector. If a subsidiary is not producing profits because it is robustly investing in R&D we understand that and do not put short term pressures. After all we need them alive to keep us alive. Yes, I said them. There is US and there is THEM, and it is always going to be like that. I do not know why, maybe it has to do with the culture.

We ask all the subsidiaries to spend at least 5% of their turnover in R&D. Our goal is to have both a cost and differentiation advantage. It is thanks to this strategy that we were the first in the market to introduce the technology that would allow our clients to integrate all the production processes reducing the producing cycle from 33 days to less than 24 hours.” (Financial director, 2000)

At the turn of the millennium, Dr. Rossi retired and was substituted by her children, a daughter and a son. As also the son and the wife of Mr Virgili work in the company, we can argue that now the business is a family-run business with two controlling families. Currently the company is controlled through a family holding with just above 65% of the shares. The remainder of the shares are distributed as follows: 34% are traded on the market and 0,3% are controlled by a financial company.

One of the Swedish subsidiaries: Hopkins

Hopkins is a group of firms within the Rossi group. In 2008 it employed 300 employees and its turnover accounted for 9% of the whole turnover of the Rossi group. Its history dates back to 1856 when the firm, which was previously producing iron, turned to the production of components employed in the larger plants produced by Rossi. Thanks to the invention by one of its employees of a new and proprietary technology during the 1870s, the company soon became leader in the Nordic countries, selling products both locally and abroad. During the 1950s, the firm consolidated its positions thanks to the introduction of patented products, which represented a great improvement in the technology employed in the sector as a whole.

Since its set up and until 1975, the firm, which soon became a group of firms with subsidiaries abroad and a wide net of agents, was a privately owned family business. The owners not only sat

Democrats in 1932, personal income and personal wealth had been subject to steeply progressive taxation. The crisis did the rest. Our performance started to decline and the family progressively lost interest and moved abroad. Year after year we became less efficient and less innovative. This trend continued after we were sold to the financial company and, with even more intensity, when we

in the Board of Directors but were also active in the management of the firm. In 1975, a trading company, which few years later merged with a large multinational (which we will call Various) with its core business in another sector, bought Hopkins. In 1987, the multinational sold Hopkins to the Rossi group, one of Hopkins main competitors. The fear that Rossi had bought the company just to shut it down was widely felt among the employees but this was not in Rossi's plans. After an important process of rationalisation (half of the workforce was laid off) and a few attempts to find a suitable strategy to manage the relationship (direct competition first and geographical subdivision of the market later), the two firms seem now to have found a solution. Rossi has integrated the production of the parts of the plants once produced by Hopkins, and Hopkins takes care of the revamping of old plants, both produced by Rossi and by its competitors.

The relationship between the two companies and the impressions aroused during the process of acquisition are in our opinion rather explicative of the attitude of this family business towards its “non-local” subsidiaries.

The relationship seen by the two sides

The acquisition according to Hopkins “We used to be a family business. That one was a great period. We were among the leaders in the North-European market and introduced a large number of innovations. As a matter of fact, during the 1960s Ing. Rossi had come to visit our company and we were very pleased to show him around. We let him in our shop floor and illustrated our products. Rossi at the time was a very small Italian company and we did not consider them as a serious competitor. That's why we were so open about everything. Indeed, I know that Ing. Rossi really admired our company because his daughter after the acquisition told me that her father had always spoken about us with very positive words. That was a great period. Then, during the crisis of the 1970s things started to collapse. Since the arrival of the Social

passed to Various. We were a very small company within the conglomerate and we operated in a sector that was not correlated to its core business. During such period we had indeed lots of money to spend but we were not motivated at all. We felt marginalized and this turned into a very low commitment by the employees. For several years we did not introduce any innovation and we had

difficulties in finding new clients. As our core business is the revamping of old plants we basically sell solutions rather than products. You need strong and long-term relationships with the clients and our sales persons did not have any incentive to nourish those relationships. We did not know what our future would be, besides being perfectly aware that the conglomerate would not keep us for long. Then came Rossi. In the previous years they had bought several companies and some were shut down immediately after. At that point, we felt that the end of Hopkins was close. But Dr. Rossi's intention was different. She remembered what her father used to say about Hopkins and had decided to buy the group as some sort of 'present' to her retired father. They started a huge process of reconfiguration and rationalization and in less than a year half of the workforce was laid off. Several of my friends and colleagues at various levels in the company had to leave. For the first two years Dr. Rossi would come to visit us more than once a month. The consultants would spend here a week every month. At the end of the process, I must admit, we had become again a very efficient and effective company. We really needed to change. Now, however, we feel that the control is still very tight. We know how to do our job. It is obvious that we have not turned into a copy of Rossi. We are Swedish. We have a different approach to work. Our job for us is a means not a goal. The persons and their families come first. I know we work fewer hours but in those ours we are probably more productive. We really love our company and feel like a large family. In Rossi, I am told, things are rather different. They are some sort of a strictly Fordist company and the power distance is very high. We are not keen on power distance and we do not like to be treated at arm's length. Take for example the innovation process. Here in Hopkins everybody is invited to share his or her ideas and if some idea is turned into a new product or a process that person gets to share in the revenues or gets a prize proportionate to the cost reduction. I know that in Rossi only those who work in the R&D department can make suggestions or proposals. The other employees are invited to work and not to think. Everything is so rigid and strictly controlled. We could never work like that. Everybody can have something to contribute. Now they do not come here very often but expect results. We are not directly controlled as in the past, but indirectly through the financial indicators. We have not slack resources to spend and when we under perform we have to have a very very good reason for doing

so. I suppose that if we were listed on the stock exchange and had outside shareholders things could be much worse. But we do not waste time and money, they should trust us a little bit more. We could do much more if we had more flexibility in deciding about our investments. I cannot say that we feel some sort of a real short term pressure but sometimes we feel that we are expected to cut on everything, also on those costs that are necessary to keep innovative. (CEO, 2003) The acquisition according to Rossi

"Ing. Rossi had gone to visit Hopkins in 1965. He went on a business tour around Northern Europe to see several companies. He was very surprised because all of them welcomed him and showed him around. In Italy we are much more secretive about our business. No competitors would have let him in. He remained particularly fascinated about Hopkins. He used to say about this company that they had the most innovative technologies he had seen and that one day he would have liked to buy it. He also liked the little village in the North of Sweden, 'nearly at the end of the world'. The opportunity came several years later. The company had gone through a 'dark period'. The founding family had moved abroad and the company had become part of Various. Such acquisition was an unintended result of the acquisition of the financial holding that, at the time, owned Hopkins. When we approached Various to buy the company they were very happy to get rid of it. The company was not profitable and it was not in the interest of the group to invest further in it. They admitted they had neither the time nor the competences to understand the business and to know what needed to be done. Hopkins had not introduced new products for years but their ability in revamping old plants was still there. After several years without a strict control the company had grown too much and become very inefficient. This is common. When managers are not strictly controlled they tend to create empires and this is what happened in Hopkins. We had to restructure the company and cut the workforce by half. We put a lot of effort in this operation. Dr. Rossi would go up there with the private jet once a month. We needed to make them understand that there is an owner, a real one, who understands the business and knows how things should be done. They had been on their own for too a long time. They had lost the habit of making profits. We need profits to support the activity of the headquarters. It is not our habit to squeeze the subsidiaries to death and we understand very well if they need to invest

in innovative projects. But our first priority is the stability of Rossi, and if this means exploiting the subsidiaries we do it.” (Financial director, 2002)

After a few years Dr. Rossi stopped going to Sweden so frequently and the company is now mainly monitored on the basis of financial indicators. I know that they do not appreciate that. However when I go up there and see the secretaries working with their babies on their laps and the company closing down on Fridays at 15.00 I feel that we are not exaggerating. In Rossi we work hard. Our employees come to work on Saturdays and Sundays. They never go home before 18.30 and we are open on Christmas and New Year’s. We take care of them, and none of them has lost their job in the past few decades. They work with us for this to happen. In Sweden things are different. The culture is different and we cannot change it. We tried, but it does not work. Plus, Sweden is too far for us to monitor the managers directly. We need to use indirect forms of monitoring and control. And we need to be strict. The tendency towards empire building is still there and we need to be careful. We cannot afford to have other liabilities. Our main concern has to be Rossi. Moreover in Sweden it is very difficult to lay off employees. The labour market is not as flexible as in the UK or in the US and if the company grows in size without a correspondent growth in sales we can get in trouble.” (Personnel director, 2003)

Discussion and conclusions

In this case study we described the growth process undertaken by the Rossi group, which has occurred both through international acquisitions and internal growth. Among the various components of entrepreneurial orientation reported in the theoretical section of this work, those that fostered Rossi’s growth were:

1. autonomy: since the entry of Mr. Virgili in the firm’s dominant coalition, has been completely autonomous in processes of decision making, strategy definition and strategy implementation. Also the listing on the stock exchange did not bring about any sort of constraint. Indeed, the strategic impact of the company goes as far as reducing the resource dependence through the structuring of its own environment. For example, the group finances and defines the contents of university degrees in the fields of engineering and chemistry. Moreover, thanks

to its dominant position and technological advantage in the industry it has the power to set the “rules of play” rather than taking them.

2. innovativeness: the group has always invested 5% of its turnover in R&D activities and it forced each subsidiary to do so. Its competitive advantage has always relied both on cost and quality, in contrast to the traditional trade-off between cost and differentiation.
3. proactiveness: the proactive inclination is rooted in the founder’s culture. The second generation of the family, with the support of Mr. Virgili, has always scanned proactively the environment in order to find good opportunities to pursue. As a matter of fact, the decision to integrate downwards into the clients’ market is just one among the several strategies undertaken to gain a better industry specific expertise. Another example in this sense is the establishment of the corporate university, as a way to continuously renew its human capital.
4. competitive aggressiveness: the acquisitions campaign described in the case study is self explanatory in this sense.

As expected, in line with previous findings on family firms, the risk taking orientation is not pronounced. Any decision taken by the dominant coalition is aimed at preserving the stability of the headquarters avoiding any investment that could imply a costly failure.

The above entrepreneurial behaviours are inspired by two sets of goals. The first set is made up of competitive and economic goals and it is profoundly influenced by the characteristics of the sector. Indeed, its maturity comes with an inevitable process of concentration among few players whereby only those which grow can survive. Moreover, the controlling families have also the typical familiar goal of trans-generational wealth creation. However, this goal is pursued through a “family in business” rather than “family as investor” attitude. This attitude is connected to the second set of goals which are exquisitely non-economic, namely the preservation of the long-term stability of the headquarters even when strategic divestments, flexibility and delocalization strategies would be more profitable. This corporate strategy is sustainable thanks to the relationships carried out with the subsidiaries, which, when needed are used as buffers of flexibility.

The interplay between entrepreneurial behaviours and firm's goals is influenced by the dimensions of organisational culture and identity. The strong community culture of Rossi originates from the founder's legacy. His commitment towards the local community was carried out by his daughter and then passed on to the nephews. For example this attitude emerges clearly from several philanthropic donations (to the local church, to the basketball team, to the local library, etc.). The relationship with the local employees is inspired by the stewardship logic whereby the loyalty is prized with a long-term employment and good opportunities of vertical progression. The psychological contract with the local employee involves not only the individual work relationship but also his/her entire family through cross-generational job opportunities. The stewardship attitude is reinforced by a paternalistic leadership style aimed at "taking care" of the employees throughout several familiar situations.

The dimensions of corporate image and reputation are also extremely important to understand the relationship between identity, entrepreneurial orientation and growth. The dominant coalition has put a lot of effort in building a reputation of a leading and successful company that drives the economic growth of the entire region through the continuous development of cutting edge technologies and the employment of high-quality human capital.

In sum, the description of our conceptual model through the case shows how growth processes of family business may occur not through an holistic strategy trying to maximise the overall value of the activities, but through the focus on the value maximization of those companies that can have a positive impact on the local community, often at the expense of the other activities and subsidiaries.

In our case two contrasting goals appear to be driving the decisional process of a family firm. On the one hand there is the long-term survival of the business, strictly connected with the long-term interests of the family. On the other there is the feeling of social responsibility towards the employees and the other stakeholders living in the local community and exerting some sort of public pressure on the family. The end result is that the development strategies appear to include as "budget constraint" the full employment and continuous growth in the headquarters also at the expenses of the other subsidiaries.

Teaching notes

Organizational culture is often identified as the main driver that influences strategic decisions in family firms. The values and beliefs of the founder and the attitudes of family owners usually shape firm's culture and identity, creating a firm-specific pool of resources defined as "familiness". Familiness may be a unique source of competitive advantage but may also limit the development of the family enterprise, generating, for example, resistance to change, commitment to status quo, difficulties in making strategic divestments.

This case study shows how the relationship between family ownership, organizational culture and corporate strategy may take place in a large family business group. We focus on the Rossi group, a large Italian family business operating in a mature industry. Rossi pursued an aggressive international growth strategy in the last decades but at the same time tried to preserve the relationships with the local stakeholders that family ownership considers crucial for the corporate identity.

This case is designed to discuss the multifaceted implications of culture on structure and processes of family firms, with particular reference to international growth and related governance and management issues.

Target audiences for this case may be of course family business classes, but also strategy courses, international business courses and international human resource management courses.

Examples of discussion topics may be the following:

1. On the basis of the information provided by the case, identify the ways family culture may influence business culture and, in turn, shape organizational and strategic configurations.
2. Discuss the Rossi-Hopkins acquisition from the point of view of organizational culture and analyse the problem of cultural integration between the two organizations.
3. Analyse the sustainability of the Rossi's growth strategy in a global competitive environment. To what extent family firm's loyalty and social responsibility towards the local community is a "resource" or a "cost" for the company?

4. On the basis of the information provided by the case, discuss the relationship between familiness and pursuit of non economic goals in the family business setting.

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THE APPLICABILITY OF THEORY PERSPECTIVES TO UNDERSTANDING GOVERNANCE IN SMALL TO MEDIUM SIZED FAMILY FIRMS

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Abstract

This case explores the concept of relational governance in family business using social capital theory. Relational governance refers to the family and its management group which develops the values and norms within its social structure, and utilises social interaction embedded in relationships among family members to influence the strategic management of family business and their ultimate sustainability as a business unit (Mustakallio, Autio & Zahra 2002). While our analysis confirms the appropriateness of using social capital theory in understanding relational governance, the analysis also highlights the importance of understanding the context framing a firm's operation. We draw on the concept of embeddedness in this discussion. The paper draws on a case study of a small to medium size business to present this analysis.

Keywords: embeddedness, family business, governance, social capital

Introduction

The absence of effective governance mechanisms challenges the long-term sustainability of the family firm business model (Schulz, Lubatkin, Dino & Buchholtz 2001, p 85; Feltham, Feltham & Barnett, 2005). Family business governance is defined as the organization of management, supervisory, ownership and family in a family business, with the goals being to create value and accountability over successive generations (Ward 1997; Neubauer & Lank 1998). However, family firm governance differs from mainstream corporate governance, as owner-family members adopt multiple roles in the business (Mustakallio, Autio and Zahra 2002), typically playing dual roles as business 'managers'

as well as business 'owners' (Taguri & Davis 1996).

Until now, most analyses of family business have drawn on either systems theory, agency theory or the resource-based view of the firm (RBV theory). While useful, we would argue that these theories are unable to deal with the social complexities embedded in the 'relations' that distinguish family business as an operating unit, and which inevitably affect governance. We therefore suggest that family firm governance is characterized by the conundrum of 'relational governance' (James 1999; Mustakallio, Autio and Zahra 2002). This can be described as the 'socially-based ripples' that arise in family business as a result of the family influence on the management and operation of the firm. We conceptualise these as the usage and creation of social capital that is embedded in social relationships among the family-management group, and family owners of the business (Granovetter 1985). However, our analysis reveals that social capital or the dynamics inherent within a social capital perspective are further influenced by the 'context' framing the interplay between these dimensions. We theoretically account for this 'context' by framing our social capital analytical approach with two aspects of embeddedness: social and mixed embeddedness.

In this paper, our aim is to illustrate the appropriateness of adopting a social capital perspective, which we argue helps unravel the interplay between relationships and governance. We present this analysis using a case study of a small to medium sized (SME) family business from the construction industry, which was founded in 1967 and is now in its second generation of family management.

Using case studies as a vehicle for developing new insights is a long-held tradition. As Kumar (1996, p 99) argues, the case study is advantageous to researchers who intend to conduct the intensive analysis of all the relevant data and details specific to the case. As an empirical research method, a case study, with the aid of multiple sources of evidence, examines a contemporary phenomenon within its real-life context based on theoretical propositions (Yin 2003).

Notwithstanding, a conceptual challenge that has often emerged in the use of case studies is their generalisability. However, Kennedy (1979) argues that there is no simple answer in relation to whether a case study offers limited grounds for scientific generalisation. Kennedy instead argues that the case study does not represent a 'sample', and researchers conducting a case study should aim to expand and generalise theories (analytic generalisation), rather than enumerating frequencies (statistical generalisation). In short, case studies are generalisable to theoretical propositions without necessarily to populations or universes.

Our case was developed through two phases. We firstly conducted face-to-face, semi-structured interviews with participating family members. The interview covered a range of issues such as the family firm's values and history, the governance structure, and the embedded context framing the firm's operation. After transcribing the interview, we coded the data using NVivo, and identified the relationships suggested by our conceptual framework (see Figure 1).

Framed by a social capital perspective, our company case supports the conceptual framework by illustrating the interplay between governance and firm performance. Our case analysis reveals that it was the 'embedded' context that affects a family firm's operation. In reference to Figure 1, it is evident that the embedded contexts (social and mixed) consequently encourage the owning family to formalise their governance structure by establishing a board. Our paper begins with

describing our theoretical approach before presenting our case analysis.

Re-formulating Theory

Much of family firm analyses (e.g. Davis and Taguiri 1989; McCollom, 1990; Whiteside and Brown 1991; Stafford et al. 1999) have been dominated by systems theory, which depicts the competitive tensions between family, ownership and management as three interlinking systems in strategic management otherwise referred to as a three-circle model. Systems theory views family firm performance as a process that seeks to balance the competing interests of the systems or manage the needs and interests of competing groups within systems. From this perspective, attaining organisational goals is a result of a 'trade-off' between systems or subsystems within the family business or even a separation of these systems (Habbershon et al. 2003).

However, system theorists fail to address how the systemic interactions between family, ownership and management influence firm level outcomes (e.g. Chua, Chrisman and Sharma 1999). Besides, where systems theory analyses do attempt to include family relations, they generally portray the relational aspects of family business as overwhelmingly negative in their effects on family firm performance. According to Ghoshal and Moran (1996), it is these that make family firm business distinctive to create the 'organisational advantage' of family firms which can be 'good' rather than overwhelmingly 'bad' in their impact on the business.

Notwithstanding the dominant influence of systems theory, Habbershon and Williams (1999) have advocated the use of a Resource-Based View (RBV), which refers to a firm's internal idiosyncrasies being identified as a critical component of its potential advantage. This perspective presumes that a firm outperforms its potential competitors based on the benefits of value-creating strategies, which cannot be duplicated (Barney 1991). The gist of the RBV model is therefore to explain the role of idiosyncrasy embedded in firm resources,

otherwise referred to as 'familiness'. However, for our purposes the RBV framework is constrained in explaining the development of the resources, and the role of family management in the process, rather than the interplay between the family and the business.

To attempt to capture these dynamics, some analyses of family business have drawn on agency theory. Derived mainly from the corporate governance literature, agency theorists address the potential divergence of interests between owners and management due to the separation of ownership from control. Agency problems arise during the process because of managers' self-interests (e.g. Jensen & Meckling 1976). To protect shareholders' interest against management's opportunism, agency theorists identify boards as performing both an advisory and monitoring role to ensure the alignment between managers' and owners' interests, and the quality of the firm's strategic decision making.

The application of agency theory to family-owned and controlled business differs or even contrasts the agency tradition by identifying several inefficiencies and value-reducing incentives in principal-agent relationships within family business (e.g. Fama & Jensen 1983; La Porta, Lopez-de-Silanes, and Shleifer 1999). As the family usually plays dual roles (i.e. owners and managers) in the firm, it is argued that it is therefore possible to reduce agency costs (e.g. Andreson & Reeb 2003; Jensen & Meckling 1976). However, agency problems arise when the owning-family imposes capital constraints that inhibit firm growth and discourage innovation. Personal rivalries among key family decision makers are difficult to resolve through governance (Schulze, Lubatkin & Dino 2002).

While useful and closer to our needs, agency theory attracts criticism for ignoring the effects of good social relationships between owners and managers (Ghoshal & Moran 1998). These relationships create social cohesiveness and a sense of belongingness among the board members, managers and owners. Close social interactions among family members allows the firm to build informal, self-reinforcing governance mechanisms that complement the formal systems emphasized by agency theorists (Mustakallio, Autio & Zahra 2002). While the unification of ownership and control may reduce agency costs (Anderson

and Reeb 2003; Jensen & Meckling 1976), the dual role played by the owner-manager results in managerial constraints which limit family business to pursue value-creating strategies (e.g. Carney 2005). The implication is therefore that agency theorists fail to capture the governance complexity that characterises family firms.

Thus, we suggest that social capital theory is most useful in trying to better understand the complex interplay of variables that inform our construct of relational governance. This is because it provides a framework to study the many dimensions of social capital in family business that stem from the owner and management team and ultimately affect family firm sustainability.

In social capital theory, social capital has a number of dimensions: structural, relational and cognitive (Nahapiet & Ghoshal 1998). The structural dimension assesses the characteristics and properties of the social systems and network of relations (Granovetter 1992) between the actors (Burt 1992). This dimension further assesses the presence or absence of network ties between actors (Scott 1991; Wasserman & Faust 1994). Represented by the concept of 'shared vision', the cognitive dimension refers to resources that provide shared interpretations and language among parties. Shared vision is grounded in strong personal relationships, and thus can be viewed as the 'outcome' of the structural and relational dimension (Uzzi 1996).

Working with these dimensions, we are therefore seeking to understand how the 'structural dimension' supports the creation of a cognitive dimension or rather the 'shared vision' between family business management and ownership, which affects business performance and supports sustainability into the future. In specific terms, we have conceptualized the structural dimensions as social interaction, the size of the family management, and family institutions including informal get-togethers, formal family meetings and the family council which create opportunities for family members to meet and discuss issues. These affect the level of social interaction which in turn influences the cognitive dimension, which is illustrated by level of agreement of a shared vision for the future of the firm's operations.

However, social capital or the dynamics inherent within a social capital perspective are further influenced by the 'context' framing

the interplay between these dimensions. We theoretically account for this 'context' by framing our social capital analytical approach with two aspects of embeddedness: social and mixed embeddedness.

Social embeddedness is generally influenced at two levels: structural and relational. While structural (social) embeddedness refers to 'who' one knows by identifying the nature of social ties, relational (social) embeddedness refers to how well one knows others, in other words the quality of relationships. A key facet of relational embeddedness is relational trust. This refers to a level of mutual trust that develops between people through repeated interactions over time between trustor and trustee (Nooteboom 2002). Relational trust drives people's current interactions with each other (Granovetter 1992).

Relational trust can generate flexibility, solidarity and information exchange amongst family members that may overcome some of the drawbacks of contractual-based arrangements, especially in turbulent environments where the presence of relational trust may stimulate more co-operative behaviours between family members (Poppo and Zenger 2002). As a result, relational trust can significantly contribute to business longevity, especially when the business may not be meeting performance targets due to external circumstances arising from the business environment in which it is embedded, that is the concept of mixed embeddedness.

Mixed embeddedness is a further concept that we draw upon. This encompasses the crucial interplay between the social, economic and institutional contexts in which the firm operates (Kloosterman et al. 1999). As a type of institution embedded in a civil society, family business develops and maintains its networks with organisations, which may provide reciprocity such as mutual assistance (e.g. information exchange within industries and markets; to inform each other about business opportunities), and may also furnish a common set of largely unwritten rules with respect to business practices (Kloosterman et al. 1999). Thus, family firm operation (like non family firm operations) is influenced by factors such as economic conditions and government policies, which facilitate business

growth, hinder or stimulate governance practices and policies.

Figure 1 diagrammatically illustrates our conceptual framework. This indicates that the family institution and size of the family management unit facilitate a level of social interaction among family members that results in the creation of a shared vision, eventuating in our concept of relational governance. Figure 1 also depicts the influence of social embeddedness and mixed embeddedness on a firm's operation, such as the formation of formal governance (e.g. board monitoring). In tandem with relational governance, formal governance mechanisms such as a board interplay to influence family firm performance. We now turn to describing our company before presenting our analysis using this theoretical framework.

Background to Our Company Case

Our company was primarily founded as a local sub-divisional contractor in 1967. In mid 1984, the founder asked his son to join the business, thus enlarging the business to a second generation. The intention even then was that the son would eventually succeed the founder. Since joining, the son has subsequently been promoted and now occupies the position of managing director. His wife joined the business upon marriage as a financial manager in the early 1990s.

It is this group of founder, founder's wife, son and son's wife that form what we refer to as the members of the family management unit. These members possess the equal shares of the company. Figure 2 further shows the positions held by family and non-family members in the company. As can be noted, the founder and his wife now hold an advisory position in the company, with the son and his wife occupying key management positions, namely the position of company managing director and executive assistant.

When the business was founded, it only employed five people. The company now employs between 50 -199 people, depending on the need for employees as per the contracts secured. As a result the company is classified as a small to medium (SME) size enterprise, according to Australian Bureau of Statistics classification (Australian Bureau of Statistics 2009).

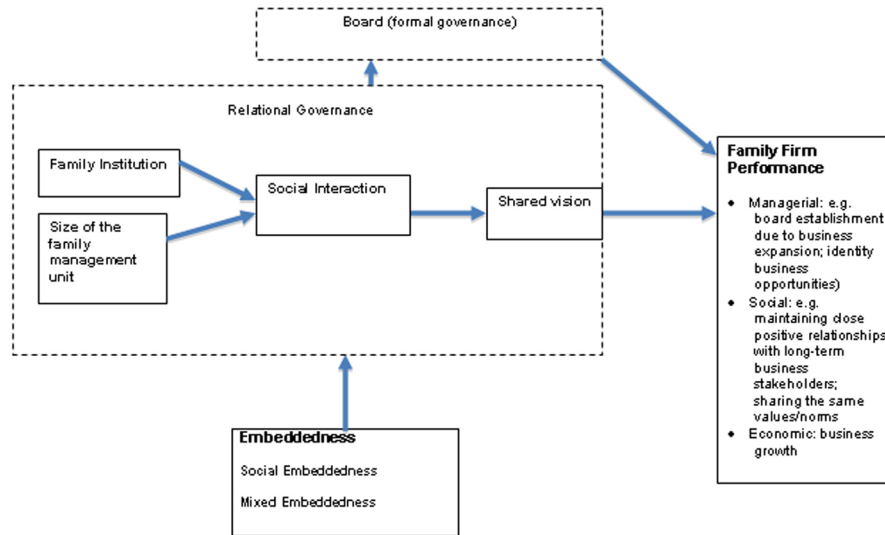


Figure 1: Conceptual Framework – Small to Medium Size Family Firm Governance

The core business of the company is construction, which the managing director describes as a 'predictable' business environment: as 'there is a five to seven year cycle... (that is)...very linked to consumer confidence on the housing market'. The company's main clientele are private developers and privately owned companies. (Managing Director, Company M Office, 1 September 2009)

Company activity was concentrated on contracting services when first formed. With the acquisition of another company, business activities became diversified, and in about 2000, the decision was made to create a more generic company name to reflect this growing diversification. Today, the business is organized into three departments, namely 'Business Growth', 'Construction' and 'Commercial' (See Figure 2).

Today, the company is a well-established entity in the construction industry in Western Australia. Business turnover is approximately \$AUD40 million per annum and, even in the face of the economic downturn associated with the global financial crisis, the company is positive about its future fortunes. While partially due to the emphasis in the Australian Government's stimulus package on bolstering the economy through infrastructure development, this is also due to the nature of the company's industry sector. As the managing director noted, 'another advantage in the construction industry

is that anytime, when the economy is down, the investment goes into infrastructure. When money is coming into the economy, it keeps us fairly busy' (Managing Director, 1 September 2009)

Using Our Conceptual Framework to Analyse Relational Governance

In reference to our conceptual model, our case firstly confirms the importance of the family institution and size of the family management unit in generating a level of social interaction not only within the family but also amongst key stakeholders of company and staff. These were significant in facilitating the shared vision that framed the company's operations.

Within the family, both formal and informal meetings were frequently held prior to the establishment of the formal board to facilitate ideas and opinions from all members of the family management unit on business operations. In terms of formal meetings, these were held on a monthly basis guided by an agenda. Minutes of the meeting were recorded and distributed. Thus, these formal meetings were business oriented and used to plan and execute business matters. It was suggested that family members would refrain from discussing family matters at these: 'We only discuss the business

issues in our formal meetings.’ (Managing Director, 1 September 2009)

On the other hand, informal meetings were considered valuable not only to discuss daily business matters, but also to strengthen social ties amongst family management members and key stakeholders. Family members would meet at social events such as a football match or family gatherings.

As a relatively small family management team of four, these meetings and social gathering enabled the family to meet and discuss issues frequently, and has been highly critical in fostering a shared vision among themselves about the future direction of the company: ‘we always have a chance to sit together and talk about the business issues. We want our clients to think that we are one of the best and professional construction companies in the industry.’ (Managing Director, 1 September 2009)

Fostering social capital at this level is of course critical in creating the cognitive dimension amongst key stakeholders about the shared vision or ‘the buy in by the people’ (Managing Director, 1 September 2009) that is needed for the business to be sustainable into the future.

Our case also suggests that these mechanisms assisted the family establish a level of relational trust, which has been significant in assisting the business to grow and remain sustainable: ‘You need to earn your trust. I mean the longer we run our company the stronger the trust we get. Trust absolutely relates to good business performance and that business is based on relationship and trust.’ (Managing Director, 1 September 2009)

However, while working at this level, the family management unit has also sought to proactively facilitate relational trust amongst two key stakeholders: staff and customers. With staff, this has been through holding almost daily informal meetings with key management staff to enhance social interaction, as well as providing the opportunity for staff training in keeping with the firm’s aim of delivering a professional service. With customers, this has been by inviting clients to social events.

Our case also illustrates the significance of forging relational trust between firm and customers in the formalisation of firm governance through creating a board mechanism. Our case analysis illuminates that it is the social dynamics of this informal governance mechanism that eventually triggered the formation of board, thus assisting the firm to achieve positive managerial performance. For instance, our data confirms the importance of establishing a board to enhance trust from corporate clients and other professionals by presenting the firm as ‘one of the best and professional construction companies in the industry.’ (Managing Director, 1 September 2009)

Hence, governance in our company case study exists at two levels: at the formal level of a board which, as Figure 2 illustrates, sits at the top of the company structure, and at an informal level between the owning management team of founder, founder’s wife, the managing director and the managing director’s wife. Their representative at the formal board level is the managing director.

As Figure 2 illustrates, the board sits at the top of the company organizational chart and has overall responsibility for strategic planning and resource allocation. This includes responsibility for financial oversight, strategy formulation, monitoring performance, ensuring policy compliance, undertaking risk analysis and recruiting and monitoring the development and performance of the managing director.

Significantly, the board is composed of two external non-executive directors, and has only one family member as a director. This is the current managing director who, as Figure 2 highlights, is the son of the business founder and is hence the second generation in the family business. The managing director also chairs the board. Two non-executive directors were selected based on criteria such as expertise and skills, and more importantly, their trustworthiness. Prior to board establishment, they were appointed as the external legal and financial advisors and shared a strong level of relational trust with the owner-family for years.

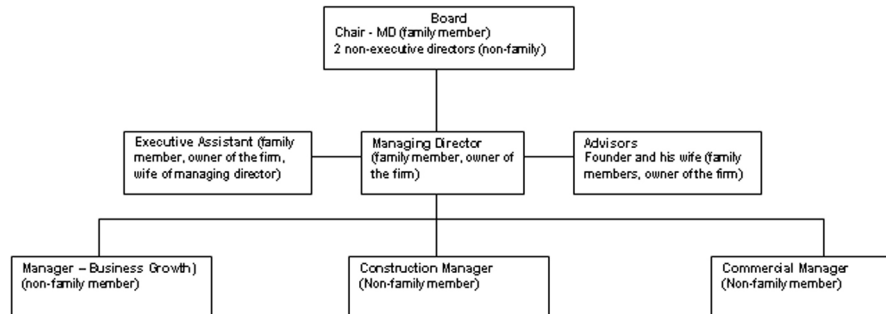


Figure 2 - Organisational Chart – Company M

Our case also illustrates that moving to this formal governance structure was at the behest of the second generation. Succession planning arises from the family firm's shared vision about the long-term survival of the firm. Particularly, it is the family's intention to address the business future of the second generation. As our analysis revealed, it was also the rapid growth of 24% experienced over the last three years (2005-2008) that had encouraged the company to formalize its governance structure by establishing a board in 2009. As the Managing Director said '... (until then) the company was not sufficiently large to facilitate such formal business mechanisms (such as a Board)' (Managing Director, 1 September 2009).

Thus, in reference to our conceptual framework (See Figure 1), it is clear that the 'mixed embeddedness' of economic conditions that framed our company's operations were significant in encouraging the owning family to formalise their governance strategy by creating a board. This was because the rapid growth phase experienced by the company had created the need to more effectively co-ordinate the company's long-term strategic development, as well as more carefully monitor operational aspects such as risk management of the company in the wake of rapid growth. Interviews with the founder and managing director confirmed this:

'We now agree to be involved to a less degree and let the Board make decisions.' (Founder, 1 September 2009)

'Parents are now not officially board members... we deliberately kept them away from the Board in the past five years. It's about risk management so decisions can be made more formally.' (Managing Director, 1 September 2009)

Our analysis of 'why' the owning family decided to establish the board confirms the significance of understanding the mixed embeddedness framing business operations. When first formed, the company's activity was mainly on contracting service. The acquisition of another company contributed to the diversification of business activities hence stimulated business expansion later in 2000. Since then, the company have further exploited their competitive advantage in business areas such as environmental construction. In addition, the nature of the construction industry enables the company to predict the market trend and consequently generated a growth rate of 24% between 2005 and 2008.

As a result of their rapid growth, the company also experienced changes in the demographics of their customer base from focussing on specific, individual and mainly small to medium enterprise based clientele to larger corporate clients whose expectations of business excellence aligned with more formalised (and by implication professionalised) practices, rather than the 'informal', 'patriarcal' and 'nepotistic' image often associated with family business. Creation of a board 'matched' this image, and in the view of the managing director helped enhance trust from these stakeholders that the business was adopting a robust business model: '...our clients are more from corporate people, other professionals and

high-network individuals – so we need to present ourselves in a very reliable image’ (Managing Director, 1 September 2009).

In analysing further the context supporting the decision to create a Board, the influence of relational (social) embeddedness is illustrated. Until the board was formed, the owning family made decisions for the business using a consensus model. Reflecting our concept of network closure (or the degree to which all actors in a network are related to one another), the managing director suggested that the rapid growth phase experienced had necessitated changing this model of decision-making because it created the perception of their firm as a ‘small business’ whose professionalism and hence reliability was questionable.

The creation of a Board created the image of a ‘professional contractor’ rather than a ‘corner grocery store’. The managing director affirmed the importance of dispelling the image often associated with family business and creating instead an image of a ‘professional’ business when responding to the question ‘why’ an independent person had been appointed to chair the board: ‘they bring skills and accountability to the company...to counteract the downside of the family business’ (Managing Director, 1 September 2009). In summary, we suggest that our case reflects prevailing views from the research that suggest family business acts upon business expansion and diversification of stakeholders by professionalising its governance structure.

However, the decision to create a board also illustrates the significance of network centrality. As we have suggested, this refers to the degree to which an individual has ties within the (family) network and exerts influence at this level. Undoubtedly, the managing director has been critical in creating the environment that has supported the creation of a Board as a formal governance structure in the business. Our interviews confirmed that at the level of the owning family members – and in particular the founder and the founder’s wife – the level of trust in the managerial capabilities of the managing director that had developed since joining the company was vital in convincing them to not only to accept the decision to create a board, but also the parameters of the decision. For instance, the founder was convinced not to sit on the Board because the company’s risk analysis had suggested this would negatively impact on the efficacy of the succession plan developed for

the business, and in turn implicate the long-term sustainability of the business.

‘We’ve been moving away from family business to corporate image...our clients are corporate and other professionals and high-network individuals, so we need to present ourselves a very reliable image.’ (Founder, 1 September 2009).

Framed by the relational governance model, our case illustrates formalisation of board as a critical example of the managerial parameter that measured firm performance. While confirming the existence of relational governance, our case analysis illuminates that it is the social dynamics of this informal governance mechanism that eventually triggers the formation of board, thus assisting the firm to achieve positive managerial performance.

Between 2005 and 2008, the company also generated a rapid growth rate of 24%. This economic parameter of firm performance was by exploiting their competitive advantage in being specialists in environmental construction, an area in which there are few competitors in their market location. However, the managing director also emphasized that paying attention to quality of the products and focusing upon customer satisfaction enabled the family business to stay competitive. In his view customer relationships were critical in realizing commercial success: ‘create(d) high value for clients through networking...we do it on time with reasonable price but not cheap price... and relationship, it is important too.’ (Managing Director, 1 September 2009)

In addition, the company believes that it is important to work with a clientele (i.e. both buyers and suppliers) that share the same values as the company, which indicate the social perimeter of firm performance. These were listed as ‘honour, loyalty, respect, integrity and working to exceed expectation’ (Managing Director, 1 September 2009). As was stated: ‘we work with clients who share the same values...we are very conscious of who we work with’ (Managing Director, 1 September 2009). Both founder and Managing Director expressed the belief that commonality with clientele on these values was crucial in developing relationships that not only support the business temporally (or long-term) from one generation to the next, but also assist the business in managing turbulent business periods: ‘the networks definitely

help us in the (economic) downturn' (Executive Assistant, 1 September 2009).

The firm's managing director has also developed a proactive strategy to extend relational embeddedness by expanding the firm's external networks, as well as maintaining connectedness at a social level with the firm's clientele. This has been through inviting clients to social events such as sports events as well as providing sponsorship for client related interests, for example, sponsoring young professional development awards with a related industry association. In essence, it is the close positive relationships with key business stakeholders sharing the same values and norms that consequently contribute to the company's growth and long-term sustainability into the future.

Overall the formation of a board enhances the concept of social capital and leverages the owning family's ambition to grow. When board meetings do occur, owning family members are able to express their opinion about board agenda items to their board representative, the managing director. Framed by a relational embeddedness perspective, the position of relational trust that the managing director holds is crucial in mediating between the strategic interests identified by the board as necessary for the company's operation and future, and the family interests. While illustrating the functioning of formal governance in our company, we argue that it is the relational governance that captures the social dynamics of key family members, particularly on forming a shared vision about their strategic decisions onto the future through frequent positive social interactions. Given the challenges posed by environmental turbulence, our company case highlights the tentative relationship between relational and formal governance (i.e. board). It is the consensus among the owning family's members that board monitoring contributes to family firm performance, and in turn generates momentum for business expansion in the foreseeable future.

Conclusion

Family business is argued as one economic entity that differs from non-family businesses in aspects of governance. While a debate rages about whether businesses under the owning-family's control encourages inefficiency and opportunistic behaviour, others (e.g. Granovetter 1985; Mustakallio, Autio & Zahra 2002) argue that

such criticism chooses to turn 'a blind eye' on the positive aspect of governance practices in family firms. Specifically, family governance demonstrates the social aspect of business operations, such as relational governance framed by social capital theory.

This case illustrates the presence of relational governance as an 'informal control mechanism' that enables the owner-managers to balance the interplay of family welfare and business objectives. This informal governance is accomplished through cultivating values, attitudes, beliefs and morality that over time become internalized within the individual to form a response at the business level. It is the functioning of relational governance that allows the key players of family business to maximize their performance by responding to the 'effects' of embeddedness, for example, maintaining close positive relationships with business partners sharing the same 'values' and 'norms'. As time evolves, both parties develop and maintain relational trust, which feeds back to the efficacy of relational governance. On the other hand, mixed embeddedness plays a dominant role to challenge the 'limits' of relational governance by coercing the family to establish a 'board', which is functioned as formal governance with the non-family manager involvement.

Our case suggests that the formal governance structure enhances the concept of social capital, which in turn leverages the family's ambition to achieve long-term business growth for the next generation. In particular, it is the family's shared vision about an agreeable succession plan that facilitates board establishment. This consequently enables the transfer of management control from one generation to the next, thus ensuring the long-term survival of the family firm.

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A LONGITUDINAL CASE RESEARCH OF A LARGE FAMILY FIRM: SAPUTO INC.

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Abstract: This case research tracks a large family business in Canada, Saputo Inc., over three generations. The objective is to explore longevity in a family firm from the founder-entrepreneur, Giuseppe Saputo, to the current third generation. The methodology followed a longitudinal single case research approach. Data for the Saputo case study was collected and triangulated from multiple sources including archives, biographies, annual reports, speeches, and interviews. The case is then presented in story-narrative format with some quotations from key sources and documents. This case study is part of a large study by the research team to examine factors contributing to longevity in family firms.

Key words: Family business, succession process, longevity.

Introduction and Conceptual Framework

Despite the significant role family businesses plays in both the stability and health of the new global economy, the survival rate of these firms beyond the founder's generation is extremely low. It is estimated that only 30% of family businesses survive beyond the first generation and only 10-15% survive through the third generation (Ward, 1987; Beckhard and Dyer, 1983). Fukuyama's (1995) popular expression, from shirtsleeves to shirtsleeves in three generations symbolizes this challenge. Despite these alarming figures there are many worldwide examples of successful family businesses that have endured for many generations, names like: the Agnelli Family of FIAT,

the Wallenberg family of Investor AB, the Michelin family of Michelin Tire and the Johnson family of Johnson Family Enterprises (O'Hara, 2004; Jaffe and Lane, 2004).

A key research question is why some family firms were able to survive successfully for multiple generations? What are the critical factors that contributed to their survival and success? Therefore, the objectives of this case research are to track a successful Canadian large family business, Saputo Inc., over three generations and to explore the longevity and survival of the firm as a family owned and controlled business. This case research is part of a large study by the research team to explore the factors that contribute to longevity in family firms.

Recently, there has been an increased interest in research in multigenerational businesses (Lambrecht, 2005; Miller and Le Breton-Miller, 2005; Jaffe and Lane, 2004; Miller, Steier, and Le Breton-Miller, 2003). Jaffe and Lane (2004) suggest that global family business dynasties control a major share of the world's wealth. Miller and Le Breton-Miller's (2005) study – "Managing for the Long Run: Lessons on Competitive Advantage from Great Family Businesses" revealed how successful multigenerational family firms such as the New York Times, L.L. Bean, Wal-Mart and IKEA have managed to survive.

Research has acknowledged the impact of family embeddedness on the unique behavior of family firms. The resource-based view (RBV) suggests that the family firm unique resources and capabilities-familiness enhance its ability

to survive (Habbershon and Williams, 1999; Habbershon, Williams, and MacMillan, 2003). Nothing can illustrate family embeddedness better than succession. Several studies suggest that succession is a central factor in family business survival (Lambrecht and Lievens, 2008; Ibrahim and Ellis, 2006; Le Breton-Miller, Miller and Steier, 2004; Stavrou, 1999; Handler, 1990, Kets de Vries, 1988, Lansberg, 1988). Indeed, research studies have widely acknowledged the importance of succession planning to the survival of the business as a family firm (Ibrahim, Soufani, and Lam, 2001, Poutziouris, Smyrnios, and Klein, 2006; Kets de Vries, 1993; Handler, 1990). On the other hand a very small percentage of family businesses engage in any kind of succession planning (Ibrahim, Soufani, and Lam, 2001; Handler, 1990). Handler (1990) cited lack of succession planning as a primary reason for the high mortality rate of family firms.

Family members' commitment, grooming and integration as well as successor's qualities are key ingredient to an effective succession and long term survival of the family firm. Kuratko, Hornsby, and Montagno (1993) suggest that survival of family firms require commitment and proper grooming of family members. Studies by Hollander and Ellman (1988) and Schein (1983) argue that family members' level of commitment is determined by their level of involvement and the degree of integration into the family business. Hollander and Ellman (1988) contend that the founder should develop the appropriate culture that integrates family members into the business effectively. The family business culture is shaped by the family vision and shared values (Harris, Martinez, and Ward, 1994). Recent studies acknowledged the significant relation between family members' commitment and the performance of the family firm (De Massis, Chua and Chrisman, 2008; Zahra et al., 2008). Miller and Le Breton-Miller (2005) study of well-known large multigenerational family firms revealed that these firms place much emphasis on continuity and long term commitment that rest heavily on strong clan culture and lifetime continuity. Research also suggests that qualities of the successor are critical to the survival of the family firm. Qualities include both leadership traits and management capabilities (Goldberg, 1996; Foster, 1995; Ward and Aronoff, 1994).

Corporate social responsibility- CSR- can indeed contribute significantly to the longevity of the firm.

Miller and Le Breton- Miller (2005) noted that family firms tend to develop long term commitment with their employees and outside stakeholders. The enlightened self-interest approach to CSR suggests that the community and its various stakeholders respond positively in the long run to the family business involvement in the community. The economic benefit of the social actions is often greater than its cost (Uzzi, 1996; Aram, 1989; Mescon and Tilson, 1987; Galaskiewicz, 1985; Arlow and Gannon, 1982).

Furthermore, the governance literature suggests that the governance structure of family firms tend to be more efficient than non-family firms and focus on long term and continuity rather than on short term profit maximizations (Jones, Marki, and Gomez-Mejia, 2008; James, Jess, and Reginald, 2004; Daily and Dollinger, 1992). Daily and Dollinger (1992) suggest that family firm offer the least costly type of organizational governance. Fama and Jensen (1983) argue that agency cost of family controlled firm tend to be significantly low as a result of the close alignment between the interests of owners and managers.

Methodology

The Saputo case followed a longitudinal single case research approach. Gerring (2007) defines case study research as a rigorous study of a single case where "the purpose of the study is- at least in part to shed light on a large class of cases (a population)." According to Stake (2005) the case approach "is not a methodological choice, but a choice of what is to be studied." Stake (2005, 1994) contends that the case approach can be used as an exploration that can lead to generalization-producing studies or as a step toward theory building.

Theory building from case research is a popular and appropriate research approach. The case research allows the researcher to develop theoretical constructs and/or propositions about a specific phenomenon based on rich empirical evidence of multiple sources (Eisenhardt, 1989; Yin, 1994). Studies suggest that case research has been widely used in family business research (Abetti and Phan, 2004; Miller, Steier, and Le Breton-Miller, 2003; Tsang, 2002; Dunn, 1995; Barach and Ganitsky, 1995; Alcorn, 1982).

The Saputo case research was selected because the business has endured successfully

for three generations as a family owned and controlled business. Siggelkow (2007) argues that it is appropriate to use theoretical sampling if the organization has unique characteristics and represents an opportunity. These characteristics provide more insight into the phenomena than if the case had been randomly selected or multiple cases had been used (Siggelkow, 2007; Weick, 2007). Theoretical sampling implies that the case can best demonstrate the patterns of relationships amongst constructs and the underlying logical arguments (Eisenhardt and Graebner, 2007; Siggelkow, 2007; Yin, 1994).

Following guidelines suggested (Eisenhardt and Graebner, 2007; Siggelkow, 2007; Gerring, 2007; Yin, 1994, 1984; Eisenhardt, 1989) data for the Saputo case study was collected and triangulated from multiple sources including archives, biographies, annual reports, speeches, and interviews. The case is then presented in story-narrative format with some quotations from key sources and documents.

Saputo Inc

Overview

The Saputo case is an inspiring entrepreneurial tale of determination, hard work and dreams of an Italian immigrant family that gave rise to a successful family business empire. The family business grew from a modest cheese operation founded by Giuseppe Saputo in the early 1950's, delivering quality cheese on a bicycle to the Italian community in Montreal to a global company with over 9600 employees operating 45 dairy plants and offices in Canada, the US, South- America and Europe with total sales of \$5 billion and net income of over \$280 million.

Through a clear and consistent growth strategy coupled with strong family values and tradition, three generation of Saputos contributed to the growth and development of the family business. Their active involvement in the community and philanthropy reflect deeply rooted family values and a sense of appreciation to the country that welcomed them and gave them the opportunity to achieve their dreams.

The Founders: The Artisan Cheesemaker and Son

Giuseppe Saputo, a master cheese- maker by training decided in 1950 to leave his small village of Montelepre, near Palermo, Sicily. He joined a growing number of Italian emigrants who left Italy after the Second World War to seek new opportunities in North America. For the Saputos, Canada represented a beacon of hope for a better future. "We thought Canada was the promised land and a place for people who wanted to succeed," said Lino (Gibbens, 1999). Giuseppe and his eldest son, Frank, landed in Montreal, Canada and worked as labourers to save money to bring the rest of the family. In 1952, Lino Saputo, his brother Luigi, sisters Rosalia, Elina, Maria, Antonina, and his mother Maria all travelled to join Giuseppe and Frank and the entire family were re-united in Montreal. Lino Saputo was quoted saying: "like a lot of people, we didn't see much of the future at home after the war" (From ricotta to riches, 2003). The family lived in St. Leonard, a district that served as the heart of the Italian community in Montreal. However, their first year in Canada was not easy either. Like many immigrants in a new land each family member had to work in order to put food in the table.

Two years after his arrival in Montreal, Lino the fourth of eight children persuaded his father to start a business in September of 1954. According to Lino Saputo, he feared that his father was losing his dignity working as a labourer and encouraged him to set up a small cheese making operation to make mozzarella cheese for the Italian community. With \$500, the Saputo family started the new venture from a small 3 meter by 3.6 meter room rented at the Delca cheese factory. "I knew he could do much better for himself, so with \$500 I'd saved we started making cheese in a corner we rented at a downtown cheese factory", said Lino Saputo. The initial investment of \$500 went towards the purchase of basic equipment and a bicycle to deliver products.

The Saputos began their entrepreneurial journey. Giuseppe and his wife Maria made the cheese and Lino was in charge of delivery using his bicycle. Lino was 19 years old and prior to leaving his native country he had completed high school. The initial production was limited to 10 Kg per day (22 lbs). After a few months, the family was able to afford a small truck. Lino Saputo recalls "I'd wrap

the cheese and deliver it by bike. We didn't buy our first truck until three months after we started" (Delean, 2002, 2003). Giuseppe was a master in creating high quality cheese, in particular mozzarella cheese, which was in high demand within the Italian community that had seen a large influx of Italian immigrants arriving in the 1950's (Fusaro, 1998). Giuseppe did not believe in using machines to make cheese. "He didn't believe in machinery. He said good cheese must be made by hand. At the start, it was all made by hand," says Lino Saputo (Saunders, 1997). By 1957, sales of Saputo's cheese products had grown to the point that they had to move out and set up their own production facility in the St. Michel district, north of Montreal (Saputo Annual Report, 2004). All the investment in facilities and equipments were paid in cash out of Giuseppe's conviction not to take any debt for fear of losing control of the business. This philosophy has become part of the family business culture since. Through out the years the acquisition strategies were pursued without taking on too much debt or relinquishing control of the family business.

Company Growth

Demand for cheese had grown steadily throughout the late 1950's. The Saputo's family business grew popular among the Italian community in Montreal as a result of the high quality and distinct taste of their cheese. The Saputos earned the reputation as the "missionary of mozzarella" for the Italian community (Saputo is Golden, 2004). With the increasing popularity of pizza in North America in the late 1950's demand for cheese grew and Saputo's sales increased dramatically since mozzarella was a main ingredient of pizza.

The invention of the pizza dates back to the ancient Babylonian and Egyptian civilizations, but it was the Italians who perfected the modern pizza and spread it, through migration to other places in Europe and North America. A young generation of baby boomers consumers in North America eventually would turn pizza into an international food. Riding the crest of this trend, the Saputos took full control of the opportunities; and each member of the Saputo family contributed through effort, determination, and sacrifices to the successful establishment of the company during those initial years of the family business. By now the Saputos were able to expand their family business beyond

the ethnic boundaries to the larger mainstream market (Saputo is Golden, 2004).

Throughout the 1960's, Saputo experienced substantial growth as demand for its products continued to increase. While the bulk of the sales were in the Montreal market, the company was also selling to the rest of Quebec, Ontario, and the Maritime region.

The Second Generation: The Visionary Leader

In 1969, Giuseppe retired from the company and Lino his fourth son succeeded him. Giuseppe knew his limitation and after all it was his young son's vision that convinced him to start the business. Since its inception Lino has been working closely with his father and was intimately familiar with the business. Giuseppe's influence on his son was quite deep. He inherited many traits including persistence, strong will, hard work, and shrewdness. The succession was a smooth process and the family rallied behind their young son. Lino took full control of the family business, becoming the Chairman and President and embarked on achieving his vision to turn Saputo from a cheese company into a leading Canadian dairy company. By the 1970's, the company's strategy focused on acquisition of manufacturing facilities to increase its production. In addition, with the help of John Saputo, Lino's younger brother who was born in Montreal, the company started to develop a national distribution network. Targeting the food service segment of the industry, Saputo had also become the leading producer of mozzarella cheese in Canada and held about one-third of the national market (Saputo Annual Report, 2004). However, Lino continues to follow the high quality strategy pursued religiously by his father and has since become the cornerstone of the family business philosophy. "I taste our cheese everyday and if it's not right my people hear from me immediately," says Lino Saputo (Gibbens, 1999).

During the early 1980's, the company's strategy focused primarily on geographic market penetration and expansion. This involved acquisition of small dairies in Quebec, as well as the acquisition of a cheese making company in Ontario. In 1984, the company continued its vertical integration by acquiring a plant outside of Montreal that turned

liquid whey by-product from cheese production into value-added products such as lactose, whey protein, and other food ingredients (Saputo Annual Report, 2004). Then in 1988, Saputo entered the American market by acquiring a production facility in Vermont, as well as Jefferson Cheese, a cheese manufacturer in Maryland. A year later, Saputo moved into a modern industrial complex in St. Leonard that became the family business new headquarters and incorporated state-of-the-art production facilities, national distribution centre, and its regional sales offices (Saputo Annual Report, 2004). By the late eighties, Saputo's vertical integration strategy to cheese by-products and milk suppliers up to the supply chain has allowed the family business to develop a strong distribution network and become the leading mozzarella supplier in Canada and a key player in the United States.

Going Public

The early 1990's were a period of internal growth and consolidation. Mozzarella cheese was still considered the family firm's main core product. In 1996, the company acquired Fromages Caron, a competitor in the Quebec market. This acquisition allowed Saputo to add imported fine cheeses, as well as more distribution networks to its product lines.

The reduction of trade barriers in the dairy industry as well as the need to continue its aggressive growth strategy motivated Saputo to go public to raise capital. The initial public offering (IPO) raised \$160 million of which 80 percent went to the Saputo family (Yakabuski, 1997). Commenting on the drive to go public and expand fully into the American market, Camillo Lisio, Executive V.P. of the company had noted that "What really triggered our plans last year [1997] was the signing of the GATT (General Agreement on Tariffs and Trade) in 1993. Over the next few years, GATT caused all world markets to open. The Europeans were reducing their subsidies and Canada was also under pressure to reduce subsidies and open up. There was also the concern that family businesses often do not survive past the first generation if not properly structured."

In 1997, Saputo continued its vertical integration strategy by acquiring more small milk and milk products companies. When Saputo went public, it also restructured the family business. Lino Saputo

became the Chairman and CEO of the new public company. At the end of the year, Saputo tripled in size by acquiring U.S.-based Stella Foods for US\$405 million. This move allowed the company to reach \$1.5 billion in sales (Fusaro, 1998) and positioned Saputo as one of the leading natural cheese producers in the American market, with 9% market share. According to Lino Saputo, "a dairy processor can achieve significant growth only through acquisitions because any attempt to grow internally is stymied by the plant quota."

The quota system refers to production contracts that specify how much milk the farmer can produce. The Canadian government instituted this national management supply system in the early 1970's in order to keep supplies steady so that prices and income would be stable. This would also guarantee high quality of milk supply, as well as protect the farmers. The government also used the quota system to restrict import of milk, but after the signing of the GATT in 1993, import quotas were replaced by tariffs decreasing by a rate of 15% over the six years that the agreement was in effect (Boyd, 1999).

The company's goal to expand into the American market was also driven by a desire to remain competitive, reduce its sales dependency on the home markets, and consolidate its share of the American mozzarella cheese market segment, which was growing due to the growing popularity of frozen pizza, lasagna, and other meals. By 1997, Saputo accounted for 34% of mozzarella production in Canada and 80% of its total cheese production was mozzarella. In addition, 76% of the company's total sales were from Canada (including 35% from the province of Quebec), 15% in the U.S. and 9% in international markets (Fusaro, 1998). In 1998, Saputo moved into Wisconsin, the cheese making capital of the United States, through the purchase of Avonmore Cheese Inc. and Waterford Food Products, adding in the process additional Italian cheese production, as well as powdered and condensed milk to its product lines. These acquisitions were followed by further acquisitions in the Canadian market, Riverside Cheese and Butter based in Trenton, Ontario and Bari Cheese Ltd, a producer of specialty Italian cheese in Vancouver, British Columbia. The company now accounted for almost 40% share of the mozzarella market in Canada and earned Lino Saputo the nickname "Mozzarella King."

In 1999, Lino Saputo followed his entrepreneurial intuition and ventured outside the family firm's core business through the acquisition of Culinar Inc., one of the main manufacturers of snack cakes, fine breads, soups, and cookies in Canada. One Culinar's most recognizable brands is the Vachon cake, which has a long history in Quebec dating back to the 1920's when entrepreneurs Arcade Vachon and Rose-Anna Giroux bought a bakery and turned it into a successful family business. Over two generations, the business grew and expanded across Canada and into the United States. Culinar's acquisition allowed Saputo to make good use of the vast distribution network developed in its core business.

In 2000, Saputo consolidated its leading position in the cheese market through the purchase of Quebec-based Groupe Cayer-JCB Inc., a company specializing in the production of European-type cheeses (Saputo Annual Report, 2000). After the acquisition of Culinar, the family business were restructured into two sectors, dairy and grocery products. The dairy sector operations, which accounted for 86% of total sales revenue, included 17 manufacturing plants in the United States and 11 in Canada. In addition, Canadian operations also incorporated a network of 17 distribution centres from coast to coast. The grocery products sector operated five plants in Canada, 53 warehouses that delivered products directly to stores, and five distribution centres.

In his fiscal year 2000 message to shareholders, Lino Saputo expressed the company's ambition to build a worldwide dairy family business, as well as to build a strong grocery products sector to complement its dairy sector operations (Saputo Annual report, 2000). Total sales revenue in 2000 was \$1.86 billion, a decline of 2.9% from the \$1.91 billion in sales in 1999; but still more than doubled the 1998 total sales revenue of \$817 million. This decline in revenue was due to a lower selling price per pound of cheese on the American market. Nevertheless, the company's net earnings increased by 26.5% to \$100.1 million (\$2 per share), compared to \$79.1 million in 1999 (\$1.63 per share). Net earnings in 1998 were \$45 million (\$1.23 per share).

Also in 2000, the company maintained its strategy in the dairy sector as a low-cost producer and operator, while continuing its market penetration goals. A further breakdown of sales in 2000 in the dairy sector showed that mozzarella cheese now

accounted for 48% of cheese sales, while other manufactured cheeses, fluid milks, and butter accounted for 41%. Imported cheeses and other dairy by-products, as well as non-dairy products accounted for 11%. Moreover, the American market accounted for 69% of total dairy sector sales, the Canadian market 27%, and international markets for the remaining 4%. Strong brand recognition has also been one of the company's key factors in its success.

The Dairy sector was also diversified according to market segments. Forty-four percent of its dairy sector sales were in the foodservice segment, 29% in retail, and 27% in the ingredients segment. The foodservice segment customers consisted of pizzerias, restaurants, hotels, distributors, as well as branded and private labels manufactured products. In the retail segment, customers included supermarket chains, grocery stores, warehouse clubs, as well as specialized gourmet cheese boutiques. In the ingredients segment, customers included other food processors, such as salad dressing, ready-to-eat, and frozen meals manufacturers. As in the dairy product sector, strong brand names provided strength to the company's products. In the grocery products sector, snack cakes accounted for 66% of its sales, cookies was a distant second at 22%, followed by fine breads and soups at 9% and 3%, respectively.

In 2001, after the acquisition of Vancouver-based Dairyworld Foods, a major Canadian producer of cheese, fluid milk, and other dairy products, Saputo became the leader in the Canadian dairy industry and the fifth largest dairy group in North America. Also in 2001, Saputo reached a partnership agreement with Dare Foods.

Given the number of acquisitions and the rate of growth that the company was experiencing, Saputo's corporate image and organizational structure underwent changes. In 2001, the company changed its name from Saputo Group Inc. to simply Saputo Inc. In addition, long time executive, Camillo Lisio-a non-family resigned as President and Chief Operating Officer in June 2001 (Saputo Press Release, April 6, 2001). Lino Saputo assumed full control of the company's activities and spearheaded a restructuring of the company's operations into business units. The dairy products sector was split into three units, Cheese (Canada), Cheese (USA), and milk, while the grocery products operations were consolidated into the bakery division. Each division had its own

operating structure, which allowed the company to gradually position itself for further acquisitions and to become a major player in the North American food processing industry. In 2002, Saputo underwent further internal consolidation of its activity in order to increase operational efficiency. As a result, several plants were closed throughout the year (Saputo Annual Report, 2003).

The year 2003 brought further growth acquisitions that made Saputo the leader in blue cheese production in the American retail market segment. In addition, Saputo entered into a partnership agreement with Western Marketing & Sales LLC based in California to produce and market whey products. (Saputo Press Release, May 1st 2003).

A few months later, Saputo completed its first acquisition outside of North America. The acquisition for \$50 million of Molfino Hermanos S.A., the third largest dairy producer in Argentina, added 850 employees to Saputo's growing workforce of 7,500 employees. Molfino's sales were US\$90 million, 60% of the sales coming from the domestic market and 40% from exports to other countries. In addition, this acquisition expanded Saputo's product lines in cheese and other dairy products (Saputo Press Release, November 28th, 2003).

The Molfino acquisition provided Saputo with a location outside Canada and the United States to serve as a platform to enter world export markets. Furthermore, according to Lino Saputo, the acquisition represented a better fit with Saputo "when we were first looking at this, Argentina was going through some real difficulties. But what impressed us most about the company was the quality of the people, and that their sense of pride was not touched but what was happening. The passion for what they were doing was as good in Canada as in the U.S. What we look at when we look at a company is the human resources, and we were very impressed at what we saw at Molfino Hermanos."

The Third Generation: The Charismatic Leader

In 2004, the Saputos celebrated the 50th anniversary of their family business. For Lino Saputo, this celebration was a crowning achievement and a reflection of his vision, determination, and perseverance to turn a small family business into a

global dairy company. The company's performance reached new records, as sales revenue topped \$3.57 billion, up 5.1% from 2003, while net earnings reached \$212.4 million, up 22.3% from the previous fiscal year. During the seven years that Lino Saputo guided the family business as a public company, total sales revenue more than quadrupled from \$817,255 million in 1998, and the annual return on average shareholders' equity has ranged from 16% to 19.5% (see Exhibit 1). As he put it, "when my family and I founded the company 50 years ago, we had dreams. But I never thought one day I would be managing a business with 46 plants across North America and more than 7000 employees" (Swift, 2003). Recently, Lino's achievements were recognized by the Forbes World's Billionaires List, where he was listed with a personal net worth of over \$2.5 billion.

More important though for Lino Saputo was his commitment to the family and to the business. As he celebrated this important milestone his brothers, Frank, Luigi, John, and sisters Rosalia, Elina, Maria, and Antonina are all beside him. All of his siblings, as well as nephews, nieces and other extended family members are shareholders in the family business. Moreover, the Saputo family controlled 58.04% of all outstanding common shares, of which Lino Saputo held 33.61% (34,939,962 common shares out of a total of 103,970,432 common shares) and brothers, sisters and their families held the other 24.43% (25,405,164 common shares). Lino Saputo Jr. also held 33,589 shares and his cousins Patricia Saputo and Caterina Monticciolo both of whom sit on the Board, held 1,800 and 119,000 shares respectively (Saputo Management Proxy Circular, 2004).

Recognizing the need to prepare the next generation for their eventual role in the family business, Lino began grooming his offspring since they were very young. He and Mirella Saputo have two sons and a daughter-Joey, Lino Jr. and Nadia. Lino, Mirella and all their children are involved in the family business, but it is Lino Jr. that has been anointed as possible successor (Delean, 2002, 2003). Growing up, Lino Jr. was exposed at an early age to the business and its family culture and never doubted that he would spend his life at the company founded by his father and grandfather (Yakabuski, 2003).

"Not that I ever took it for granted, but because I love the dairy industry. And I grew up with the

same values and beliefs that we promote in the company. The fit couldn't be better," said Lino Jr. He started working in the family business at age 13 making cheese, mopping floors, and cleaning vats. While studying political science at Concordia University, he used to drive trucks to deliver mozzarella cheese to local pizzerias (Yakabuski, 2003). "...I have been in business since I was 13 years old. I started on the plant floor, washing the floors, sweeping and mopping, and then I graduated to cheese making. I grew up in our manufacturing division," said Lino Jr. (Pitts, 2008). About studying political science, Lino Jr. said, "I never felt that I needed to get into different faculties in order to build a résumé. Growing up, a lot of our discussions around the table at home were about the business. So I didn't feel the need to duplicate that education in school."

At age 21, Lino Saputo Jr. joined the family business in 1988 as an Administrative Assistant. Two years later, Lino Jr. became the plant manager of a cheese plant in Cookstown, Ontario (Yakabuski, 2003). In 1993, he became Vice-President Operations. When the company went public in 1998, Lino Jr. became Executive Vice-President, Operations and Plant Manager. In 2001, he joined the Board as a Director and later became President and Chief Operating Officer of the Cheese Division (USA), a post he held until January of 2004. These jobs provided the opportunity for both Lino Jr. to prove himself and to earn legitimacy among family and non-family employees and for his father to test his leadership qualities and commitment to the family business. Lino Jr. distinguished himself and demonstrated shrewd entrepreneurial style in the highly competitive US market. According to Raymond Lai, an analyst with Raymond James Ltd., "Lino Jr. is an accomplished operator and highly regarded in the industry. He could take the top spot in five to ten years" (Gibbens, 2001).

Nevertheless the selection process was systematic and objective. A succession committee was formed from the Saputo's Board of Directors and Lino Jr. was selected to succeed his father. André Bédard, Chairman of the National Bank of Canada and a member of both Saputo's board and the succession committee was quoted, "Lino Jr. has a lot of his father's quality; he has proven himself. His father was more demanding of him than any

other employees. Without doubt, he and his team are ready to take over" (Delean, 2003). Pierre Bourgie, a member of Saputo's Board of Directors, echoed Bédard's comment: Lino Jr., can achieve results but also follow his father's approach. "I have known the father for over ten years and the son for slightly less, but Lino Jr. has impressed me a lot. First, like his father, he knows the business to the smallest detail. When you ask him questions, he responds immediately in a clear and direct fashion. But there are differences between father and son. Lino Sr. has a fiery personality, resembling that of Maurice Richard. The son has a more measured personality; he displays charisma as well as a lot of leadership, which is essential for a company of the size like Saputo. Moreover, the son's independence is manifested not only in his thinking but also in his actions. He does not try to be like his father" (Des Roberts, 2004). In a recent interview Lino Jr. said "I knew I would be in the business, because I had a passion for the dairy industry. I have milk in my blood. I never expected to be CEO. It just evolved that way. But I knew in some capacity, as a labourer, supervisor or plant manager, I would be in the company" (Pitts, 2008).

In his annual address to the shareholders Lino Saputo said, "At 66 I have to think of enjoying life a little more....it is time to let go, gradually to curtail my responsibility....I am proud and happy with the decision...I know he has the competence and energy to lead this business to the new horizons" (Delean, 2003).

On March 30th, 2004, Lino Saputo Jr. officially became President and CEO of the company. While the transfer of leadership from father to son started in August 2003, the succession process had been in the planning from the time the company became public. Although Lino Saputo. had expressed his intentions to retire and turn over the CEO position to his son before the end of the 2004 fiscal year, the delay allowed Lino Saputo to guide the acquisition and integration of the Molfino acquisition, as well as to set up the stage for the next step, the global dairy industry. Lino Sr. said "I'm very happy to see Lino Jr. take over management of the business I founded with my family in 1954. I have no doubt that Lino Jr. with the support of his entire team will carry our Company to new heights."

Commenting on his appointment, Lino Jr. said: "I'm extremely happy to be taking over this position. My goal is to propel the basic culture and values that characterize Saputo Inc., which consistently shape our activities. Up until now, Saputo Inc. has achieved its success by working in close cooperation with its employees and business partners. I intend to ensure that Saputo Inc. continues to grow in the same manner to become a world-class dairy processing company, in the best interests of our employees and our shareholders."

Lino Jr. continued the company's aggressive growth strategy through acquisitions. World consumption of cheese was still growing at historical rates of one to two percent per year, and the industry was still fragmented (Saputo Annual Report, 2005). Lino Jr. believed that the American market continued to offer opportunities, but at the same time, the industry was still driven by a trend towards consolidation into larger players. In 2005, Saputo acquired two Quebec-based cheese companies and added fresh cheese curds and specialty cheeses to its product line. It also acquired Schneider Cheese Inc., an American producer of cheese strings and sticks, which manufactured these products under their brand, Schneider, as well as private label brands (Saputo Annual Report, 2005).

Sales in 2005 reached a new high of \$3.88 billion, up from \$3.57 billion in 2004; and net earnings were \$232.1 million, up from \$212.4 million in 2004. This financial performance was a reflection of not only the strength of the company, but also the skills and vision of Lino Jr. in guiding the family business. Sales breakdown shows that dairy product sales in the American market grew by 5%, compared to dairy products sales in Canada and Argentina combined, which grew by almost 12% (Saputo Annual Report, 2005).

A comparison between the dairy product sales streams from the Canadian and American markets shows a diversified approach (Saputo Annual Report, 2005). The foodservice segment accounted for 44% of total American cheese sales; retail sales accounted for 30%, and industrial sales accounted for 26%. In Canada, 48% of total cheese sales came from the retail segment, 39% from foodservices segment, and 13% from the industrial segment. In 2005, Saputo processed 20% of all fluid milk in Canada and had a market share of 38% of all natural cheeses manufactured in the country. Eighty percent of Canadian revenues from fluid milk activities came from the retail sector,

and the other 20% from the foodservice sector. In Argentina, Saputo processed 5% of all fluid milk in that country; and 56% of its production was sold in international markets through a network of 150 distributors covering 30 countries in six continents.

In addition, the company created a specialty cheese group that focused on the growing demand of Canadian consumers for fine and gourmet cheeses. This involved the launch of new premium cheese brands (Saputo Annual Report, 2006). The efforts in developing innovative products earned Saputo industry recognition and many accolades worldwide. The product innovation strategy follows in the tradition set up by the founder-Giuseppe Saputo of carefully crafting high quality products. Indeed, for the Saputo family, cheese making is still considered an art.

Saputo's marketing strategies are also highly innovative and reflect a clear vision. In 2005 Saputo increased market penetration of milk activities in Quebec and Ontario, including vending machines programs to sell Milk 2 Go and Lait's Go lines of flavoured milk. In response to consumer trends, Saputo also positioned its milk products within growing market niches, such as yogurts. In the summer of 2005, Saputo launched a new line of single-serve iced coffee, under the Cafécchino brand name to compete in the beverage market.

In 2006, Saputo entered the European market by acquiring Spezialitäten-Käserei De Lucia GmbH, a producer of Italian cheeses based in Heiden, Germany. This acquisition also served as a base towards increasing exports of Saputo products into Europe. In Europe, Germany, which has the largest production of cow milk in the EU, is also considered the most important cheese producer country (Saputo Annual Report, 2006).

Following the acquisition of Spezialitäten-Käserei De Lucia GmbH, Saputo's organizational structure also underwent a revision. The company was structured in three sectors (Saputo Annual Report, 2006). The Canadian and Other Dairy Products sector was made up of three divisions: Dairy Products Division (Canada) which grouped two activities, Canadian Cheese and Canadian Fluid Milk activities, Dairy Products Division (Argentina) and Dairy Products Division (Germany). The second sector was the US Dairy Products Sector which contained one division, Cheese Division (USA). The third sector was the Grocery Products

Sector which contained one division, the Bakery Division.

Historically, Saputo's core activities have been in the dairy sector. In 2006, the company processed over 4 billion litres of raw milk and produced approx. 400 million Kg of cheese (Saputo Annual Report, 2006). However, Lino Jr. also made a commitment to improve sales in the Bakery Division by injecting an investment of \$20 million to develop new products (Saputo Annual Report, 2005). According to Lino Jr., "the management at Saputo had not given the necessary attention to this division. We have been busy, even distracted, by all the acquisitions in the dairy sector. But this will change rapidly." Lino Jr.'s objective was to inject a dose of entrepreneurial spirit into the bakery division, as well as enhance its strategic advantages to the company (Des Roberts, 2004).

Because many of the products in the Bakery Division fall into the indulgent product category, Saputo introduced in 2006 a new line of wholesome products to tap into the healthy eating consumer trend. New products such as Hop&GO! Multigrain received the endorsement from the Heart and Stroke Foundation of Canada. The company's renewed commitment to continue growing the bakery division was enhanced through the strategic acquisition in 2006 of two Quebec-based companies, Boulangerie Rondeau Inc. and Biscuits Rondeau Inc. The aim of these acquisitions was to diversify Saputo's baked products line by entering the in-store baking products segment (Saputo Annual Report, 2007).

The Challenges Ahead

In March 2007, Saputo continued its international growth path by acquiring Dansco Dairy Products Ltd., a manufacturer of mozzarella cheese based in Newcastle Emlyn, Wales in the United Kingdom. Dansco's production, which targeted primarily the foodservice segment, provided Lino Saputo Jr. with another entry point to the EU market (Saputo Annual Report, 2007). Saputo had used the acquisitions of Molino and Spezialitäten-Käserei De Lucia, as learning experiences to gain insights and information about the dairy industry and retail consumer segments in those international markets. The company saw the addition of Dansco as a platform for further European activities.

A month later in April 2007, Saputo followed the Dansco acquisition with another acquisition in the United States. It acquired Land O'Lakes West Coast Industrial cheese business based in Tulare, California. More importantly, these acquisitions increased Saputo's processing and production capacity from 4 billion litres of raw milk and 400 million Kg of cheese, to 5 billion litres of raw milk and 500 million Kg of cheese (Saputo Annual Report, 2007).

With production plants in five countries and increasing complexities in its operations, Saputo restructured its organization into two sectors: Dairy Products and Grocery Products. The Dairy Products was divided into Canadian and Other Dairy Products and US Dairy Products Sector. The Canadian and Other Dairy Products Sector now consisted of four divisions: Canada, Argentina, Germany, and UK. The US Dairy Products Sector retained its Cheese Division. Furthermore, in 2006 the company embarked on a cost cutting strategy to streamline its operations and make them more efficient. The results were the closing of two cheese production plants, as well as the closure of a packaging plant (Saputo Annual Report, 2007). In 2006, total sales revenue were \$4.0 billion, an increase of 3.6% from 2005 sales of \$3.88 billion. However, for the first time in company history, sales revenue in 2007 did not increase and had decreased by -0.5% (though sales revenue were just slightly over \$4.0 billion). While in 2006 net earnings had decreased by 17%, in 2007, net earnings increased by 24.1%.

Moreover in December 2007, the Saputo family would face defamation to its integrity and character when an Italian newspaper associated the Saputo name with mafia activities in Italy, a story that was then picked by local Quebec French newspapers and the national Globe and Mail newspaper (Delean, 2008). This unfounded attack on the Saputo family name resulted in Saputo filing on March 10, 2008, a defamation suit against the Italian newspaper and the three Canadian media groups. "Mr. Lino Saputo has worked honestly all his life to create one of Canada's most prosperous businesses. We are proud of the development of the business and thank all Quebecers and Canadians for their relentless support since 1954, without which this success would not have been possible. The newspaper articles contained false allegations about Mr. Lino Saputo and Saputo Inc. and we will not tolerate the dissemination of false and misleading information which is harmful to our

name, reputation, and business interest,” said Lino Saputo Jr. in a statement. In the 1970s, the Saputo family fought similar unfounded allegation of a business deal with New York mob Joseph Bonanno which hampered the family business entry in to the US market (Saunders, 1997).

The lack of sales revenue growth and the legal distractions did not deter Saputo from its growth strategy. In 2008, the company completed two more acquisitions in the United States and Canada (Saputo Press Release, Dec. 1st, 2008). In 2008, total sales revenue grew by \$1 billion to reach \$5.0 billion, an increase of 25% from 2007 and net earnings grew by almost 21% from \$238.1 million in 2007 to \$288.2 million in 2008. While the Canadian dairy industry remained stable, American dairy industry continued to experience volatility and high fluctuations in dairy prices. The price of dry whey products which has a positive effect on the price of milk rose to unprecedented high levels, which then affected the price of cheese (Saputo Annual Report, 2008).

The global dairy industry is affected by government regulations, tariffs, and market barriers that create disjointed markets with diverse cost structures across and within countries, differences in production systems and standards. Governments play an omnipresent role in market barriers through trade policies, by subsidizing export, as well as by introducing arbitrary technical packaging and labeling standards and regulations (IDFA, 2007). Climatic changes, such as floods and drought as well as the increasing demand for dairy products from other emerging countries such as Russia, China, and the Middle East and the effect of globalization play a significant role on the production of milk and the price of the dairy industry in general.

According to Umhoefer (2008), three major trends will drive the dairy industry: Mergers and acquisitions, global impacts of prices, and growth of branding and niches. Umhoefer stated that the trend in the industry will be towards consolidation into bigger companies that can compete at the global level. Moreover, he noted that “product innovation, whey-product development, nutrition marketing, and gourmet niches will define the dairy companies that survive to 2050.”

The industry challenges faced by Saputo in 2007 and 2008 were severe and the company was able to steer through the volatility. In 2008, Saputo

regained its ranking as the third largest dairy processor in North America (last held in 2006). In 2008, Saputo was ranked as the 13th largest dairy processor company in the world. Exhibit 2 lists the world’s top 20 dairy companies. The global dairy industry is highly fragmented. Nestle, the top dairy company in the world has 5% of the global dairy market share in 2006, followed by Danone with 2.5% market share (Business Insights, 2008). The top 10 companies accounted for approximately 22.5% of the global dairy industry’s market share. In 2006, the global dairy industry was worth \$402.5 billion and had a 5-year compound average growth rate (CAGR) of 3.7%. The industry was forecast to grow by a CAGR of 4.9% to reach \$487.2 billion in 2011.

Corporate Governance

In 2008, the company revised its corporate governance policies and added two new independent directors to the Board in order to reflect the growth of the company, as well as to ensure shareholder’s interests. The number of directors increased from ten to twelve, with the majority of the Board members being independent directors and a smaller number of family members (Saputo Annual Report, 2009). At Saputo, directors are expected to learn about the culture of the family business, through presentations and trips to facilities where they can learn firsthand about the operations and gain knowledge about the industry (Saputo Annual Report, 2008). Exhibit 3 lists Saputo’s Board of Directors.

The Board also created two committees, the Corporate Governance and Human Resources Committee and the Audit Committee that reviews performance and the stewardship of the company. It was a sub-committee of the board that selected Lino Jr. to succeed his father. Lino Sr. is still Chairman of the Saputo Board and while he is no longer involved in day-to-day running of the family business, he is involved in strategic decisions. Recently, Lino Jr. was quoted saying, “the Saputos are absolutely devoted to their model of family ownership (Pitts, 2008).

Lino Saputo has ensured that the family business’ interests were aligned with shareholders’ interests. At the time when Lino Saputo stepped down and passed the baton to Lino Jr., his salary as a CEO was \$600,000, plus a performance bonus of \$330,000 (Gray, 2004). Lino Saputo’s salary

had never been over seven figures; and his total compensation over the last three years was below the compensation paid to the President and Chief Operating Officer of the company (Gray, 2004). Moreover, Lino Saputo had never received stock options during his tenure as Chairman and CEO of the company. According to David Newman, an analyst at National Bank Financial, "At Saputo there is a complete alignment between the interests of shareholders and management. Saputo is very cautious in everything it does. They make good acquisitions, integrate them well into the operations, and never overpay." In contrast to CEOs of other companies, Saputo has refrained from offering executives perks, such as private loans, subsidized apartments, private jets, and stock options. In 2004, Lino Jr.'s salary was also \$600,000, same as his father's departing salary, plus a performance bonus of \$330,000. Lino Jr.'s salary increased to \$630,000 in 2005 and \$725,000 in 2006; while performance bonuses went up to \$488,000 in 2005 and \$673,000 in 2006 (CEO Annual CEO Scorecard, 2007). However, in keeping with the company's policy, Lino Jr. received no stock options. Hadekel (2006) noted that Lino Jr. was ranked as one of the top CEO delivering value on the money.

In order to gain more experience and knowledge about corporate governance, Lino Saputo Jr. has also served as a Director at Transcontinental Inc. since 2008, where he sits in the Governance committee. In addition to his corporate duties, Lino Jr. has devoted time to serve as Co-Chair of the 2005-2009 fundraising campaign of the Sacré-Coeur Hospital Foundation and has also chaired organized events for Quebec Cystic Fibrosis Foundation, the Fondation Armand-Frappier, and the Fondation Scolaire de Laval amongst others.

Social Responsibility and Philanthropy

Even though Saputo had a long tradition of giving back to the community dating back to its founders, the company confirmed and embraced higher social responsibility activities. These included donation and sponsorship policies that contributed to the social and economic development of the communities where they operated (Saputo Annual Report, 2006). The company also adopted policies to promote and encourage healthy nutritional habits, developing innovative products that meet changing dietary needs, providing information about healthy nutritional choices, as well as

supporting organizations that promote good nutrition. Furthermore, the company adopted several social causes that foster proper eating habits and physical activities in children, as well as sponsored organizations such as Le Club des petits déjeuners du Québec and Breakfast for Learning. These two organizations focused on feeding underprivileged children (Saputo Annual Report, 2006). Over 260,000 children in 2,600 schools across Canada benefit from the school feeding programs. Saputo also participates and contributes to food banks in the countries where they operate.

Furthermore, the Mirella and Lino Saputo Foundation donated \$1 million to the Growing Up Healthy Project of the Sainte-Justine Children's Hospital in Montreal (The Foundation Mirella and Lino Saputo, 2006). The Mirella and Lino Saputo Foundation was founded in 1979, on the company's 25th anniversary, to help sick and disabled children, women, and seniors. It is also active in financing services for Quebec hospitals and research projects. In April 2007, the Mirella and Lino Saputo Foundation received the 2007 Philanthropic Merit Award from the Federation of Quebec Chambers of Commerce (Mercuriades, 2007). This award recognizes individuals from the business world who have distinguished themselves in their careers for their social and community work.

A third major social cause has been Saputo's commitment to promote sports and athletes by providing scholarships to athletes who excel nationally and internationally. In addition, the family and the business have been behind a drive to encourage youth leadership through Soccer, a sport that combines team spirit and brings people from various cultures closer together (Saputo Annual Report, 2006). The Saputo family privately committed to donating \$7.5 million to pay for 50% of the construction costs of the new soccer stadium which will serve as the home for the Montreal Impact, the professional soccer team owned in part by Joey Saputo, Lino Saputo's eldest son (Phillips, 2005). The Saputo family had invested in the Montreal Impact since 1992; and in 2001, Lino Saputo rescued the team from bankruptcy (Beacon, 2002). Joey Saputo has been not only a founding member but also President of the team since 1993 (Phillips, 2008).

Other social causes includes supporting the Make-A-Wish Foundation of America, an organization

devoted to granting wishes to children who are ill, as well as various organizations in Argentina focused on helping children and adolescents with special needs. Saputo also adopted environmental policies to develop environmentally sensible and sound solutions to raising cattle, farming, milk transformation and processing, waste reduction, and raw material utilization, amongst many (Saputo Annual Report, 2006). Furthermore, the company's educational policy focuses on supporting agri-food research and development, providing scholarships to the next generation of leaders, and supporting many educational institutions.

Employees: The Extended Family

Lino Jr. rarely spends time in his office, as he prefers to visit plants and chat with employees, "everyone is family" said Lino Jr. (Lacey, 2008). His philosophies reflect the family business entrenched values. Lino Saputo Sr. stated that his son's involvement and growing up with the family business was not a unique experience at Saputo because "I am not the only individual in the organization that is among the second or third generation. There are lots of people in the company whose mothers and fathers have started with the company, and they are now part of our extended family. So I grew up knowing those parents and now I am working with their kids." Working at Saputo means that employees are treated as part of an extended Italian famiglia (Yakabuski, 2003).

During the company's 50-year celebration, Lino Sr. affirmed the family philosophy towards its employees. He noted, "For us the 50-year anniversary is really a testament to the quality of the people we have in the organization. We call our people entrepreneurs, and we are proud, not so much of our success, as we are of the fact that we are able to maintain the kind of environment where those people are supported in their efforts to improve the company."

Looking To The Future

The Saputo family has come a long way. Their success story is an example of hard work, persistence, commitment and dreams. The family business grew from a humble start up of an immigrant delivering quality cheese on a bicycle to the Italian community in Montreal to a large global family business empire. Over the years

the three generations of Saputos have shown a clear, consistent, entrepreneurial vision and skills to start and grow a family business successfully (see Exhibit 4 for a summary of acquisitions under each generation). Their aggressive growth strategy through acquisition reflects shrewdness of a master entrepreneur and a strong grooming process to ensure that each generation adheres religiously to the family values and philosophy. Recently Lino Jr. summarized the family philosophy: "Our primary focus, back to the days of my father and grandfather, has been to keep our house in order, and produce the best cheese at the most competitive price. That focus has allowed us to keep our nose on the grindstone. That platform has allowed us to make acquisitions. We say, as long as we take care of our own home, the opportunities will come" (Pitts, 2008).

Lino Jr. believes that the company should continue its growth strategy through acquisition. Since he took over as President and CEO of the family business in 2004, Lino Jr. had seen sales increase by 168%, from \$2.16 billion to \$5.8 billion (Exhibit 1). While Saputo diversification outside the core business has been successful, nonetheless 97 percent of the family business revenues come from dairy products, which leave the business vulnerable to the volatility of the dairy industry. Indeed, Saputo's biggest share in the market is in mozzarella. "Mozzarella is what we came from" said Lino Jr. in an interview in the Canadian Club (Lasalle, 2006). On the other hand, some analysts questioned Saputo's diversification strategy into bakery products on the basis that it lacks strategic fit (Des Roberts, 2004).

Lino Jr.'s spends half his time visiting countries where the company has operations; he travels now in the family-owned Challenger jet where practical. He makes a point also to travel to other countries to see firsthand the markets in those countries (Swift, 2005). "We have to get out there and see how things are evolving in the dairy industry, or they (other countries) will be surpassing us without us knowing it, and we'll be in a catch up mode," says Lino Jr. He further added that "I think the opportunities are limitless. If you look on a worldwide dairy scale, we're in the top 20. There are some very large companies out there, but there are still some very small fragmented players, so we believe there's still a huge opportunity for us to grow our business, either organically, but mostly through acquisitions. Based on the information we have, we don't believe

there is any one company that has more than ten percent of the market share.” Lino Jr., believes that the US market represent great opportunity for growth: “the growth opportunities in the U.S. are much greater than in our own backyard” (Swift, 2005; Pitts, 2008). But he has also been looking for opportunities in Europe, Australia, China and India. Lino Jr. believes that Australia and New Zealand offer good opportunities because of their low priced milk (Gibbens, 2007).

Despite their success the Saputos remain committed to their community and never skip a chance to give back to the country that gave them the opportunity to achieve their dreams. Their involvement and devotion to the welfare of the community are reflected in their deeply rooted family values and traditions.

Lino Jr. is still very young to think about stepping down. At age 19, Lino Jr. met his future wife Amelia at the company’s 1985 Christmas party. Amelia, a third generation Italian-Canadian and daughter of Lino Saputo’s administrative assistant, underscores the strong family atmosphere relationship that exists between the Saputos and their employees (Yakabuski, 2003). Amelia has been working in the family business after marriage. She is now actively involved in community activities including the Montreal Heart Institute Foundation and Breakfast Clubs of Canada, which support more than 2,500 feeding programs for children across Canada. Lino Jr.’s siblings Joey one year older and Nadia the youngest are both married and have children. Both have been working in the family business but lately ventured into their own. “My brother is actually the president of the Montreal Impact soccer team, which he founded back in 1993. He has other investments. My sister is a mother of three and

she has a fashion boutique for women’s clothes and a party planning business,” said Lino Jr. in a recent interview (Pitts, 2008). Like the rest of the family both Joey and Nadia are actively involved in community activities and philanthropy.

The Saputos fourth generation are too young to be involved in the family business (Exhibit 5). Nonetheless, they are getting a glimpse of the family business action during family get together, and dinner table discussions. Lino Jr.’s work ethic comes from the time he started working at the family business when he was 13. Sipping coffee in his office in 2005 showing pictures of Lino Jr. as hockey goalie, as well as pictures of his wife Amelia and two young sons, Giordano (11) and Emanuele (9), Lino Jr. said that he wants the same for his sons. “They will work in our plants, only so that they can learn what it is to sweat eight, 10 hours a day, earn minimum wage, so they can appreciate what it is to earn a dollar” (Swift, 2005). In a recent interview, Lino Jr. re-iterated his family grooming philosophy: “Even if my father had sent me somewhere else, I wouldn’t have gone. I follow the same model with my kids - you need to understand the business from the grassroots. You need to rub shoulders with the folks who are busting their behinds to make an honest day’s pay” (Pitts, 2008).

However, as Lino Jr. looks ahead to the future, a number of strategic issues are lingering. Could the entrepreneurial characteristics that have driven the business be sustained? How? How will the family ensure survival and longevity of the business as a family controlled firm? How could the family firm sustain its aggressive growth strategy, in light of the changing global environment?

Appendix

Exhibit 1. Financial highlights 1998-2004 (in thousands of dollars) under Lino Sr.'s leadership

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|--|---------|-----------|-----------|-----------|-----------|-----------|-----------|
| Total Revenue | 817,255 | 1,915,637 | 1,860,878 | 2,161,671 | 3,457,412 | 3,398,112 | 3,570,190 |
| Dairy Sector | | | | | | | |
| Canada | 454,907 | 521,146 | 528,466 | 803,970 | 1,987,486 | 2,017,383 | 2,161,852 |
| USA | 362,348 | 1,394,491 | 1,186,136 | 1,106,039 | 1,282,555 | 1,212,810 | 1,240,954 |
| Total Dairy Sector | 817,255 | 1,915,637 | 1,714,602 | 1,910,009 | 3,270,041 | 3,230,193 | 3,402,806 |
| Grocery Sector | - | - | 146,276 | 251,662 | 187,371 | 167,919 | 167,384 |
| EBITDA | 95,427 | 191,087 | 236,945 | 270,974 | 352,422 | 354,270 | 403,257 |
| Net Earnings | 45,745 | 79,093 | 100,068 | 110,241 | 160,161 | 173,728 | 212,365 |
| Cash Flow generated by operations | 63,972 | 128,334 | 176,047 | 190,090 | 199,606 | 223,532 | 287,572 |
| Working Capital | 115,935 | 98,459 | 150,562 | 242,878 | 258,908 | 269,326 | 297,202 |
| Total Assets | 896,662 | 1,072,049 | 1,373,565 | 2,012,979 | 2,046,675 | 1,970,686 | 2,069,548 |
| Long-Term Debt including current portion | 361,334 | 377,784 | 501,575 | 795,896 | 675,125 | 521,135 | 371,911 |
| Shareholders' Equity | 369,893 | 449,933 | 628,894 | 628,894 | 900,588 | 1,016,504 | 1,156,829 |
| Net Earnings Per Share | | | | | | | |
| Basic | 1.23 | 1.63 | 2.00 | 2.15 | 1.56 | 1.68 | 2.05 |
| Fully Diluted | 0.93 | 1.59 | 1.99 | 2.14 | 1.54 | 1.66 | 2.03 |
| Dividends Declared | | | | | 0.22 | 0.40 | 0.48 |
| Book Value | 3.81 | 4.12 | 6.14 | 7.30 | 8.73 | 9.83 | 11.15 |
| Debt/Equity | 1.04 | 0.99 | 0.83 | 1.07 | 0.78 | 0.53 | 0.39 |
| Return on Average Shareholders' Equity | 18.9% | 19.3% | 18.6% | 16% | 19.4% | 18.1% | 19.5% |
| Saputo Cumulative Total Return | | 100 | 69 | 98 | 158 | 119 | 177 |
| TSE Composite Total Return Index | | 100 | 145 | 118 | 124 | 103 | 141 |

Source: Saputo Annual Reports, 1998-2004

Exhibit 1 Cont'd. Financial highlights 2005-2009 (in thousands of dollars) under Lino Jr.'s leadership

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|--|-------------|-------------|-------------|-------------|-------------|
| Total Revenue | 3,883,069 | 4,022,210 | 4,000,980 | 5,058,900 | 5,793,263 |
| Dairy Sector | | | | | |
| CEA* | 2,415,541 | 2,611,402 | 2,794,099 | 2,966,293 | 3,323,541 |
| USA | 1,308,735 | 1,206,601 | 1,036,830 | 1,927,983 | 2,304,613 |
| Total Dairy Sector | 3,724,276 | 3,858,003 | 3,830,929 | 4,894,276 | 5,628,154 |
| Grocery Sector | 158,793 | 164,207 | 170,051 | 164,624 | 165,109 |
| EBITDA | 407,759 | 365,965 | 426,332 | 526,044 | 547,799 |
| Net Earnings | 232,145 | 192,102 | 238,467 | 288,200 | 278,948 |
| Cash Flow generated by operations | 268,676 | 299,567 | 343,501 | 291,062 | 467,288 |
| Working Capital | 452,635 | 423,623 | 521,114 | 416,292 | 166,728 |
| Total Assets | 2,133,072 | 2,253,933 | 2,488,367 | 2,733,476 | 3,499,103 |
| Long-Term Debt including current portion | 302,521 | 241,854 | 116,140 | 282,704 | 713,001 |
| Shareholders' Equity | 1,315,850 | 1,402,543 | 1,533,018 | 1,619,160 | 1,972,348 |
| Net Earnings Per Share | | | | | |
| Basic | 1.12 | 0.92 | 1.15 | 1.40 | 1.35 |
| Fully Diluted | 1.10 | 0.91 | 1.14 | 1.38 | 1.34 |
| Dividends Declared | 0.30 | 0.36 | 0.40 | 0.48 | 0.56 |
| Book Value | 6.30 | 6.74 | 7.39 | 7.86 | 9.52 |
| Debt/Equity | 0.21 | 0.17 | 0.08 | 0.17 | 0.36 |
| Return on Average Shareholders' Equity | 18.8% | 14.1% | 16.2% | 18.3% | 15.5% |

*CEA= Canada, Europe, and Argentina

Source: Saputo Annual Reports 2005-2009

Exhibit 2. World's Top 20 Dairy Companies (sales in billion of EUR).

| Rank | Company | Country | 2008 Sales |
|------|--------------------------|----------------------------|------------|
| 1 | Nestle | Switzerland | 16.9 |
| 2 | Danone | France | 10.2 |
| 3 | Lactalis | France | 9.6 |
| 4. | Friesland & Campina | Netherlands | 8.8 |
| 5 | Dairy Farmers of America | USA | 8.1 |
| 6 | Dean Foods | USA | 7.6 |
| 7 | Fonterra | New Zealand | 7.6 |
| 8 | Arla Foods | Denmark/Sweden | 6.4 |
| 9 | Kraft Foods | USA | 4.7 |
| 10 | Unilever | Netherlands/United Kingdom | 4.4 |
| 11 | Parmalat | Italy | 3.5 |
| 12 | Bongrain | France | 3.4 |
| 13 | Saputo | Canada | 3.3 |
| 14 | Land O'Lakes | USA | 3.1 |
| 15 | Meiji Dairies | Japan | 3.0 |
| 16 | Morinaga Milk Industry | Japan | 2.8 |
| 17 | Schreiber Foods | USA | 2.4 |
| 18 | Nordmilch | Germany | 2.3 |
| 19 | Dairy Crest | United Kingdom | 2.3 |
| 20 | Müller | Germany | 2.2 |

Source: Rabobank International (2008)

Exhibit 3. Saputo's Board of Directors.

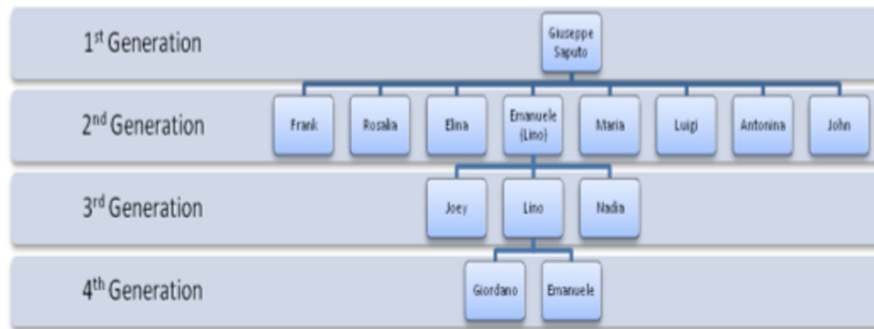
| Director | Title |
|----------------------------|--|
| Emanuele (Lino) Saputo | Chairman of the Board |
| André Berard | Corporate Director |
| Lucien Bouchard | Senior Partner, Davies Ward Philips & Vineberg LLP |
| Pierre Bourgie | President and Chief Executive Officer, Soci t  Financiere Bourgie Inc. |
| Frank A. Dottori | President FADCO Consulting Inc. |
| Jean Gaulin | Corporate Director |
| Caterina Monticciolo, CA | President Julvest Capital Inc. |
| Lino A. Saputo, Jr. | President and Chief Executive Officer, Saputo Inc. |
| Patricia Saputo, CA, ICD.D | Chief Financial Officer, Placements Italcant Inc. |
| Louis A. Tanguay | Corporate Director |
| Anthony M. Fata* | President, Sager Foods Inc. |
| Tony Meti* | President, GDNP Consulting Services Inc. |

Source: Saputo 2009 Annual Report

Exhibit 4. Summary of Saputo Acquisitions

| Generational Leader | Acquisitions | Products added |
|------------------------|---|---|
| Lino Saputo | | |
| 1970's | Manufacturing plants (Quebec) | Increase internal production |
| Early 1980's | Small dairies (Quebec) | Fluid milk |
| | Cheese company (Cookstown, ON) | Various cheese products |
| | Liquid whey by-product plant (Quebec) | Lactose, whey protein, food ingredients |
| 1988 | Production facility (Vermont, U.S.) | Increase production for cheesemaking |
| | Jefferson Cheese (Maryland, U.S.) | Various cheese products |
| 1996 | Fromages Caron Inc. (Quebec) | Import of fine cheeses |
| 1997 | Cr merie de Trois Rivi res (Quebec) | Liquid milk, ice cream |
| | Stella Foods (Lincolnshire, IL) | Mozzarella cheese |
| 1998 | Cabano Kingsway (Ontario) | Trucking company |
| | Avonmore Cheese Inc. (Wisconsin, U.S.) | Italian cheese and other cheese products |
| | Waterford Food Products Inc. (Wisconsin, U.S.) | Powdered and condensed milk |
| | Riverside Cheese and Butter (Trenton, ON) | Various cheese and dairy products |
| | Bari Cheese Ltd. (Vancouver, BC) | Specialty Italian cheese products |
| 1999 | Culinar Inc. (Quebec) | Snack cakes, fine breads, cookies, and soups |
| 2000 | Groupe Cayer-JCB Inc. (Quebec) | European style cheeses such as brie, camembert, feta, havarti, goat milk cheese, and others |
| 2001 | Dairyworld Foods Inc. (Vancouver, BC) | Cheese and dairy products |
| 2003 | ConAgra production facilities (Pennsylvania, U.S.) | Mozzarella and provolone cheese |
| | Treasure Cave and Nauvoo Blue brands from ConAgra | Blue cheese |
| | Agreement with Western Marketing & Sales to start Gallo Protein 2003 (California) | Cheese spreads and other whey products |
| | Molfino Hermanos S.A. (Argentina) | Dairy and cheese products |
| Lino Saputo Jr. | | |
| 2005 | Fromage C te S.A. (Quebec) | Fresh cheese curds and specialty cheeses |
| | Kingsey Distributions Inc. (Quebec) | Fresh cheese curds and specialty cheeses |
| | Schneider Cheese Inc. (Wisconsin, U.S.) | Cheese strings |
| 2006 | Spezialt tten-K serei De Lucia GmbH (Heiden, Germany) | Mozzarella, ricotta, mascarpone, and other cheese products |
| | Boulangerie Rondeau Inc. (Quebec) | Baked tarts |
| | Biscuits Rondeau Inc. (Quebec) | Cookies |
| 2007 | Dansco Dairy Products Ltd. (Newcastle Emlyn, Wales) | Mozzarella targeted to foodservice segment |
| | Land O'Lakes West Coast Industrial Cheese Operations (Tulare, CA) | Mozzarella, provolone |
| 2008 | Alto Dairy Cooperative (Wisconsin, U.S.) | Italian and American cheeses |
| | Neilson Dairy Operations from Sobey's (Ontario) | Fluid milk and creams |

Sources: Saputo Annual Reports 1998-2009

Exhibit 5. Saputo Family Tree**References**

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KEY STRATEGIC DECISIONS THAT GOVERN TRANS-GENERATIONAL FAMILY BUSINESS CONTINUITY: THE CASE OF EXOR-FIAT

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ROBERTO QUAGLIA
ROBERTA DELMASTRO

This case study considers the strategic decision making process in the context of trans-generational development of EXOR-FIAT, which is controlled by one of the oldest industrial families in business in Europe - the Agnelli dynasty. It expounds the key dimensions of the decision-making processes that have safeguarded the successful turnaround of EXOR-FIAT during 2003 and 2009.

The analysis offers the guiding principles which constitute the DNA of the trans-generational entrepreneurial spirit, namely: long-term planning perspective, multi-dimensional governance structures and support for the nurturing of talented management.

The case study illustrates best practice in terms of trans-generational strategic planning that hopefully can enlighten other owner-managed family firms and thus improve their survival, growth and prosperity across generations .

Key words: Large enterprising families; Automotive; Succession; Decision making; Turnaround

INTRODUCTION

Family businesses are often among the top players in their respective sectors. For example, within the global automotive industry, six family businesses are ranked amongst the top ten players, dominating the world corporate landscape. The family business model is well established both in Europe and worldwide. Despite this, the longevity of family businesses is under threat, especially when the macro-economy is in crisis. Empirical research consistently highlights that about one in ten of owner-managed family businesses reach the third

generation of family ownership .More specifically , Ibrahim et al (2000) shows that only 12% of family businesses survive to the third generation, while only 3% continue into the fourth generation and beyond.

According to researchers an enterprise is family controlled when the owning family can effectively control the strategic direction of the business; and benefits from the business, or derives a significant portion of its wealth, income or identity from the business (Astrachan et al 2002). In the Handbook of Research in Family Business Poutziouris et al (2006) provide a range of open and closed definitions as to what is a family in business. In line with such definitions, FIAT Group Automobiles is a family controlled business as the Agnelli family is a major owner with over 30% of the shareholding via EXOR, which is the family investment company. Furthermore, FIAT Group represents about 57% of the net asset value of EXOR.

The objective of the case study is to offer an analytical discussion about of EXOR-FIAT and how key strategic decisions taken during 2003 - 2009 has contributed towards the long-term sustainability of the family in business model .

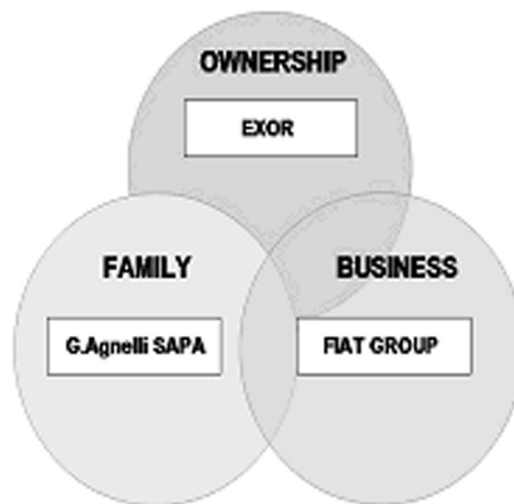
THE CONCEPTUAL FRAMEWORK

The rationale to investigate EXOR-FIAT case is based on the fact that Agnelli family for five generations has effective family control of the business which represents a substantial part of the family wealth. Thus, in accordance to Andrews (1980) who advocated that a strategic decision "...is one that is effective over long periods of time, affects the company in many different ways,

and focuses and commits a large amount of its resources to the expected outcomes” this case study analysis of EXOR-FIAT will enlighten how practically the overlapping sub-systems of family , ownership and business (Davis and Tagiuri, 1982) are inter-dependent .

As exhibit 1 demonstrates, the unit of analysis constitutes the key strategic decisions taken by the family owner-managers and how these affect the Family (Giovanni Agnelli e C, Società in Accomandita per azioni – GaeC Sapaz), the Ownership (EXOR) and the Business (FIAT Group: representing about 57% of the NAV of the investment company).

Exhibit 1: EXOR-Fiat –family owner-managed business model



The conceptual framework of effective decision-making process, has the following dimensions : long-term strategic thinking ; governance for reaching timely decisions; nurturing talented management.

Long-term strategic perspective: As demonstrated by Miller & Le Breton-Miller (2005) family businesses and business families are characterised by long-term strategic planning where owner-managers take bold and risky decisions with an impact across inter-generational horizon. From a financial point of view, the long-term approach refers to long-term investments (James 1999, Kang 2000), higher investments in R&D (Weber et al 2003), and disproportionate higher retention of profits and undistributed profits (Anderson et al, 2003; Daily & Dollinger, 1992; Gallo & Vilaseca, 1996, Poutziouris , 2006) From a strategic point of view, the long-term approach tends to build core competences and resource capabilities that are not easily imitable (Barney 1991, Dierickx & Cool 1991; Teece, Pisano, & Shuen 1997).

Governance mechanisms: Autio and Zahra (2002) suggest that the governance mechanisms found in family firms influence the quality of strategic decision-making. Such governance is proving effective for timely decisions – that can be executed promptly with a clear chain of command . Most scholars agree that the separation of ownership and management creates agency costs as managers who are not owners will not watch over the affairs of a firm as diligently as owner-managers. According to Chrisman, Chua, Litz (2004), such agency costs do not prevail in the owner-managed family business regime . On the other hand Anderson and Reeb (2004) found that superior performing quoted family companies tend to have a more balanced board of directors where they often have independent board members.

Evidence from EXOR-FIAT shows that although the Agnellis are in the minority on the FIAT Group board (with the majority coming from outside the family); however they do have the responsibility of picking the CEO. The CEO has always been (at least, since 1939 when Giovanni Agnelli

nominated Vittorio Valletta) a non-family member. Thus, independent board members represent the majority of the FIAT Group board, regulating the power of family ownership (Anderson & Reeb, 2004; Carney 2005; Miller & Le Breton-Miller 2006).

Ensuring the Support of Talented Management: The growth and development of the family business group calls for the professionalization of the management team by choosing, attracting and developing talented outsiders, non-family professional management to support the family in business Reid and Adams (2001) state that family business practices within Human Resource Management (HRM) are different to those in non-family businesses and should be treated differently. The decision of a family business owner to delegate to professional managers requires shared beliefs, attitudes and values, a process which requires time and investment. Furthermore, family businesses that have experienced growth tend to pay a lot of attention to finding, motivating and retaining good staff (Mazzarol, 2003). These two factors increase the average tenure of CEOs in family businesses.

Therefore, the endurance of a CEO in an owner-managed family firm is an advantage more characteristic in the family business sector as it seems more difficult for non-family firms to achieve. The emotional link with the family and the business can easily be created in the family-controlled business (Miller & Le Breton-Miller, 2005b; Barnett & Kellermanns, 2006); and the managerial satisfaction is higher, even before compensation is taken into consideration (Beehr, Drexler & Faulkner 1997). Finding, grooming and retaining top management for a family business are both a key strategic challenge and a long term investment.

CASE STUDY STRUCTURE AND RESEARCH METHODOLOGY

The structure of the case study is based on the five components of a research design, as defined

by Yin (2003) as follows: research question, proposition, and unit of analysis, logic linking the data and the proposition and criteria for interpreting the findings.

The case study examines events spanning from the beginning of 2003 to mid-2009 and throws light on the following research question: How did the Agnelli and associates make strategic key decisions for the successful turnaround of FIAT group during 2003-2009.

The proposition by the authors is that key strategic decisions taken by families in business can be linked to a limited number of guiding principles or decision criteria which constitute the DNA of their entrepreneurialism. With respect to the unit of analysis, the focus is on key strategic decisions taken by the family council and governing bodies during 2003-2009, post the death of the founder, G. Agnelli. Furthermore, during this period the company had to make swift and savvy decisions that had major impact on its future strategic path and helped to overcome both internal and external challenges.

In this case study, the 'family in business', refers to the family business leaders entitled to take such action, which in the case of EXOR-FIAT are the president of one or more of three legal entities as follows: Giovanni Agnelli e C Sapaz, EXOR and FIAT Group.

THE EXOR FIAT CASE

In line with Davis and Tagiuri (1982), the overlapping subsystems that characterise the owner-managed family business model, require effective communication and decision-making process within and across the family, the business and the ownership regimes. Using the framework to analyse the EXOR-FIAT case, we have identified three legal entities which help the Agnelli family to govern the inter-dependent family, ownership and business sub-systems:

Exhibit 2: The Presidents and CEOs of the Family in Business Group

| FAMILY | OWNERSHIP | BUSINESS | |
|--|---|--|---|
| <i>G. Agnelli SAPA</i> | <i>IF/EXOR</i> | <i>FIAT GROUP</i> | |
| PRESIDENT | PRESIDENT | PRESIDENT | CEO |
| <u>John Elkann</u> from 2010 | <u>John Elkann</u> from 04/07 -vicepresident from 02/07 to 04/07 -Board member from 03/03 | <u>Luca Cordero di Montezemolo</u> from 05/04 (John Elkann vicepresident from 2004) | <u>Sergio Marchionne</u> from 05/04 |
| <u>Gianluigi Gabetti</u> from 06/04 -vicepresident from 03/03 to 06/04 | <u>Gianluigi Gabetti</u> from 06/04 to 04/07 and now board member -vicepresident from 06/97 -AD from 09/91 | <u>Umberto Agnelli</u> from 02/03 to 05/04 (mortis causa) | <u>Giuseppe Morchio</u> from 02/03 to 05/04 |
| <u>Umberto Agnelli</u> from 02/03 to 05/04 (mortis causa) | <u>Umberto Agnelli</u> from 01/03 to 05/04 (mortis causa) | <u>Paolo Fresco</u> from 06/02 to 02/03 | <u>Alessandro Barberis</u> from 12/02 to 02/03 |
| <u>Giovanni Agnelli</u> from 11/96 to 01/03 (mortis causa) | <u>Giovanni Agnelli</u> from 09/91 to 01/03 (mortis causa) | <u>Cesare Romiti</u> from 02/96 to 08/98 | <u>Gabriele Galateri di Genola</u> from 06/02 to 12/02 |
| | | <u>Giovanni Agnelli</u> from 1966 to 02/96 | <u>Paolo Cantarella</u> from 02/96 to 06/02 |
| | | | <u>Cesare Romiti</u> from 04/76 to 02/96 |

- Giovanni Agnelli e C Sapaz: The Agnelli family council formed by integrating the holdings in IFI (Istituto Finanziario Italiano), the main shareholder of EXOR, led by G.Agnelli (until 2003), U.Agnelli (until 2004), G.Gabetti (until 2010) and J.Elkann (due to take the position in 2010). All family members are represented in the family council which currently has about 90 heirs as shareholders bringing the family to the 5th generation. The major shareholder, Vice President and President elected is J. Elkann, the grandson of G. Agnelli and leader of the 5th generation of Agnelli. The President of the GAeC Sapaz is G. Gabetti, a long time serving manager of family companies and trusted by all past leaders and present members of the Agnelli family. The GAeC Sapaz represents the family sub-system where as a legal entity allows them to formally group a huge number of shareholders representing different generations.
- EXOR: This is the family investment company with €5 billion worth of investment, which is the main shareholder of FIAT Group. EXOR is the result of the merger between IFIL (Istituto Finanziario Italiano Laniero) and IFI, led by G. Agnelli (until 2003), U. Agnelli (until 2004), G. Gabetti (until 2007) and J.Elkann. EXOR represents the ownership sub-system and has the role of making investment decisions on behalf of the family and other shareholders, among the other business Exor control Fiat Group, which as block shareholders owns around 30%. The family equity stake ensures the strong representation of the family nominated members on the board. Furthermore EXOR's status as a listed company brings several advantages to the family: up-to-date market based value of the wealth, shareholders maximization culture, liquidity of the asset base and the option to raise additional capital when and if is needed.
- FIAT Group: This is the major holding of the family in business, led by P. Fresco (until 2003), U. Agnelli (until 2004) and L. Cordero di Montezemolo. It was founded by Giovanni Agnelli Senior in 1899. FIAT Group is a listed holding company, owning several other subsidiary companies: automobiles (FIAT Group Automobiles), agricultural and construction equipment (CNH), truck and commercial vehicles (IVECO), components and production systems (Magneti Marelli, Teksid, FIAT Power Train, Comau), etc. Today, FIAT Group is one of ten biggest automotive companies in the world, with 203 factories, 198,000 employees, with sales across five continents which exceed two million cars, trucks, industrial vehicles and agriculture machinery.

In May 2009, FIAT Group agreed to a strategic alliance with Chrysler that will consistently increase its performance indicators. Fiat Group is active in a number of industries such as automotives, trucks, excavators, tractors and combine harvesters. The company was founded by Giovanni Agnelli Senior, the offspring of the Agnelli family, and today is the largest industrial company in Italy.

THE SIX KEY DECISIONS OF STRATEGIC DECISION MAKING PROCESS

During the year 2003 to mid-2009, the Agnelli family and EXOR managed to transform a near-bankrupt company that apparently had only one last chance to be saved, to one that could be sold to GM, a solid company, and a firm ready to take up the Chrysler challenge. In 2009, FIAT Group signed a Memorandum of Understanding (MOU) for a strategic agreement with Chrysler, a deal which had the full support of the Obama administration.

During the preceding seven years, many events occurred and many decisions were taken. We have summed up six key strategic decisions which represent the milestones of the post-2003 turnaround. Several factors contributed to taking these strategic decisions, namely hands on - responsible ownership, business and family connected thinking, as well as the ability of the family leaders to manage and make decisions in the best interests of both the business and the family.

(1) J. Elkann succeeded G. Agnelli (2003-2007). This succession decision was taken by Giovanni, the family leader, at the end of the 1990's, and was supported by his brother Umberto and various trusted family business managers and advisors (e.g. Gabetti and F. Grande Stevens). The decision was necessary due to the old age of both Giovanni and Umberto Agnelli.

The transitional process was not a smooth one. The succession planning was actually launched in the late 1980s, when the GAeC SAPAZ was set up. The first nominated successor was Giovanni Alberto Agnelli, son of Umberto, who died at 33-years-old. Therefore G. Agnelli, as the previous generation leader, started to build up a structure (GAeC SAPAZ) to keep the family united and also

to attract the new generation to the business. The involvement of family business managers (Gabetti) and advisors (F. Grande Stevens) was important to ensure the continuity of the family given the young age of the nominated successor (Elkann was only 26 years old when Giovanni died and 28 when Umberto died).

(2) The family kept investing in FIAT Group after the death of the family leader (2003). On January 24th 2003, Giovanni, the family leader for more than 30 years, died. FIAT Group's financial year closed on December 31st 2002 showing a net loss of 3.955 million EUR and a negative ROE (-39.9%) and ROI (-4.7%). The company was losing a lot of money and there was no clear plan how to recover the business. Furthermore, the existence of a put option to sell the automotive business to GM with the banks holding convertible bonds contributed to this unstable situation. The put option to sell was included in a partnership agreement signed with GM. Through this agreement the American giant acquired 20% of FIAT Group Automobiles. At the same time FIAT Group had the right to sell the remaining 80% at fair market value. Even if merging the low margin automotive business with the world biggest company appeared to be a sound strategic decision, from the management point of view, it actually proved to be constraining their decision power, the development of new products and the forging of partnerships. It was a company waiting to be sold.

On the other hand the 3 billion EUR convertible bonds were due in September 2005. If FIAT Group would have failed to repay the debt, the banks would have had the right to convert it into equity and become the first shareholder of the company, holding around 30% of the shares, reducing the shareholding by the Agnelli family to 20%.

In this context, at the beginning of the 2003, the loss-making company had a gloomy future in front of it, due to a combination of factors: the economic results of the business, the put option to sell would have been exercised at a price close to zero, while the banks held convertible bonds that would have entitled them to a 30% shareholding –giving them control of FIAT Group. In an investor presentation at the end of 2006, Sergio Marchionne, the current CEO of FIAT Group, said:

"The death of FIAT was widely expected. In 2002/2003, it was clear to everyone that FIAT was in dire straits. The number of rescue plans

increased in inverse proportion to the number of cars sold. Everyone has a magic recipe for saving the company. The government had one, the banks had one and you [investors], labour unions and individual businessmen had yet others.”

Despite the desperate situation, on March 25th 2003, 2 months after the death of Giovanni Agnelli, given the family commitment to support the group, the GAeC SAPAZ approved a capital increase of 250 million EUR. The increase was partly done through a convertible bond and added to the 1.8 billion million EUR capital increase of FIAT Group. The objective was to turn around the FIAT Group Automobile business. Even though the capital increase seemed to lack economic sense, due to the very difficult situation, all shareholders approved it and every member of the family supported the investment, giving the market a signal of confidence in the future of the business. The family members decided to follow their leaders. The option was supported by Gabetti, who became Vice President of the GAeC SAPAZ in the same general assembly which approved the capital increase. The risk of the investment was mitigated by the presence of a promising new generation leader: J. Elkann.

3) The FIAT Group drops the exit option to sell the automotive business to GM ; Marchionne takes control of the turnaround strategy (2004-5). In 2001, FIAT Group and GM signed a partnership: the contract gave a put option to FIAT Group to sell the remaining 80% of FIAT Group Automobiles in February 2004. The put option blocked the strategic development of FIAT Group Automobiles, with managers and employees waiting effectively for the sale to GM and watching the company losing its development strength. In January 2003, the FIAT Group President, P. Fresco, and the CEO, A. Barberis, negotiated a possible settlement of 1 billion EUR cash with GM, in exchange for FIAT to renounce the put option. A few days later, Giovanni Agnelli died and Fresco and Barberis were replaced by U. Agnelli and Morchio. The discussions were frozen until the end of 2004.

On 13th February 2005, Marchionne, CEO of FIAT Group, agreed with GM to renounce the put option for 1.5 billion EUR; on the 17th, he became CEO of FIAT Group Automobile and began the turnaround of the automotive business. From the beginning of 2004 to the beginning of 2005, EXOR started to understand that selling the firm would

not be effective and the only way to increase the value of their automotive business was to embark on a turnaround. It was a bold decision: who would have bet on a business that GM paid 1.5 billion EUR not to own?

The appointment of a strong CEO (Marchionne) had several effects: the settlement of the put option; the change in the mindset of the management; a massive launch of new products; and the exploitation of the FIAT dynamic capabilities in engineering and engines. The company's mindset was transformed and Marchionne was the driving force for this change. As he wrote in his article FIAT's Extreme Makeover : "My job as CEO is not to make business decisions – it's to push managers to be leaders."

On 21st March 2003, Marchionne appointed new managers for the departments of design and development of product portfolio. Soon after that FIAT Group Automobiles launched a number of new models. In order to exploit FIAT capabilities in engineering and engines, on 24th March 2003 Marchionne created the FIAT Power Train. The Group's collective engineering skill base was focused on this initiative. From this point onwards FIAT Group closed a number of strategic alliances on the basis of the value of its technology: Ford (2005), Tata (2006), SAIC (2006), DaimlerChrysler Truck (2007), Chevy (2007) and Severstal Auto (2007). These partnerships were the prelude to the Chrysler partnership which was signed in 2009.

4) EXOR has preserved the control of FIAT Group (2005). The GAeC SAPAZ owns 59.1% of EXOR, which in turn owns 30.45% of FIAT Group. EXOR, as the main shareholder of the FIAT Group, appointed the CEO and the President of the board whose synthesis revealed a majority of independent members. On two occasions, the Agnelli family (collectively the main shareholder) acted to keep a strict control on the FIAT Group.

The first occasion was with the death of Umberto on May 27th 2004. G. Morchio, FIAT Group's CEO, insisted on becoming President and keeping his CEO role, as well as having the opportunity to invest in the GAeC SAPAZ. This went against the second guiding principle, namely the maintaining of a clear chain of command. Therefore, the board of directors was called on May 30th to nominate a new board president. The decision to replace G. Morchio demonstrates the importance of a clear chain of command for the family and accountability

for business affairs. It was Morchio's turnaround plan, approved by shareholders and banks, which gave the first positive signs after three years of deep crisis. Furthermore, the new CEO would have been the fifth nominated CEO in less than one year.

Despite all of this, Gabetti, representing the family after the death of the two leaders Giovanni and Umberto, acted to keep the separation of power between shareholders, represented by the President, management and the CEO. He also appointed new managers for the troubled company. The FIAT Group board nominated L. Cordero di Montezemolo as President and S. Marchionne as CEO. Montezemolo was the President of Ferrari (a subsidiary of FIAT Group) and of Confindustria (the Italian industrial association). He was also a manager with FIAT Group for a long time and was very close to both Giovanni and Umberto. The new CEO, S. Marchionne, was a FIAT Group board member and the CEO of SGS, one of the companies in which EXOR invested. Before his death, Umberto indicated him as a successor of G. Morchio. At the same meeting, the board nominated J. Elkann as Vice President, giving a strong sign of continuity of the Agnelli family.

The second occasion was the conversion, in September 2005, of the 3 billion EUR convertible bond subscribed by a group of banks in September 2002. The capital increase originated by the conversion of the sbonds would have diluted the EXOR participation to roughly 20%, creating a new major FIAT Group shareholder, the banks.

There are many hypothetical scenarios as to how the banks would have exercised their new role. The most prevalent one is the splitting of FIAT Group on a financial basis and retaining Alfa Romeo to create a luxury car company in partnership with another manufacturer, supposedly Volkswagen. Fortunately for FIAT Group, we will never know how things might have gone had this option been followed. In the event, G. Gabetti acted boldly and vigorously to protect the family guidelines for the second time in less than one year. The day when the capital increase became effective, EXOR bought through an equity swap the quantity of shares necessary to maintain the 30% of FIAT Group and its controlling shareholding. The financial transaction was put under scrutiny by the CONSOB (Italian Stock Exchange Commission) and was criticised by the financial market because EXOR bought the shares from a subsidiary company, and such valuable ties

were emphatically communicated. However, the transaction kept the ownership in the hands of the industrial shareholder and without this decision, the FIAT Group turnaround would have never come to a successful end.

5) EXOR launched the new growing phase of FIAT Group from 2 to 6 million cars per year (2008). The 2008 financial crisis dramatically changed the automotive industry's outlook. The FIAT Group, led by its CEO Marchionne, acted quickly to respond to the shrinking market and to seize new opportunities by creating a new growth strategy, approved early in the financial crisis by J. Elkann. In 2008, Elkann declared to the Wall Street Journal, "In a consolidation scenario, finding the right partner and the right combination would be the priority; the level of the shareholding would be secondary to the competitive position and the value any new combination would produce."

In an interview for Automotive News Marchionne said:

"It cannot continue as it did in the past. Independence in this business is no longer sustainable. I cannot keep working on cars on my own. I need a much larger machine to help me. I need a shared machine."

This common vision allowed EXOR-FIAT to seize the opportunity of the Chrysler deal and to bid for Opel. The perfect timing, the clear roles and the quick chain of command permitted Marchionne to close an Memorandum of Understanding with Chrysler in January, which also proved to be a key part of the financial aid granted to the new FIAT-Chrysler by the US government. The same perfect tuning was clear in the Opel bid when the FIAT Group, in agreement with EXOR, declared the intention to create a FIAT-Chrysler-Opel New Co which would be listed in the financial markets.

6) FIAT Group pursues the deal with Chrysler, launching a new phase of growth (2009).

President Obama, 2009:

"Recently, Chrysler reached out and found what could be a potential partner: the International car company FIAT, where the current management team has executed an impressive turnaround. FIAT is prepared to transfer its cutting-edge technology to Chrysler, and has committed to building new fuel-efficient cars and engines right here in the United States.....I'm committed

on doing all I can to see if a deal can be struck in a way that upholds the interests of American taxpayers.”

President Obama supported the agreement between FIAT Group and Chrysler on 3rd March, 2009. The first news reports on a possible partnership between the two companies were published in the Financial Times in August 2008, and said: “Chrysler confirmed on Wednesday that it had held talks with FIAT to use some of its idle North American capacity to build vehicles for the Italian carmaker.” On 20th January 2009, Obama took his oath at the presidency inauguration ceremony.

FIAT Group signed a MOU for a strategic agreement with Chrysler, including a clause to take a 35% share of the company. The basic elements of the agreement were announced officially by FIAT Group on April 30th 2009. They are as follows:

- In exchange for providing small-car technology, FIAT received a 20% stake in the Chrysler NewCo.
- FIAT’s equity interest could increase incrementally by up to 15% in the event that certain targets mandated by the agreement are achieved. These refer to producing Fiat’s FIRE engines in the US, selling Chrysler vehicles outside of NAFTA, and producing a Chrysler model based on FIAT technology.
- FIAT got an option of a further 16% of Chrysler, which could be exercised between 2013 and 2016.
- Chrysler granted 55% of its equity to the VEBA (Voluntary Employee Benefit Association), and 10% to the US and Canadian governments.
- Chrysler NewCo will also benefit from the 6.5 billion USD US government facility and the new collective bargaining agreements with UAW (United Auto Workers).
- FIAT Group had to increase the dimension of its automotive business to 4-6 million cars (see decision n.4). This was possible because of the engineering competences enhanced in the turnaround phase.

The EXOR President, in his role of major shareholder and Vice President of the FIAT Group, was not only ready to make fundamental decisions

on adapting the company to the new situation, but also to endorse the execution process, taking ultimate responsibility for the other shareholders and stakeholders of the biggest Italian industrial company. According to a financial analyst calculation, on 30th March 2009 the value of FIAT Group increased by 1.9-3.7 billion EUR, providing a successful execution of the Chrysler plan.

THE THREE GUIDING PRINCIPLES

In analysing the above mentioned six key dimensions of strategic decisions clearly expound three guiding principles that Agnelli adhered to, in order to safeguard the long-term continuity of the family in business. Herewith, the three principles that are a testimony to the entrepreneurialism of the family in business :

Long-term perspective - take bold and risky decisions with an inter-generational horizon: Despite a number of unforeseen fatalities, the Agnelli family have been busy grooming a fifth-generation family member to take the role of the leader. This required Giovanni and Umberto to work on reorganising leadership until the last days of their lives. By itself, this was not a sufficient action, and it became necessary to leverage another family asset to bridge the inter-generational gap. The investment they made in choosing a fifth-generation member will ensure a longer period of stability in the leadership, ideally for the next 30-40 years.

The family also decided to keep investing in a near-bankrupt company, betting on a turnaround that would provide returns in the long term. EXOR opted to remain the key shareholder of FIAT Group, opposing the break-up of the company, which was preferred by the banks due to its short term and less risky return. EXOR also decided to keep investing in the automotive business, even during the 2009 financial crisis, thereby pursuing growth through acquisitions and reaching a suitable position to compete in the market in the long run. Seizing this opportunity will allow FIAT to be a stronger player when the financial and macro-economic crisis ends.

Furthermore, FIAT decided to face the difficult circumstances and not allow the firm to be sold to GM. Instead they put Sergio Marchionne in charge of the turnaround, which required additional investment and risk-taking decisions. In the long

term this has proven to be a far better decision. FIAT pursued the Chrysler deal despite evidence that profits would not be made for another five years, proving again their long-term commitment.

Governance for timely decisions - execute promptly with a clear chain of command:

This represented a formal investiture as leader of the family business: this decision was a clear indication that having a single head in command has been a key decision-making criterion in the succession planning. John became board member of FIAT Group and was indicated as successor directly by Giovanni Agnelli. Umberto took the leadership of the family after the death of Giovanni, and with the capital increase in process he became the new GAeC SAPAZ president, the new EXOR president and the new FIAT Group president, assuring the continuity of the chain of command while John was preparing for the leadership.

As FIAT Group president, Umberto substituted P. Fresco, a non-family manager, confirming the clear chain of command. When the family decided to keep investing in FIAT Group, it was also decided to (re)define the governance to ensure accountability and a clear chain of command. In April 2005, when it was clear that the conversion of convertible bonds by the banks was sufficiently large, EXOR invested in equity position sufficiently to maintain the FIAT Group control. Thus, the chain of command remained in the hands of the Agnelli family leader, indicating that having a single head in command has been again a guiding criterion. Without this decision, FIAT Group would have had two shareholders: a group of banks with a 30% stake and EXOR with 20%, creating unclear governance.

EXOR (with president Elkann) launched a new growing phase of FIAT Group, considering possible mergers/partnerships only where FIAT would have led operations (e.g. Chrysler, Opel) and dismissing mergers (e.g. Peugeot) where the chain of command wasn't clear. The renouncing of the put option (re)created clear governance in the business: the governance for timely decision-making produced in these circumstances quick execution with a clear chain of command.

On February 13th 2005, the GM agreement was closed and the put option abandoned. On February 17th, Marchionne became CEO of FIAT Group Automobile (remaining CEO of FIAT

Group), taking full responsibility of the automotive business turnaround. FIAT Group acquired, thanks to the Chrysler deal, the operational management responsibility from day one (e.g. Marchionne is the CEO of Chrysler), and the right to increase its shareholding up to 51%. The majority shareholding and the management control were, again, guiding principle in the discussion with the US government and Chrysler shareholders.

Ensuring the support of talented management: choose, attract and develop talented non-family managers.

Gabetti came out of retirement to supervise the succession from the old generation to the next, taking responsibility for difficult decisions, coaching and protecting the new leader, and demonstrating an uncommon loyalty towards the family and the business. This is also evidence that the Agnelli family has always been investing in grooming talented and trustworthy management. Umberto chose Morchio to manage the new phase of the FIAT Group after the capital increase, giving a new stability to FIAT Group, creating trust with the banks and launching a turnaround plan. Umberto's intent was to keep the manager for a long period of time; unfortunately, Morchio left the group one year later to attempt to break the second guiding principle in asking to become both President and CEO of FIAT Group and investor in the family holding structure.

EXOR retained control thanks to the actions undertaken by Gabetti. He took personal responsibility for protecting the family's control and the mission he inherited from the previous generation. Without the presence of Gabetti, the decision to preserve the control of FIAT Group wouldn't have been taken. Ensuring the management capabilities to retain control of the investment was necessary and vital.

The new phase of growth was decided as a result of the presence of Marchionne. He acted to seize the opportunities of the new automotive outlook, leveraging his ability to turn around troubled companies and inject a new driving force. This decision prolonged the employment of the talented managers. Umberto chose Marchionne as CEO of FIAT Group, and the US government and FIAT Group wrote in the agreement a mandatory obligation for FIAT to supply Chrysler with the talented management necessary to accomplish

the turnaround. This criteria was stated openly in the contract.

CONCLUSION

The case shows that savvy decision-making processes can shape the long-term survival, growth and longevity of families in business, and that finding, grooming and retaining top management for a family business are both a key strategic challenge and a long-term investment. It also offers a conceptual framework based on three guiding principles: long term perspective, governance for timely decisions and support of talented managers, all of which can help family businesses and business families to safeguard their sustainable success and longevity.

This framework adds to the panoply available to advisors working with family firms. There is scope for scholars to empirically validate this explorative model. Moreover, the following related topics warrant further discussion:

How HRM practices of family firms evolve across their life cycle?

How do governance structures evolve as family businesses transform to business families?

How the capital structure and funding strategies evolve as the independent family firm becomes part of complex holding structures?

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FACTORS DETERMINING THE INVESTMENT STRATEGIES OF FAMILY WEALTH: CASES FROM WESTERN EUROPE

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Abstract

Even though interest in the family business sector has steadily increased over recent decades, little research has been conducted on how families manage their accumulated wealth. This paper aims to address the literature gap by examining the elements determining the investment strategies of family wealth. It builds on existing literature in the field of family wealth investment strategies and discusses three cases taken from different western European countries, highlighting a range of variables central to wealth management and the investment process. The paper proposes a framework for the factors determining the investment strategies of family wealth. Through the analysis of three cases, it explores in detail those factors which influence the development of wealth investment strategies in terms of 1) family mission; 2) family characteristics; and 3) macroeconomic and asset class performance. The role of a family wealth advisor is to reconcile all the factors in each of these three categories and devise successful investment strategies.

Key words: wealth investment strategy, family business, wealth manager

1. Introduction

Over the course of human history, some family-owned businesses have thrived to become empires with multiple international operations, including

the Rockefellers, Carnegies, Fords, Vanderbilts, Morgans, Rothchilds and Astors. Nevertheless, great business successes often lead to new sets of problems. Successful and affluent owner families found themselves immersed not only in the day-to-day operations of the businesses they had built, but also in managing the outcome of those businesses: their enormous wealth (Gray, 2005). Some wealthy entrepreneurs decided to delegate the very difficult task of wealth management to external advisors, banks or industry experts; others, in an effort to protect their privacy and keep matters within the family, chose to set up family offices. Regardless of the nature of these wealth management organisations, the primary goal is to devise efficient wealth investment strategies and to protect, if not further increase, the family's fortune. Therefore, it is becoming increasingly important to further our understanding as to how these successful families devise their wealth management strategies and to identify the factors involved therein.

This paper is organised as follows: the next section briefly reviews some of the literature on family business and the small amount of prior research on the management of family wealth. Section 3 presents the methodology, while section 4 looks at three examples of how successful families from Italy, France and Germany manage their wealth under different family and business circumstances. These families vary a great deal in terms of family structure, nature and current state of the core family businesses as well as the economic contexts they

face. This section ends with a discussion of how these characteristics influence and impact the respective wealth management strategies. The subsequent section provides and discusses the findings. The final section offers some concluding remarks.

2. Literature review

Research on family firms has grown both in scope and number over the past several decades. For instance, many studies have focused on identifying the differences between family and non-family businesses by exploring aspects such as size, behaviour, and performance (e.g. Daily and Dollinger, 1992; Gallo and Estape, 1992, 1994). Others are concerned with succession issues (e.g. Handler, 1989; Sharma and Rao, 2000), as well as with growth strategies (e.g. Poutziouris and Wang, 2004; Sorenson, 1999). Yet a cursory inspection of existing family business literature indicates that only a very small fraction of it mentions the wealth investment strategies deployed by successful business pioneers and their successors. A partial explanation for such scarcity is that family businesses place great value on maintaining their privacy, especially when the focal point is their wealth (Family Business, 2008). This implies that the desire for families to maintain confidentiality has discouraged knowledge distribution in the field.

Naturally, when considering wealth investments, regardless of the amount of money invested or of the investment's individual or group basis, the principal decision tool has been the modern portfolio theory (Brunel and Gray, 2005). For example, the risk preference of the wealth owners and the prevailing economic conditions often set the parameters as to how portfolios are composed and managed in a planned and strategic fashion (e.g. Campell and Viceira, 2002; Pompian, 2009). It represents a commonly used investment method for managing assets, including family wealth (Chhabra, 2005), despite the fact that such a strategic asset allocation tool is far from limitless (Authers, 2009; Curtis, 2004; Lo, 2005).

These studies notwithstanding, there remains a dearth of literature that seeks to reveal the non-financial factors driving the management of wealth accumulated from successful family business operations. One of these factors is family dynamics and governance structures (Brunel and Gray,

2005). After all, a family is a group of kin-related individuals, and as a group families inevitably combine several individuals with potentially diverging interests, investment preferences, time horizons and expected rates of return, to name a few. Indeed, the payout of the investment to the family is not necessarily restricted to growing or protecting their wealth. Traditionally, research in the area of family business has been largely defined by financial outcomes. Lately, an increasing number of studies such as that co-authored by Astrachan and Jaskiewicz (2008) seek to understand the importance of non-financial concerns. Successful family firms do not necessarily pursue profit maximisation; they may also often take into account non-financial goals, such as conservation of the family firm's social capital (Arregle et al., 2007) or taking care of family members (Schulze et al., 2003). The expected level of return from a family business and hence its total value should therefore be a combination of financial and emotional value (Astrachan and Jaskiewicz, 2008). Given that the success of a family business represents the direct cause of family wealth, it is highly likely that such non financial goals are equally applicable to the investment and management of family wealth.

Two notable studies represent early attempts to analyse and investigate factors that drive family wealth management strategy. Gray (2005) suggests that family dynamics can have strong influence in the management of family wealth. These dynamics are rooted in different facets of a family including the number of generations, the legacy of a preceding generation, and the governing generation's outlook on life. In a small or medium-sized family firm, there is typically a single owner-manager (Gersick et al., 1997). In this situation, the founder will inevitably express his/her aspirations and values through the governance and management of the business. As the business grows, especially where there are outside shareholders, the family will typically hold sway over the governance and management of the business through majority ownership. Therefore, the aspirations and values of the family are reflected in the pursuit of opportunities, management of resources, and social responsibilities (Chrisman et al., 2003). This argument can thus be applied to the management of wealth. As Elliot (2008) points out, a partial explanation for the success of families sustaining their wealth is that they purposefully nurture constructive values and are committed to maintaining them. This implies that

family aspirations and values can significantly determine the wealth management strategy.

The generation possessing the wealth also appears to affect the management of their wealth, as different generations are found to have different attitudes regarding this issue (Gray, 2006). For example, the old generation would delegate the management of wealth to a trusted advisor rather than engaging in investment decisions. Members of this generation would also have a higher inclination to keep their investments simple and straightforward since options for investing individual assets were limited in their days. By contrast, in wishing to make their mark on wealth decisions and stewardship, the generation that was born in the last 20 years much prefers to work with advisors and wealth managers who consider their desires. In addition to the generation of wealth owners, the age of the family members could also play an important role in family wealth investment, particularly in terms of risk preference. While some studies such as Bodie and Crane (1997) show a negative relationship between age and the proportion of equities held in portfolios, others including Heaton and Lucas (2000) find investors increase their proportion of equity held as they head towards retirement. A partial explanation to the latter finding is that investors have finally reached a stage when they can afford to take the risks to do so (Summers et al., 2005). Another possible argument is that individuals become more financially astute as they age. Older generations tend to have accumulated knowledge throughout a lifetime, thereby potentially enhancing financial sophistication. This in turn may boost their confidence to invest in riskier assets (Dow, 2009).

3. Methodology

This study explores the different factors that influence wealth management investment strategies. It adopts a qualitative approach that draws on two sources of data: primary research includes interviewing representatives of various family offices and wealth management companies, while secondary research is based on industry and market reports, as well as newspaper articles. It is necessary to note that since this is a very discrete business domain, there exists very little publicly available information. Interviews are considered one of the most important means of collecting data for studying a case in-depth (Yin, 1994). Interviews each lasting one to three hours were

conducted with family offices and private wealth managers from Germany, Italy, France and the UK. It has to be noted that some families employ wealth managers specialised in particular asset classes who are based in different countries. Therefore, in order to gain a broad understanding of the families' investment strategy, interviews with wealth managers from several European countries had to be conducted. The interviews followed a pre-formulated questionnaire structure, with a combination of open-ended and closed-ended questions. Furthermore, this research benefits from the support of wealth investment industry experts for further supplementing data, as well as validating earlier findings. Whenever possible, this study follows Yin's (1994) recommendation of providing the informants with the opportunity to confirm or deny the analyses and findings, as well as to suggest corrections.

The three families studied are chosen partially because they are in three separate western European countries, but also because their businesses are at different stages of the company life cycle and because the family compositions vary from one another. It has to be noted that obtaining access and interviews with these families' wealth managers has proven to be an extremely difficult task given the secretive and protective nature of the sector: very few experts are eager to reveal much in the way of information. It can be argued that three cases are insufficient when searching for a general sample of this type of business activity. Nevertheless, the selected families were chosen on the grounds of theoretical rather than statistical reasons, reasons that are geared towards maximising the insight that may be gained relative to the research questions (Eisenhardt, 1989). Furthermore, such a multiple case study approach makes it possible to compare different investment strategies in different cultural, contextual and business backgrounds, as well as to identify different factors with an important impact on the investment strategic process. For this particular research, an in-depth case study method of analysis is highly appropriate because of the need for a detailed understanding of all aspects of the family wealth investment process.

4. The cases

Case 1: The Boriolli Family

The family and company background. The case deals with an Italian family firm which specialises in the textile industry. Founded four generations ago, the firm, which has grown over time to become a major player in both the domestic and international textile markets, is currently run by several members of the fourth generation. Ever since its founding, the Boriollis have grown out into four different branches on the family tree, of which only the children belonging to two of these branches are currently involved in managing the business. The other children have created their own companies, also related to the textile industry. The family's total wealth is some €100 million, out of which €20 million is tied up to the original textile business. The remaining €80 million represents the 'manageable wealth', i.e. the amount of money that the family has at its disposal to make investments and further increase the business' worth.

The wealth investment strategy. Until five years ago, the chief financial officer of the core business handled the Boriollis' €80 million of manageable wealth. It should be noted that this person was not a member of the family and the investment strategy was built on an on-going basis, following the recommendations of several private wealth managers, mostly brokers and private bankers. The result was an extremely fragmented portfolio of assets with a high-risk profile. Furthermore, following the advice of the aforementioned professionals, the continuous changes in the asset allocation strategy incurred significant commissions and trading expenses on the management of the portfolio.

Consequently, after a series of unimpressive financial results in their portfolio and a steady decline of the family business, the family council decided to hire a dedicated professional advisor, a multi-family office which specialised in providing unbiased advice. Their business model did not rely on commissions or trading fees, but rather on professional fees. These professionals started their mandate with a thorough analysis of the portfolio based on the family's risk and return profile. They devised a clear set of investment principles based on the aspirations and values of the family. Any future investment strategies developed had to conform to these principles.

Deconstructing the prior investment approach, the multi-family office suggested a radical reform of the investment portfolio. A greater portion of the manageable wealth was placed in the most liquid forms of investment, making it easier for funds to be released in case the main business required monetary injections. The new investment strategy proposed by the family office was based on: a) a careful analysis of the external environment and the risk perceived in the economic markets; b) a clear understanding of the situation of the family's core business (which was on a downward trend); and c) a clearer focus on the various interests of this large and fragmented family.

After long consultations with the family members involved in running the business, the multi family-office advisors devised the following investment strategy:

- 15% would be allocated to hedge funds. Even though these are risky investments, the small portion invested would constitute a safe bet for capturing any potential high profit;
- 75% would be invested in fixed income, including bonds issued by established, long-standing companies and governments worldwide;
- 10% would be invested in highly liquid assets such as cash and marketable securities.

The multi-family office also decided to remove highly volatile components from the portfolio, such as private equity. The result was a very well-balanced investment strategy which not only preserved the family's wealth but also brought significant returns in a slow but steady fashion. After two and a half years of following the aforementioned asset allocation strategy, the family members decided to move away from hedge funds. The composition following this re-allocation became the following:

- 90% invested in fixed income products
- 10% allocated to liquid assets

Such a decision was based on the advice of the multi-family office after they detected a further deterioration in the core family business. This is important because the main investment goal of the Boriollis has been to preserve their wealth. By avoiding this risky asset class completely, their wealth could be better preserved. Another reason for the adjustment in the allocation of assets was

the continuing fragmentation of the decision-making power within the family. This was caused by the fact that some members had reached the age to participate in the formal decision making process over their wealth. Consequently, there was a diverse view on how the manageable wealth should be invested. The end result of the heavy investment in fixed income assets is due to the fact that losses could lead to a feud within the family. At the time this case was written, this strategy brought about a 12% increase to the family's wealth over the last four years and at the same time maintained both a very low risk level and a high liquidity level.

Case 2: The Roux Family

The family and company background. The case features a manufacturing firm founded in France three generations ago. Today, it is not only the leader in its industry but also one of the most recognised companies in the world.

Four members own the entire family fortune. The business is currently managed by the son of the founder (i.e. the second generation) and one of the three siblings belonging to the third generation. The family wealth is estimated at €12 billion. With €8 billion of the wealth tied up in the business, the family has a manageable wealth of €4 billion. Additionally, each of the four members has accumulated substantial wealth in their own right through either businesses or marriage.

The wealth investment strategy. The current patriarch of the family – the son of the founder – formulates the overall strategy regarding the investment of the family's accumulated wealth. This is achieved with the support of a family office composed of financial experts in different asset classes. There is currently one expert focusing on equity, one on fixed income and cash products, and another on alternative investments including hedge funds. Nevertheless, it is the chief financial officer and the chief executive officer of the core business who make the final decisions. If there is a disagreement between the two on a specific trade, the trade will be abandoned. Interestingly, none of the family members interfere with this investment decision process as the management of its wealth is completely delegated to the family office and the two officers.

The family office has long been managing the wealth of the Rouxs. Two of the most important factors that drive their investment strategies are

levels of risk acceptance and combating inflation. Since it is the patriarch who determines the overall strategy of investing the family's fortune, such strategy has insofar favoured conservative trades. Nevertheless, as one family office member put it, "this may change if the patriarch is no longer in the position to take charge."

Behind all the different individual financial goals, the principle underpinning the investment of family wealth has always been to increase their fortune. This is reflected in the current asset allocation of the family by the fact that income-generating investments play a relatively small role:

- 5% hedge funds and real estate
- 75% equity
- 10% bonds
- 10% cash

In addition to meeting the risk tolerance and following the intention to accumulate further cash, other factors also influence the wealth strategy. Given the family's strong cultural, emotional and political connections to France, they have a particular preference to invest in this country. Familiarity with the investment environment also drives the wealth management strategy. As a market leader in the manufacturing sector, the Rouxs have concentrated their investments only in those sectors closely related to this origin, such as utilities (which also provide stable payouts). Knowledge is another factor that determines the wealth strategy. As the family owns one of the blue-chip companies in France, they have a much better knowledge of traditional equity. Inevitably, they have a clear preference for dividends as returns over those generated by other types of financial products. The family is therefore keen to stay away from those products of which they have little understanding, including commodities and derivatives.

The heavy concentration on equity in the Roux's portfolio also reflects its investment horizon. The family typically chooses long-term over short-term investments since the latter enable their fortune to grow at a steady pace. Another reason for the preference of equity is tax benefits. According to French regulations, investors can enjoy tax benefits if they hold more than five percent of a company for two years. Hence, the current strategy of focusing on equity has remained unchanged for

the last 15 years. Consequently, any changes to the investment strategy have been made to the non equity portion of their portfolio.

Case 3: The Schmidt Family

The family and company background. The family in this third case built its fortune on a firm that specialised in the basic materials sector founded in Germany 160 years ago. The firm had enjoyed tremendous business success and was therefore able to fetch a handsome amount when it was sold in 2002. From this sale and other sources of income, the family accumulated a manageable wealth of €2 billion. This wealth is shared amongst 13 family members from several generations of the family: one member from the fourth, eight from the fifth, and four from the sixth generation.

After the sale of the business, a professional family office was set up to manage the family's wealth. Since the windfall was distributed amongst the 13 members, this case differs from the previous two in the sense that there is no family head that holds the decision-making power over the investment of the family wealth; indeed, unlike the previous two cases, the core business no longer exists. An important implication is that it is unnecessary to set aside funds for the business. The fact that the business is sold and the wealth split leads to another issue: the family office has to devise individual investment strategies for each of the 13 family members separately, with each family member enjoying complete autonomy in deciding how their money should be invested. Investment decisions are therefore made after close consultation with the individual wealth owners following their own preferences, liquidity needs, time horizon and risk appetite. Interestingly, however, this is applicable only to those members from the fourth and fifth generations. This is because the four members from the sixth generation have yet to reach the age and/or maturity to make their own investment decisions. The responsibility for their wealth lies instead with their parents.

The wealth investment strategy/strategies. While the family office is currently offering different strategies for each of the 13 family members, these strategies can be placed in five different categories with varying degrees of risk and return. For instance, the chief investment officer of the family office points out that: "For the older members of the family, staying rich instead of getting rich is

far more important as the underlying objective." Consequently, they prefer less risky investment strategies. At the other end of the same spectrum, younger family members are more eager to demonstrate their ability to grow their inherited wealth. Therefore, they tend to invest in riskier asset classes with the aim of achieving short-term profits. The end result is that the asset allocations within the five categories vary a great deal. By comparing the portfolios at the two extremes, it is clear that different members often have different investment objectives:

The least risky portfolio

- 95% bonds
- 5% equity

The riskiest portfolio

- 50% equities
- 25% bonds
- 10% hedge funds
- 10% real estate
- 5% cash

The remaining eleven portfolios have different levels of risk between these two extremes. Older members tend to favour fixed income products in order to preserve their wealth, whereas the younger ones choose to grow their fortune by accepting greater risk in their portfolios. As a rule, investment strategies are geared towards long-term investments regardless of their risk appetite.

It is interesting to note that none of the family members have expertise in financial management. Thus, they rely heavily on the family office for advice. Consequently, the five major categories of investment strategy and the 13 portfolios are reviewed and adjusted twice a year. This action is paramount in protecting the family's wealth. Since the Schmidts do not receive further contributions to their wealth from the sold firm, they tend to be more sensitive to fluctuations in the economy and the financial markets. For instance, the current financial crisis has prompted the more risk-prone family members to withdraw their hedge fund investments from their portfolio, as well as to reduce some of their equity holding.

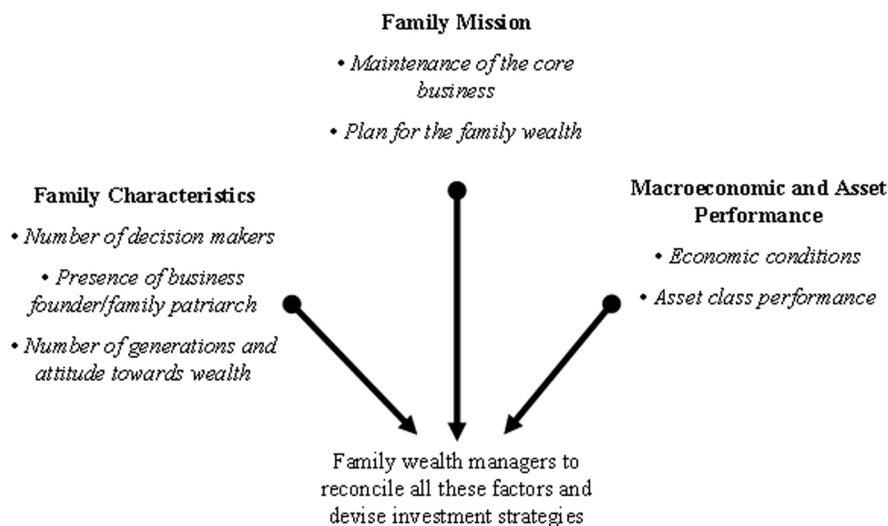
Given the entrepreneurial background of the Schmidts, they have a greater affinity for equities, especially amongst the younger members. The family also refrains from making unethical investments or investments in certain sectors where they have had poor experiences, such as the hotel and property sector.

5. Discussion of findings

This study contributes to filling the research gap in the area of family wealth investment by aiming to uncover those factors underpinning the decision-making process of family wealth investment

strategies. The three cases presented above highlight a range of variables that seem to play an important role in the process of formulating such strategies. They add several new elements to the literature discussion, while at the same time reinforcing others previously discussed by the present literature. Figure 1 illustrates a framework that summarises some determinants of family wealth management strategy grouped into three categories: family mission, family characteristics, and macroeconomic and asset performance. Given that the third category is more related to the area of modern portfolio management and the subject is well known, the rest of this section focuses on the first two categories.

Figure 1: A proposed framework for various potential factors determining the investment strategies of family wealth.



Similar to a company's mission statement, the 'family mission' reflects the aspirations and values of the family that will drive and shape the actions and behaviours of members, as well as the major goals and objectives of the investment strategy. This category encompasses two determinants, one of which is related to the maintenance of the family business: the existence of the family business plays an important role in investment decisions. As shown in the case of the Schmidt family, the wealth owners are more cautious with their asset allocations in the absence of the family firm, with the highest risk portfolio containing only 50% equity. In contrast, the Rouxs, a family sustained by robust business operations, can afford to accept a higher risk in their portfolio and invest more of the family

wealth in equity. The Boriollis, on the other hand, have to set aside funding for their deteriorating business, making it necessary to invest 90% of the manageable wealth in fixed income products.

Another 'family mission' determinant is the family wealth planning, which can be further split into two aims: 'wealth preservation' and 'wealth growth'. While such a family wealth plan is partially directed by the values and aspirations of the family, such as no unethical investments for the Schmidts, it can also be guided by the prevailing condition of the business. In the Boriolli family's case, both the dwindling fortune of the core business and the deteriorating family wealth have led the family to seek protection for their fortune. The fact that they have invested 90% of their portfolio in fixed

income products is vital not only to safeguarding their wealth from economic downturn, but also in case the core business requires capital injections. Ensuring that there is sufficient liquidity to meet the needs of the core business and minimising risk exposures are the key elements in the Boriolli family's wealth management process. On the contrary, the Roux family has a higher amount of investable wealth since its core business remains very solid and each member, individually, has amassed substantial personal wealth. The Roux can therefore afford to continuously increase their wealth since the core business is providing the family with a steady income.

The Roux family case also excellently illustrates a determinant from the family characteristics group, namely that the existence of a family patriarch has a huge impact upon the final investment strategy decision. The Roux family patriarch has a great deal of influence on the overall direction of the investment strategies, even though the final investment decisions are made in consultation with financial experts and the two most senior officers in the firm. This case also points out that the wealth management strategy for the family may change should the patriarch no longer be in a position to head the family. With a preference for investing in traditional and secure asset classes, this case provides support to Gray's (2006) claim that if the family patriarch is still in charge of the business as well as wealth management process, the traditional wealth-creation methods will take precedence over the new, more proactive entrepreneurial strategies associated with new wealth-creating activities.

Another determinant underpinning the family wealth strategy is the generation to which the family members belong. As mentioned by Gray (2006), different generations have different attitudes towards wealth. This is clearly illustrated by the two extremes of the Schmidt's five categories of portfolio. The older members prefer to invest most of their wealth in very secure asset classes, such as fixed income, whereas members of the younger generation adopt riskier strategies in pursuit of greater gain. Thus, the existence of various generations may pose obstacles to choosing an efficient investment strategy for the family.

The increased number of decision makers inside a family can further complicate matters in the decision making process because of the variety of views and attitudes towards investments. This is reflected in case 1, where the various members

of the Boriolli family and their conflicting views on wealth management raised many problems within the family itself. This shows that if the shareholdings in a family are spread between several family members, the process of identifying and reconciling different views can be a sensitive one. The Roux family case, where only two family members are involved in devising the investment strategy, provides support to the claim that the less family members involved in the investment process, the less complicated it is to reach consenting opinions (Gray 2005). These findings seem to be consistent with previous family business literature (Gray 2005), which states that optimal wealth management has to address the views of all family members involved.

While certain factors from the family characteristics group and the role of the wealth manager have been acknowledged in previous literature, the family mission (including the macroeconomic environment and asset performance groups) have received very little attention thus far. Therefore, this paper contributes to the family business field by acknowledging the importance of these elements to the investment strategy process and by proposing a framework that, it is hoped, will benefit both scholars and practitioners.

6. Conclusions

While the challenge of formulating efficient wealth investment strategies has been on industry experts' agendas for years, no framework has been put forward by existing research. This should not be a surprise: the players in this industry are often very discreet, and the industry as a whole is quite secretive. This study proposes a framework that contains three sets of factors impacting upon the investment strategy formulation process. The first set relates to the family's mission, the second set to family characteristics, and the third set to macroeconomic issues and asset class performance. The role of family wealth advisors is therefore to reconcile all the determinants in each category and devise successful investment strategies. This case study represents one of the first attempts to uncover some key factors driving family wealth investment strategies. It is hoped that it can inform researchers and newcomers to the field by setting a basis for potential further study. As the field of family wealth management represents an important yet often overlooked aspect of family business, more research needs to

be conducted in this area in order to benefit wealth management scholars and practitioners, as well as the families themselves.

Teaching notes

This paper proposes a framework that highlights the various factors affecting the investment strategies of family wealth. Thus far, there has been very little research conducted in this area of family business. To use the material within this case, it is suggested that instructors first cover the different factors of building and growing a successful family firm. The instructors can then commence discussing which factors potentially affect the management and investment of the family's wealth. The ultimate goal is to create a list of potential factors. In the next step, the instructors can provide students with three cases, either through storytelling or the provision of a written copy. Alternatively, students can read the three cases beforehand. The discussion that follows should enable instructors to relate to those factors already noted in the aforementioned list, as well as deriving new ones. In the process, instructors can build up the proposed framework and even add new elements to it.

Questions

1. Discuss the factors that can potentially drive the investment strategy of family wealth.
2. Discuss the merits of the different factors related to 'family mission'. What are the potential issues that can arise when such mission is in conflict with that of individual family members?
3. Discuss the merits of the different factors related to the characteristics of a successful business family. How would changes in the family composition or dynamics affect these factors which, in turn, influence the family wealth management strategy?
4. Explore, explain and elaborate as to how the three categories of factors can be linked and related to each other.

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