

**Key success factors in transforming traditional family business for
success and long-term survival in changing markets.**

By

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Submitted to the Alfred P. Sloan School of Management
in Partial Fulfillment of the Requirements for the Degree of

Master of Science in the Management of Technology

at the

MASSACHUSETTS INSTITUTE OF TECHNOLOGY

June 2004

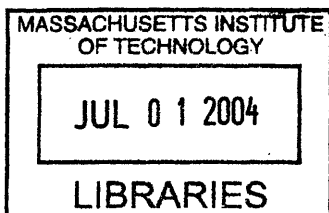
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ABSTRACT

Most of family-owned enterprises start their operations in the traditional businesses such as manufacturing, trading, or providing services. Some of them are very successful and become major global players in the industries, for example, SC Johnson, Corning, and Li & Fung.

However, technological changes often have impacts on the behaviors of the market. New technology can add tremendous capacity for a firm to pursue economy of scale or it can reduce marginal cost to zero. Moreover, in the globalization era, multinational companies expand their business territories by entering to the new markets. They exploit the advance in technology, which allows them to provide better products/services than those of local firms. Technology becomes key driver for the increase in competition in the market because the firms that adopt the technology tend to have competitive advantage over firms that did not. It also drives customers to demand more comprehensive products and services.

In order to survive and be forefront in the industry, these family firms need to transform themselves or adopt some technologies to enhance and regain their competitiveness. Not all companies realize the importance of doing so or know how to do so. But still, there are some companies that are able to transform successfully. This thesis will analyze keys to success for these family businesses in transforming themselves to maintain competitiveness in changing markets.

Thesis Supervisor: Henry Birdseye Weil
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ACKNOWLEDGEMENTS

In each phase of this thesis research, there are many people who helped and supported me to make this study become a valuable piece of work. It is not only the suggestions related to the study, but also words of encouragement that make me move on and accomplish this challenging research. I would like to express sincere gratitude to the thesis supervisors, Dr. Henry Birdseye Weil for his guidance and relentless helps. He gave me various insightful suggestions that enhanced the profoundness of the study. Also, his personal efforts provided me great opportunities to interview family members and senior executives from major family-owned enterprises.

I would like to thank you Mr. Martin Tang, Mr. Arup Gupta, as well as my best friends, Ms. Veronica Ong Go, Mr. Kevin Chester, Ms. Tomoko Ogura, Mr. Marco Tivelli, Mr. Chad Holland, and Mr. Yasushi Furuyama, who share their deep and insight life experiences, which greatly contribute to the quality of this study. I also would like to thank Ms. Urapim Aroonyadej for her suggestions and encouragements.

Last but not least, I am indebted to my whole family, especially my grandmother, Tae Zium Eng, and my parents, Jiam and Patcharin Srisomburananont, for their strong support and encouragement throughout my wonderful year here in MIT.

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1. Introduction

Family business is the most common form of enterprise, which can be found almost everywhere around the world. Many articles about family business have different estimations regarding to the number of family-controlled companies. The most conservative estimation put the proportion of all worldwide business enterprises that owned or managed by families between 65 and 80 percent.¹ It's true that many of these firms are small and controlled by one or two family members, which are difficult to grow or be passed down from generation to generation. However, it's also true that many of them are among the largest and the most successful businesses in the world.

In the U.S, the world largest economy, the data showed that more than 90 percent of all U.S. businesses are family controlled – approximately 13 million businesses include every size and type of enterprises e.g. from neighborhood grocery stores to giant firms like Hewlett-Packard.² It is also estimated that 40 percent of the Fortune 500 are family owned or controlled.³ Also, in the world fastest-growing part, Southeast Asia, in which the most important innovations in business management are occurring, the pacing element in both the business firm and the macroeconomy is the ethnic Chinese family business.⁴

Most of family-owned enterprises start their operations in the traditional businesses such as manufacturing, trading, or providing services. With the endurance and hard working of family members, these family businesses can become major players in the industries. However, technological changes often have impacts on the behaviors of the market. New technology can add tremendous capacity for a firm to pursue economy of scale or it can reduce marginal cost to zero. Moreover, in the globalization era, multinational companies expand their business territories by entering to the new markets. They exploit the advance in technology to have competitive advantages over local firms. Technology becomes key driver for the increase in competition in the market because the firms that adopt the technology tend to have competitive advantage over firms that did not. It also drives customers to demand more comprehensive products and services.

In order to survive and be forefront in the industry, these family firms are needed to transform themselves or adopt some technologies to enhance and regain their competitiveness. Not all companies realize the importance of doing so or know how to do so. But still, there are some companies that are able to transform successfully. This study will analyze keys to success for these family businesses in transforming themselves to maintain competitiveness in changing markets.

2. Research Design and Methodology

2.1 Context

The context of this thesis will focus on family-owned enterprises in general. Although family businesses from different countries and ethnics have different culture and values, which can contribute to different outcomes, this study does not focus this aspect in details. However, the study will rather focus on the factors that contribute to the success and failure of the family-owned companies, and suggest some key factors in transforming family businesses for success and long-term survival in changing markets.

2.2 Methodology

The methodology that I used in this thesis begins with the study from various books and articles around family business management, organizational changes, and business transformation issues. Then, I researched several case studies of family-owned enterprises in both successful and failure cases through readings from books, journals, and articles, as well as interviewing with many family members and senior managements. By analyzing the gathered information, I developed the system dynamics model that can capture and explain the dynamics of family business in general. I then used this model as a main tool to suggest keys to transform these family-owned enterprises for success and long-term survival in changing markets.

2.3 Issues to be Investigated

In this research, I aim to discover and discuss on the following issues around family businesses.

1. The dynamics among the three components of family-owned enterprises, ownership, family, and business, and how they affect the business transformations.

2. Typical business practices of family businesses (e.g. organization structure, management styles, board of directors, diversification strategy, recruiting policy)
 - 2.1. Why these firms choose to do so? Is this the wrong belief?
 - 2.2. Are these business practices still applicable to the competitive dynamics in nowadays?
 - 2.3. What business practices should be recommended to these firms and what should not?
3. Characteristics and limitations of family-owned companies.
4. Key success to business transformation
 - 4.1. What forces family firms to change or transform?
 - 4.2. Why many family businesses fail, while some of them become successful?
 - 4.3. What factors that support / hinder the success of the transformation?
5. Succession planning
 - 5.1. Why succession planning is important especially for family firms?
 - 5.2. Suggested strategies to succession planning.

3. Overview of the Issues around Family Businesses

This chapter will discuss on the overviews of various issues around family business such as the dynamics among each component of family firms, forces that pressing family business, business transformation and strategies to the transformation, and succession plan.

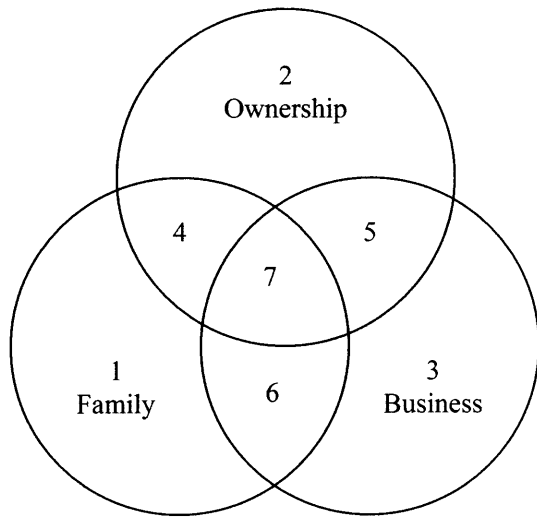
Before discussing these issues in more details in later subsections, it is necessary to know the structure of family-owned enterprises in order to effectively understand the dynamics that contribute to success or failure of these firms.

3.1 The Three-Circle Model of family business

At the beginning, many studies about family business focus on typical problems that appear to hinder the family firms, such as nepotism, sibling rivalry, and unprofessional management. The underlying conceptual model that demonstrates the dynamics of family firms consists of 2 subsystems, which are family, and business. In 1980s, Tagiuri, R. and J.A. Davis argued that a more accurate representation of the full range of family firms would need to make a distinction between the ownership and management subsystems within the business. As a result, the Three-Circle Model emerged.⁵

From the Figure 3-1, subsystem Family (sector 1, 4, 6, and 7) represents anyone who is a members, or relatives of the family. Secondly, subsystem Ownership (sector 2, 4, 5, and 7) represents anyone who owns the business e.g. shareholders. It is not necessary for people in ownership subsystem to be family members or working as managers in the company; they can only be just outside investors or shareholders of the company. Lastly, subsystem Business (sector 3, 5, 6, and 7) represents anyone who manages or controls day-to-day operation of the business. These people can be president, managing director, executives, first line manager, and employees. Again, it is not necessary for people in subsystem Business to be family members or own the company.

Figure 3-1: The Three-Circle Model of Family Business



Source: Kelin E. Gersick, John A. Davis, Marion McCollom Hampton and Ivan Lansberg, “Generation to Generation: Life Cycles of the Family Business,” Harvard Business School Press 1997, pp. 6

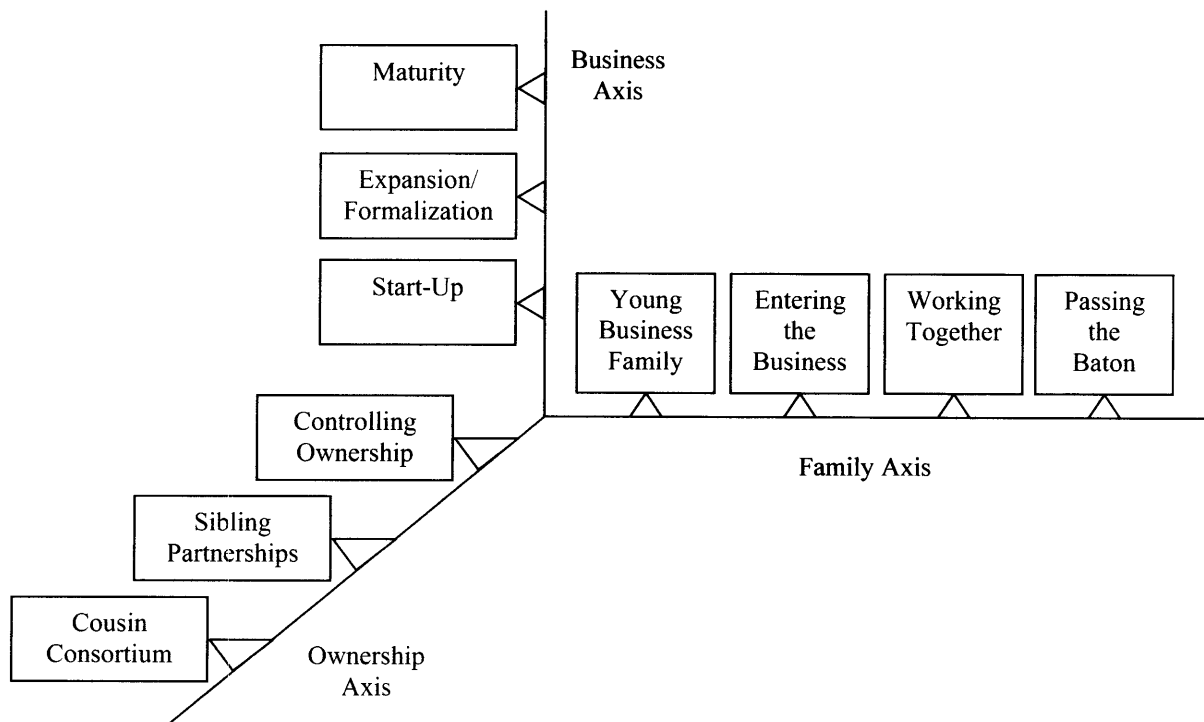
In this model, any individual that involves in the family business can be placed into one of these seven sectors in the model (Figure 3-1). The one who has only one connection to the firm is placed in either sector 1, 2 or 3. This person can be family member, owner, or manager of the family business. For people in the overlapping sectors, they have at least two or three roles in the organization. For instance, people in sector 4 are family members as well as owners of the company; people in sector 6 are those who work in the company and hold some proportions of company’s shares.

This model is very useful to identify and understand insightful dynamics within the organization such as political forces, interpersonal conflicts, role dilemmas, and priorities. For example, people in sector 5 tend to work for long-term success, while people in sector 6 may focus more on short-term gains of the company. People in sector 1 may want their children to work in the business in order to give their children chances; on the other hand, people in sector 3 may want to hire qualified person from outside, who can contribute more to the company.⁵

3.2 The Developmental Model

The Three-Circle Model, consisting of owner, business, and family, can effectively represent the snapshot of family business at a particular point of time. However, many of the challenges that family firms face are caused by the passage of time. For example, the first generation ages and retires and the business has to be handed over to the next generation, or the next generations grow up and begin to enter in the business. All these issues involve changes in organization, family, and distribution of ownership. In order to effectively understand the dynamics of family business, it is required to take time into account. The result of adding development over time to the Three-Circle Model is the Three-Dimensional Development Model of family business.

Figure 3-2: The Three-Dimensional Developmental Model



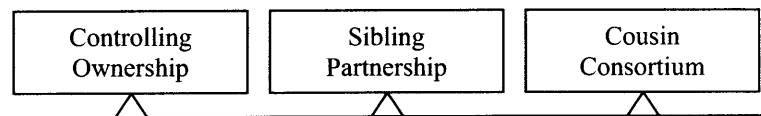
Source: Kelin E. Gersick, John A. Davis, Marion McCollom Hampton and Ivan Lansberg, "Generation to Generation: Life Cycles of the Family Business," Harvard Business School Press 1997, pp. 17

Each dimension of the developmental model (Figure 3-2) is independent; however it influences each other. Every family business has progress to a particular point on the ownership developmental axis, a particular point on the business developmental axis, and also a particular point on the family developmental axis. As family business changes over time, it moves to a new stage on any of these three dimensions, in which it takes new shape and has new set of characteristics.

3.2.1 The Ownership Developmental Dimension

There are various kinds of ownership structures for a family business, for example, a company that owned by an individual, or a couple or a group of people. Sometimes they come from different branches or even families. Therefore, there is no model that can specifically categorize and represent such a complex phenomenon. However, based on the study of John Ward⁶, the core issues of ownership development are well captured in three stages (Figure 3-3): Controlling Owner companies, Sibling Partnerships, and Cousin Consortium companies.

Figure 3-3: The Ownership axis



Source: Kelin E. Gersick, John A. Davis, Marion McCollom Hampton and Ivan Lansberg, “Generation to Generation: Life Cycles of the Family Business,” Harvard Business School Press 1997, pp. 19

Controlling Owner

The Controlling Owner stage is the stage of the firm in which ownership is controlled by one owner or, less typical, a married couple. The board of directors, especially in the first generation of an owner-manager family business, is typically a “paper board”, which exists only to meet incorporation requirements but performs no real advisory role, or a “rubber stamp board”, which meets only to endorse what the owner-manager has already decided to do. In both cases, the

boards tend to come from family members, and most of the time, the owner-manager dominates in both company and family.⁷

Table 3-1: The Controlling Owner Stage of Ownership Development

The Controlling Owner Stage of Ownership Development	
Characteristics	<ul style="list-style-type: none"> ▪ Ownership control consolidated in one individual or couple ▪ Other owners, if any, have only token holdings and do not exercise significant ownership authority
Key Challenges	<ul style="list-style-type: none"> ▪ Capitalization ▪ Balancing unitary control with input from key stakeholders ▪ Choosing an ownership structure for the next generation

Source: Kelin E. Gersick, John A. Davis, Marion McCollom Hampton and Ivan Lansberg, “Generation to Generation: Life Cycles of the Family Business,” Harvard Business School Press 1997, pp. 32

▪ **Capitalization:**

The first challenge for a family firm in this stage is about how to secure adequate capital for future business expansion. Especially for the first generation firm, where the owner is also manager managing day-to-day operation, the primary sources of capital usually come from his/her own saving or “sweat equity”, contributed by family, or close friends. For non-family sources of capital in Controlling Owner stage, the most common form is bank. However, banks tend to have quite stringent credit criteria in granting a loan to a newly start-up firm because it associates with high risk.

▪ **Balancing unitary control with input from key stakeholders:**

Controlling Owner businesses can exploit the advantages of clarity and efficiency that come from having a clearly identified single leader. However, there is also a risk at this stage. The owner-managers may reluctant to seek the advice and assistance of family members and others for the fear of losing independence. This can become a serious problem if the firms’ success or failure is depended largely on the competent, energy, versatility of a single individual. In addition, the rapid growth and development of the firm require more insights and skills that are beyond single leader’s capacity.

- **Choosing an ownership structure for the next generation:**

This is the challenge about the decision of the controlling owner to hand over the business to the next generation. This decision involves whether to continue the ownership control in one individual or to divide it among a group of heirs.

Sibling Partnership

The organizations in this stage are more likely to survive longer and grow larger than the organizations in the Controlling Owner stage. This is because almost all the Sibling Partnerships are in their second or later family generation. The control of the firm is shared by two or more brothers and sisters, who may or may not active in the business. There may be other owners, who are family members from different generations (parents' generation or among sibling's children) but they do not actively participate as owners of the business.

Table 3-2: The Sibling Partnerships Stage of Ownership Development

The Sibling Partnership Stage of Ownership Development	
Characteristics	<ul style="list-style-type: none"> ▪ Two or more siblings with ownership control ▪ Effective control in the hands of one sibling generation
Key Challenges	<ul style="list-style-type: none"> ▪ Developing a process for shared control among owners ▪ Defining the role of non-employed owners ▪ Retaining capital ▪ Controlling the factional orientation of family branches

Source: Kelin E. Gersick, John A. Davis, Marion McCollom Hampton and Ivan Lansberg, "Generation to Generation: Life Cycles of the Family Business," Harvard Business School Press 1997, pp. 41

- **Developing a process for shared control among owners:**

The challenge is to design a Sibling Partnership that fits the individuals in a particular family.

One form can be that one of the siblings adopts the role of quasi-parental leader. This form is more likely when that sibling has been given ownership control e.g. more than 50 percent of voting stocks), when there is a significant age gap between the oldest and the younger siblings, or when there is a history of a very close relationship between the parents and the selected offspring, which began long before the leadership transition.

Another form of Sibling Partnership is the “first among equals”. In this case, one individual acts as the lead sibling but stops short of the quasi-parental role. This form is more likely when minority shareholders intend to exercise some rights but do not want the responsibility of equal involvement. For this second form, in best cases, the leader has well-established credentials as the strongest visionary for the company, coupled with a style that conveys respect and openness to the other siblings. However, if too much leadership, the siblings will revolt against the parental presumptions of the leader.

The last form, called as egalitarian arrangement, is quite common as the ownership is divided equally among siblings.

- **Defining the role of non-employed owners:**

Employed owners tend to concern with achieving their career goals and receiving the status and financial rewards that they feel they deserve for their contribution to the company. Therefore, some control ownerships try to minimize the conflict by allocating the company’s shares only to those offspring who work in the business.

- **Retaining capital:**

Older companies tend to be more reliable debtors for banks and other lending institutions. With the similar reason, sibling partnership firms tend to have an easier access to the funds required for future growth than do first-generation Controlling Ownership companies. However, the Sibling Partner stage normally brings an increase in the number of non-employee owners. Therefore, the balance of priorities between reinvestment and dividends may shift, which can cause tension within the family firms.

- **Controlling the factional orientation of family branches:**

As the Sibling Partnership ages and the next generation approaches adulthood, a new challenge arises. Siblings may begin to act as if their responsibilities are to represent their own family branches, as opposed to the company or the shareholder group as a whole.

Cousin Consortium

The ownership control in this stage is exercised by many cousins from different sibling branches, but no single branch has enough voting shares to control all the decisions. However, there are also hybrid modes between Sibling Partnerships and Cousin Consortium because of the small size of the family firms or small number of generations (it usually takes at least three generation to reach this stage). This makes the Cousin Consortiums more complex than the other two types.

Table 3-3: The Sibling Partnerships Stage of Ownership Development

The Cousin Consortium Stage of Ownership Development
Characteristics <ul style="list-style-type: none">▪ Many cousin shareholders▪ Mixture of employed and non-employed owners
Key Challenges <ul style="list-style-type: none">▪ Managing the complexity of the family and the shareholder group▪ Creating a family business capital market

Source: Kelin E. Gersick, John A. Davis, Marion McCollom Hampton and Ivan Lansberg, "Generation to Generation: Life Cycles of the Family Business," Harvard Business School Press 1997, pp. 48

- **Managing the complexity of the family and the shareholder group:**

In this stage, there is a wide range of ages, family relationships, places of residence, etc. in the family business. The personal connections that have been strong in the first two ownership stages become more dilute in the Cousin Consortium stage. Typically, different career paths in the sibling generation have led to a concentration of cousin managers from one branch. As that branch becomes dominant in the management of the business in the second generation, the other branches begin to withdraw from involvement in the company. Moreover, previous family conflicts can be transmitted to current generations of cousins, polarizing them into camps.

Political dynamics that emerged in Sibling Partnership stage became magnified in the Cousin Consortium stage. Non-employee owners tend to focus more on dividends rather than the reinvestment for future profit of the company, which is the focus of employed owners. In addition, employed owners feel that they should have control of decision about risk and strategy because they are vulnerable to the outcomes, while non-employed owners may worry that the insiders are too ready to take risk with the family investment.

One arena where the differences can be played out is the board of directors. Although family constituent boards can be quite professional, they tend to focus too much on the personal interests of branches, rather than discussing tough strategic issues facing the company. In order to best management such a complexity interaction, families should clarify the distinction between membership in family and membership in business. They should work to create a shared family identity outside of the business, through extra curricular activities and communication that emphasis family but not business.

- **Creating a family business capital market:**

The conflicts from the owners, who want to withdraw their investment for other purposes but cannot, or who do not agree with the actions of management but do not have enough shares to influence the policy, can lead to very high costs in management, family argument, and ultimately legal fees. The key to this challenge is to provide an objective and fair internal market for family shareholders so that family members have options to sell their interests, trying to minimize negative consequences to the organization.

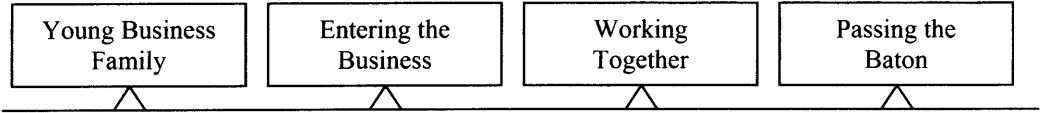
A related issue, which is not limited to Cousin Consortium stage but arises most frequently in these later-generation family businesses, is the option of going public and opening the company to non-family investors. The ones who resist are motivated primarily by their appreciation of a private company's ability to make decisions more quickly and ultimately, to control the direction and culture of the organization, and to operate more secretively with respect to its competition.

In summary for the ownership dimension, this framework suggests that most family business begin with the single owner and then move over time through Sibling Partnerships and to the Cousin Consortium. However, it is not necessary that all the family businesses always follow this sequence of development. For example, a company can begin with multiple owners as the capital is quite limited in early stage of the business, and then it can recycle to Controlling Owner stage if a single individual buys out all the others and reconsolidates ownership. Nevertheless, these three developmental stages still explain most of the variance across the widest range of companies.

3.2.2 The Family Developmental Dimension

After considering the life histories of hundreds of business-owning families of all sizes and types, the business families can be divided into four stages, defined by the ages of the members of each generation active in the business. The stages are Young Business Family, Entering the Business, Working Together, and Passing the Baton.⁸

Figure 3-4: The Family Axis



Source: Kelin E. Gersick, John A. Davis, Marion McCollom Hampton and Ivan Lansberg, “Generation to Generation: Life Cycles of the Family Business,” Harvard Business School Press 1997, pp. 20

Young Business Family

Young Business Family is a period of intense activities, including defining a marital partnership or deciding whether to have children, or forming a new relationship with aging parents. Examples of some challenges in this stage can be that the next generation leader try to resolve the conflict with his/her father, or that the wife of the business leader is suffered by the demand of the business that take away her husband’s time, etc.

Table 3-4: The Young Family Stage of Family Development

The Young Family Stage of Family Development	
Characteristics	<ul style="list-style-type: none"> ▪ Adult generation under forty ▪ Children, if any, under eighteen
Key Challenges	<ul style="list-style-type: none"> ▪ Creating a workable marriage enterprise ▪ Making initial decisions about the relationship between work and family ▪ Working out relationships with the extended family ▪ Raising children

Source: Kelin E. Gersick, John A. Davis, Marion McCollom Hampton and Ivan Lansberg, “Generation to Generation: Life Cycles of the Family Business,” Harvard Business School Press 1997, pp. 62

- **Creating a workable marriage enterprise:**

This challenge in the Young Business Family stage is about establishing a relationship with a spouse or intimate partner. The couple develops implicit and explicit agreements and habits about money, work, affection, sex, children, social behavior, relationship with in-laws, and goals for future. Violations of these agreements may lead to marital conflicts, which can impact the success of the business.

- **Making initial decisions about the relationship between work and family:**

The difficulties of Young Business Family involve with how to manage or nurture the domain of work and the domain of the family simultaneously. There are demands from business, which include late hours, seven-day work weeks, social obligations with customers and suppliers, and the takeover of family social events by business discussions.

- **Working out relationships with the extended family:**

The challenge is about how to find a place for the new family and keep a balance between sides of both spouses in the extended family. It can be more difficult if one spouse's family is involved in the business and the other spouse's family not.

- **Raising children:**

These are the issues of deciding whether to have children, when to have them, how many to have, and how to raise them. Adding the children to the family life can change the vision of the future, and priorities of the family leader, influencing business decisions.

In many business families, conveying the psychology legacy of the firm is an important part of child rearing from the beginning. That the children grow up watching their parents run the business through good and bad time makes them internalize their parents' attitude and value about the firm.

Entering the Business

For the second stage, Entering the Business, it involves the movement of the younger generation out of childhood into productive lives as adults. The business families in this stage concern with

designing entry criteria and career paths for the young adult generation; and with defining their role as the middle of three adult generations, between elderly surviving parents, and children who are now teenagers and young adults. In this stage, the younger generation is just beginning their work lives, and making their initial decisions about entering the company.

Table 3-5: The Entering the Business Stage of Family Development

The Entering the Business Stage of Family Development	
Characteristics	<ul style="list-style-type: none"> ▪ Senior generation between thirty-five and fifty-five ▪ Junior generation in teens and twenties
Key Challenges	<ul style="list-style-type: none"> ▪ Managing the midlife transition ▪ Separation and individuation of younger generation ▪ Facilitating a good process for initial career decisions

Source: Kelin E. Gersick, John A. Davis, Marion McCollom Hampton and Ivan Lansberg, “Generation to Generation: Life Cycles of the Family Business,” Harvard Business School Press 1997, pp. 72

▪ **Managing the midlife transition:**

Early in the Entering the Business stage, the parents are most likely to be going through the midlife transition. The term “midlife transition”, which came from the work of Levinson on adult development⁹, refers to a period of several years, usually the early forties, when it is common for adults to experience a time of self-assessment. The halfway point can affect the future actions as a natural stimulus for evaluating whether the path way that they have been on in early adulthood is compelling enough to achieve their ultimate goal.

▪ **Separation and individuation of younger generation:**

This challenge is about the departure of the offspring generation from the parental home. The effect separation goes far beyond a change of address to a change in family structure.

Sibling dynamics are also important to the understanding of family business in the Entering the Business. In this stage, the childhood relationships are largely shaped by parents; and these relationships will gradually evolve to adult sibling relationships, which are sustained by the brothers and sisters themselves for the rest of their lives.

Other critical concepts involving with sibling relationship are birth order, and the dynamics of differentiation and identification. Birth order is particularly important in business families because of the traditions of primogeniture (preference for firstborn males in inheritance). Differentiation is the centrifugal force of sibling groups that pull individuals apart, while Sibling identification is centripetal force, which holds them together. The differentiating pressure moves siblings to want to work in different parts of the company. At the same time, the identification pressure encourages them to visit each other unexpectedly, to defend one another against parental criticism. Both pressures should be taken into account in assessing the real collaborative potential of the sibling group in the Entering the Business stage.

- **Facilitating a good process for initial career decisions:**

The issues in this stage are not just about the questions that do the parents try to force the offspring to joining the business or are the children given truly free choices. The issues also involve other complicated ones, which need to be solved – whether the business will continue for another generation, whether their children consider careers in management, or participate only as owners, whether several members or only one individual of the next generation run the firm, or whether the offspring start working immediately after graduate or go away and then decide about coming back.

Working Together

Working Together families try to manage complex relations of parents, siblings, cousins, and children of their own and their siblings' of various ages. In this stage, two or more generation are fully involved in the family business together. The senior generation, typically between fifty and sixty-five, is at the peak of the authority in the business cycle. The members of the junior generation are now in their twenties to forties.

Table 3-6: The Working Together Stage of Family Development

The Working Together Stage of Family Development	
Characteristics	<ul style="list-style-type: none"> ▪ Senior generation between fifty and sixty-five ▪ Junior generation between twenty and forty-five
Key Challenges	<ul style="list-style-type: none"> ▪ Fostering cross-generational cooperation and communication ▪ Encouraging productive conflict management ▪ Managing the three-generation Working Together family

Source: Kelin E. Gersick, John A. Davis, Marion McCollom Hampton and Ivan Lansberg, "Generation to Generation: Life Cycles of the Family Business," Harvard Business School Press 1997, pp. 82

▪ **Fostering cross-generational cooperation and communication:**

The primary challenge of Working Together in the context of family development is creating the linking mechanisms that allow the family system to continue integrated operation in the face of dramatic decentralization and diversification. Communication is the most important aspect of these link mechanisms. The quality of communication can be represented by the quality of the following three characteristics, which are (1) Honesty, (2) Openness, and (3) Consistency.

▪ **Encouraging productive conflict management:**

Conflict can be valuable as it allows new insightful or creative ideas to emerge, or helps a group of family members work through a difficult decision. The family needs to try to diagnose the sources of family conflicts and improve the process of conflict resolution, not just to battle through until there is a winner. Managing conflict is critical because the costs of uncontrolled conflicts are higher in the Working Together stage than they were in the earlier stages.

▪ **Managing the three-generation Working Together family:**

As the family continues to grow, it may become a point where there is a mix of three generations active in the business at the same time. It becomes more difficult for Working Together families to effectively manage the dynamics between parents and their offspring simultaneously.

Passing the Barton

Everyone in this stage is preoccupied with the transition. Succession becomes more important in this stage. The Passing the Baton stage begins when the senior generation moves into late adulthood e.g. around sixties, and lasts until its death. Most of major issues are highly related with the transition of control and ownership of the family business.

Table 3-7: The Passing the Barton Stage of Family Development

The Passing the Barton Stage of Family Development	
Characteristics	<ul style="list-style-type: none">▪ Senior generation ages sixty and above▪ Junior generation between twenty and forty-five
Key Challenges	<ul style="list-style-type: none">▪ Senior generation disengagement from the business▪ Generational transfer of family leadership

Source: Kelin E. Gersick, John A. Davis, Marion McCollom Hampton and Ivan Lansberg, "Generation to Generation: Life Cycles of the Family Business," Harvard Business School Press 1997, pp. 92

- **Senior generation disengagement from the business:**

The concepts of succession and continuity encompass two different things but they complement each other. Succession reflects the sequential aspect of the transition, as one thing needs to end and be succeeded by something new. Continuity refers to the part of the present world that needs to be preserved in the new era. Both succession and continuity are essential in order to minimize the disruptive consequences of the generation transition.

The transition of management leadership is a task of the business circle in the Three-Circle Model. The family task is to consider its own transition, by first recognizing that this stage has been reached. However, the rest of the family often colludes in the resistance to acknowledge that time for transition has arrived. From his analysis of the "succession conspiracy"¹⁰ that delays attention to the inevitable transition, Lansberg identifies four classic family contributions, which are (1) the fear of differentiation among the siblings; (2) the offspring's fear of being perceived as greedy; (3) the spouse's fear of loss identity and activities; and (4) the family's fear of the leader's death. In addition, many senior family members fear retirement as a certain precursor of failing health and a quick slide toward death. Others are preoccupied with becoming less relevant or even of being forgotten by

those who follow. With all these reasons, both generations may have difficulty in thinking or talking about the senior generation's disengagement from the firm.

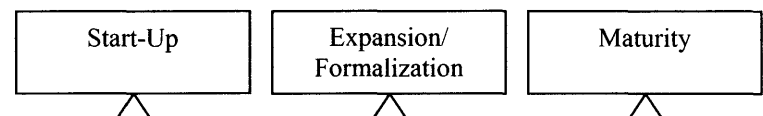
- **Generational transfer of family leadership:**

Another challenge in the Passing the Baton stage is the shift in responsibility and control of family affairs from the most senior generation to the next generation. This may happen gradually or suddenly. All families expect such events, but none is truly prepared for them.

3.2.3 *The Business Developmental Dimension*

This dimension demonstrates the development of the business over time. The description of this dimension is built on the work of a number of business life cycle theorists e.g. Neil Churchill, Eric Flamholtz, Larry Greiner, and John Kimberly.¹¹ The development of the business can be divided into 3 stages: Start-Up, Expansion/Formalization, and Maturity.

Figure 3-5: The Business Axis



Source: Kelin E. Gersick, John A. Davis, Marion McCollom Hampton and Ivan Lansberg, "Generation to Generation: Life Cycles of the Family Business," Harvard Business School Press 1997, pp. 23

Start-Up

The Start-Up stage involves the periods that the company or new business units are founded. There are two common characteristics of family firms in this stage which are (1) the owner-manager is the center of any activities, investing a great deal of time, energy and often, most of resources; (2) the company is usually focused on a single product or service, hoping to find niche where it can build up enough resources to get established for the long run.

Table 3-8: The Start-Up Stage of Business Development

The Start-Up Stage of Business Development	
Characteristics	<ul style="list-style-type: none"> ▪ Informal organizational structure, with owner-manager at center ▪ One product
Key Challenges	<ul style="list-style-type: none"> ▪ Survival (market entry, business planning, financing) ▪ Rational analysis versus the dream

Source: Kelin E. Gersick, John A. Davis, Marion McCollom Hampton and Ivan Lansberg, "Generation to Generation: Life Cycles of the Family Business," Harvard Business School Press 1997, pp. 108

▪ **Survival (market entry, business planning, financing)**

The key survival for this stage is to have adequate liquidity not only to set up a basic operation, buy materials, produce product, and get it to market, but also to withstand setbacks that were not specifically foreseeable.

▪ **Rational analysis versus the dream**

Founders must balance their judgment between staying neutral about their project and keeping their ability to analyze objectively, and feeding their passion for it. Some prospective business owners jump too quickly toward their ideas because they feel excited, not because they have analyzed all dimensions of the business situations.

Expansion/Formalization

The second stage, Expansion/Formalization, includes all the family firms from the point when they have established themselves in the market through expansion and increasing organizational complexity, to the period when growth and organizational changes slow down significantly. The transition from the Start-Up stage to Expansion/Formalization may not easily notice or it may obviously notice; for instance, establishing new facilities, hiring professional management, or introducing new products or services.

Table 3-9: The Expansion/Formalization Stage of Business Development

The Expansion/Formalization Stage of Business Development	
Characteristics	<ul style="list-style-type: none"> ▪ Increasingly functional structure ▪ Multiple products or business lines
Key Challenges	<ul style="list-style-type: none"> ▪ Evolving the owner-manger role and professionalizing the business ▪ Strategic planning ▪ Organizational systems and policies ▪ Cash management

Source: Kelin E. Gersick, John A. Davis, Marion McCollom Hampton and Ivan Lansberg, "Generation to Generation: Life Cycles of the Family Business," Harvard Business School Press 1997, pp. 114

▪ **Evolving the owner-manger role and professionalizing the business:**

In the Expansion/Formalization stage, businesses usually evolve from a founder-centered structure to a more formal hierarchy with various business units and functions. As business begins to grow, there is a pressure to hire professionals to fill key managerial and specialist roles, and for owner-manager to start delegate responsibilities and authorities to non-family members.¹²

▪ **Strategic planning:**

The key issue is not which strategy is selected (mass or niche market focus, exploit first mover advantages, achieving low-cost structure, etc.) but rather how challenges are addressed seriously. The owner-managers, who restrict information gathering and analysis, or who resist critical reflection on personal vision that sustained them in the early stage, will be working in a limited range of options. This may lead to a mismatch of resource investment with strategic opportunity, or to a failure to see new emerging opportunities.

▪ **Organizational systems and policies:**

Organization issue is also very important. Without strong organizational management, the strategies find difficult to be implemented or achieve the desired objectives. Examples of organizational issues can be that how to design and structure the reporting relationship between headquarter and the new subsidiaries oversea, or how to implement an incentive scheme that encourages two conflicting objectives (improve quality, while reduce costs) in the organization.

- **Cash management:**

Cash is not only very important in the Start-Up stage, where sufficient initial capitals are required to make the business established, but also in the Expansion/Formalization, where the firm still needs adequate amount of funds in order to finance its operation and investment for future growth.

Maturity

The last stage of the business developmental dimension, Maturity, is the stage when the firms' operations are routinized to the point of automatic behavior and expectations about the growth are very modest. The product has stopped evolving and the competitive dynamics shift to increasingly unprofitable battles over market shares. Although the companies still operate efficiently, control significant market share, or generate profits, these situations will not last long. There are two ways out of the Maturity stage which are (1) renewal and recycling, and (2) the death of the firm.

Table 3-10: The Maturity Stage of Business Development

The Maturity Stage of Business Development	
Characteristics	<ul style="list-style-type: none"> ▪ Organizational structure supporting stability ▪ Stable (or declining) customer base, with modest growth ▪ Divisional structure run by senior management team ▪ Well-establish organizational routines
Key Challenges	<ul style="list-style-type: none"> ▪ Strategic refocus ▪ Management and ownership commitment ▪ Reinvestment

Source: Kelin E. Gersick, John A. Davis, Marion McCollom Hampton and Ivan Lansberg, "Generation to Generation: Life Cycles of the Family Business," Harvard Business School Press 1997, pp. 122

- **Strategic refocus:**

As the business enters the Maturity stage, the firm finds difficult to operate profitably and compete in the market. The products become commoditized and thus the profit margin begins

to deteriorate. In order to survive, the strategic refocus is needed in order to escape out of the game, trying to find new way to compete, or continue to play in this game with different sets of strategies and tactics.

- **Management and ownership commitment:**

Non-family managers become increasingly important to the family businesses as they move through the business development stage. They can be an encouragement to other non-family employees because they demonstrate the opportunities available to successful employees. It is necessary to have a comprehensive career advancement strategy that takes into account incentive and recruitment tactics that will locate and retain the best available non-family management. And this strategy should be communicated openly not only to family members but also key non-family managers. Their fears may be worse than the reality of their opportunities.

- **Reinvestment:**

The challenge of reinvestment can become complicated if the Maturity stage in the business dimension coincides with the Passing the Baton stage in the family dimension. Psychologically, it may be more difficult for a senior generation to embrace a strong reinvestment policy, especially significantly increasing debt, during their last few years of management. As a result, family firms that face this problem tends to be left in the maturity stage longer than those who are not or those with the senior owner-managers who convince themselves that the major change is needed.

In addition, it is also important to take into account the factors that speed up or slow down the business cycle. External factors such as industry condition, technology, and economic cycle can greatly impact on the development of the business. For example, if the product life cycle of the firm's industry is very short, and if the firm cannot quickly launch new product relatively to its competitors, the firm tends to lack behind. The interaction with the developmental stage in the family and ownership dimensions is also another factor that can speed up or slow down the business cycle of the family firms.

Although the Three-Dimensional Development Model allows us to categorize the complex family businesses, too much emphasis on categorizing can lead to oversimplification. In many cases, family firms can be in hybrid forms; for example, a family company can be owned by two different generations, or some of its businesses become mature, while another business unit is in the expansion phase. The model can be best used as a predictable framework for development of family firm over time in each dimension, and helps us to analyze the dynamics and interactions among these three dimensions of these family firms.

Therefore, in this research, I will use the Three-Circle Model and The Developmental Model as the tools to discuss and analyze the company case studies in Chapter 4.

3.3 Forces for Change in family business

Over the time, the competitive environment, customers' demands, or other factors (such as organization issues, economic conditions, rules and regulations) constantly change, which can greatly impact the firm's success. In order for a firm to survive and success, the ability to provide products or services that meet customers' needs, and the ability to compete with other players in the market, are needed. Only businesses that can redefine themselves to cope with these changes can achieve long term survival and be able to success over those that cannot.

Kanter, et. al.¹³, suggested the forces that characterized the dynamic of organizational changes. He categorized these forces into three clusters. The first cluster is **environmental force**, which includes all external forces e.g. technological, competitive environment, economic, globalization, and political changes. The second cluster is **organic or life-cycle force**. This force involves with the internal forces that can be threaten the survival of the firm. For example, small start-up firms may have problem about liquidity; while the mature firms become inflexible and not be able to adjust themselves to the changes. The last force is **political force** within the organization. The interplays of individual groups within the organization can affect the longevity of the firm.

These forces can be found in any kinds of firms, which also include family business. One good example is Chinese family businesses, which are the major proportions of world wide family businesses – overseas Chinese family businesses, numbering approximately 55 million, holding assets of about \$2 trillion and generating annual economic output estimated at more than 500 billion.⁴ The traditional oversea Chinese family businesses are pressured by two related forces, which are (1) the growing importance of high technology, and (2) the rise of new generation of Western-educated business leaders.¹⁴ The former force can be categorized as environmental force in Kanter's model. This force is not perfectly applicable to family businesses in the US because U.S. family firms have better access to the source of technology e.g. highly educated personnel than oversea Chinese firms do. The later force can be categorized as political force within the firm between senior generation, with traditional way of doing business, and the later generation with western business practices and management.

3.4 Business Transformation

According to the forces mentioned earlier, a firm has to redefine itself in reaction to changes for its survival. It has to improve the linkages between its various activities that contribute to the effective creation and delivery of products and services. There are wide varieties of actions that firms perform in order to cope with changes e.g. reengineering business process, introducing brand management, implementing a merger, etc. And all these activities can be called as business transformation. In 1994, Barbara Blumenthal and Philippe Haspeslagh proposed a definition of three different types of corporate transformations with the idea that if the transformation is better defined and given a framework, firms facing the similar problems and circumstances can make meaningful comparison.

The first step of transformation is to recognize that the firm is or will become uncompetitive. In order to do so, a majority of individuals in an organization is required to change their behaviors. The extent to which the corporations change themselves can be categorized into three types as follow:¹⁵

- **Improving Operation** – the goal is to achieve a significant improvement in the company’s efficiency, often by reducing costs, improving quality and service, and reducing development time. Typically, these changes require employees to work in teams, work across functions or other organizational boundaries, and play a larger role in identifying and resolving problems, while managers are required to learn new skills, such as coaching and facilitating and rely less on monitoring and controlling.
- **Strategic Transformation** – the process of changing the organizations’ strategies seeks to regain a sustainable competitive advantage by redefining business objectives, creating new competences, and harnessing these capabilities to meet market opportunities. The strategic transformation takes place against changing technology, shifting market demand, emerging standards, and aggressive competitors.
- **Corporate Self-Renewal** – this transformation aims to create the ability for a firm to anticipate and deal with the changes in order to minimize the operational and strategic gap. Corporate Self-Renewal must be encouraged during a period long enough to create a fundamental behavior change in the managerial ranks. For example, GE aimed to become a self-renewing organization by pushing managers to face reality, accept criticism, engage in open communication, make fast decisions, and accept responsibility for those decisions.

They concluded that the top managers can play an important role in ensuring the direction and the progress of the change. For example, “They can raise performance targets, put leaders in key positions, and remove managers who pose an obstacle to change”¹⁶. In case of the family business, the success is depended largely on how critical of the transformation process the business owners or the family perceive.

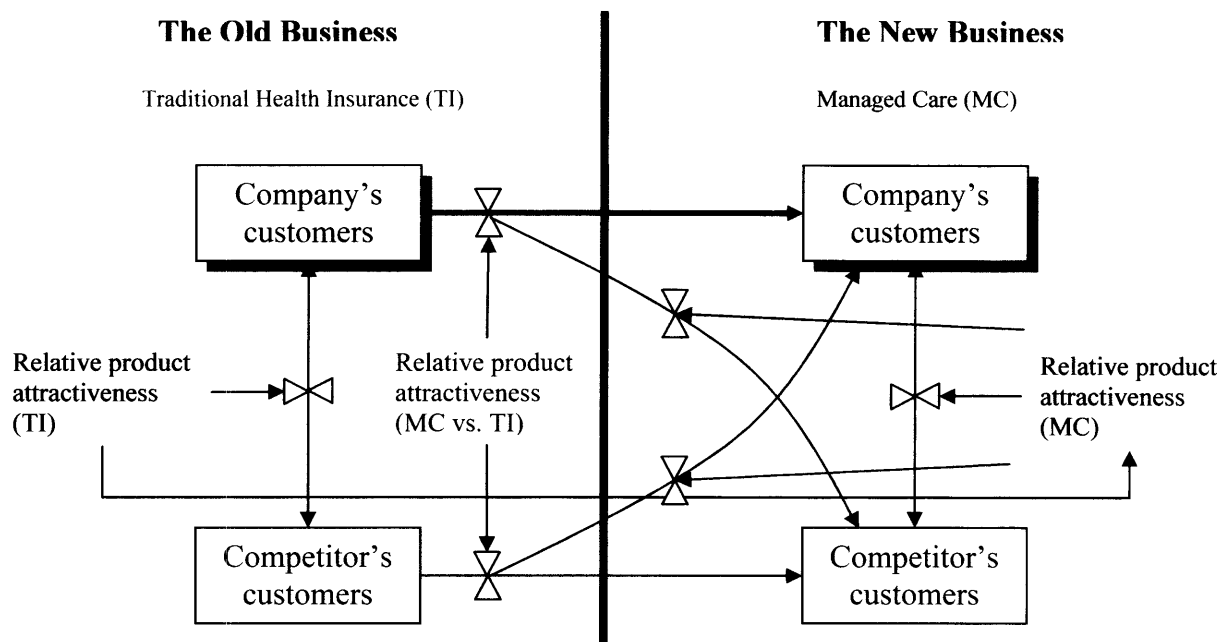
3.5 Strategy to Business Transformation

The study of Henry Birdseye Weil and Leon S. White indicated that the successful transformation is significantly involved with leveraging the synergy. From this study, they suggested strategies to business transformation by focusing on the synergy between the current and the future business. Specifically, the new business must effectively exploit key assets of the current business rather than ignoring or, worse, destroying them. And the strategic role of the core business is to conserve those assets and at the appropriate time pass them on. They proposed 3 key categories of assets for business transformation as follow:¹⁷

- **Market assets** – A substantial fraction of the current customer base should become customers for the new business. The image and reputation of the existing business can greatly affect the successful of the transformation.
- **Financial assets** – the traditional core business will be the primary source of company's profit and cash flow, which are used to perform product and service developments, new facilities, and start-up losses associated with the new business.
- **Human assets** – the company must carry its workforce through the process of transformation as much as possible. These assets include all the experience, know-how, and competencies of the company.

Their study was based on two businesses in the U.S. healthcare industry – the traditional health care and the new emerging business, the manage care. The traditional health care services are paid for by the private employer-sponsored plan, which is provided by large insurance companies. Unlike traditional health care service, the manage care has substantially different relationship among insurers, health care providers (physicians, hospitals, diagnostic laboratories, drug companies, etc.), employers, and individual consumers, aimed at controlling cost.

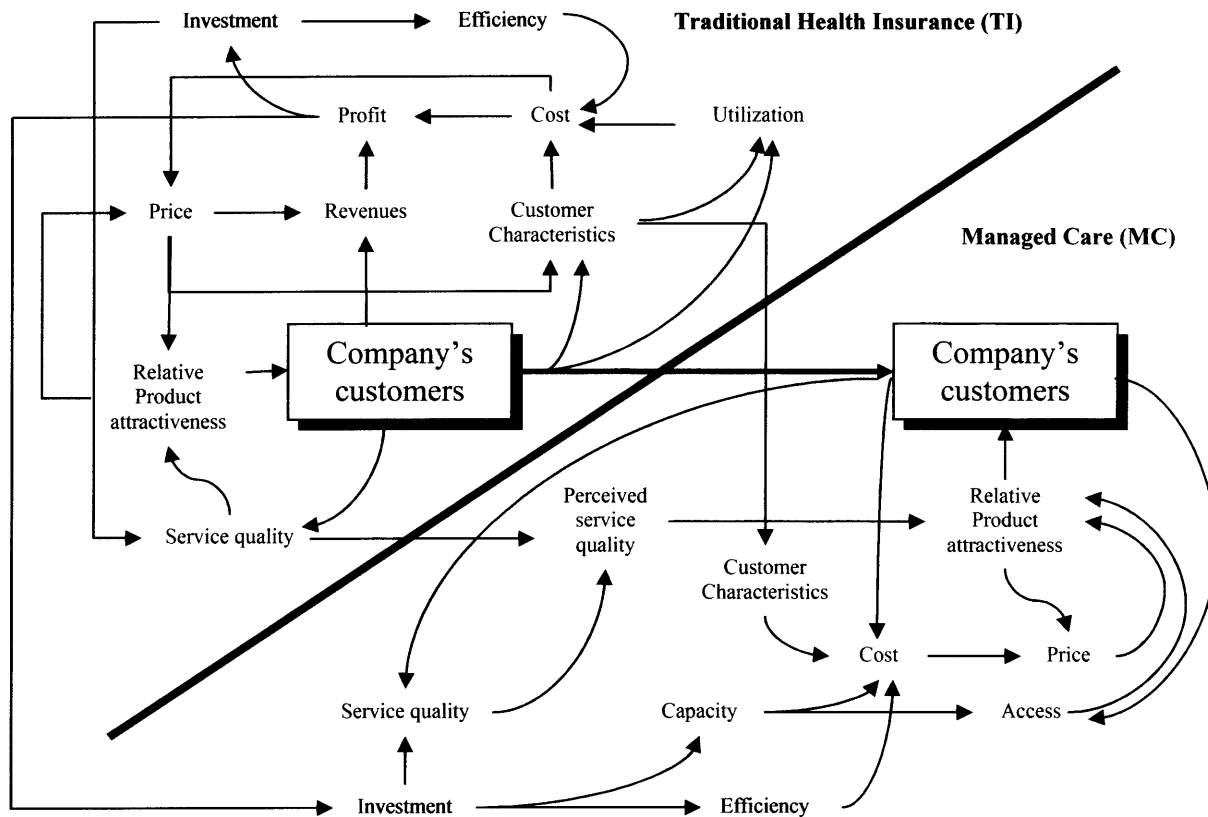
Figure 3-6: A Model of Business Transformation – The Flow of Customers



Source: Henry Birdseye Weil and Leon S. White, “Business Transformation: The Key to Long term Survival and Success”, Working Paper Alfred P. Sloan School of Management, May 1994, pp. 6

From the Flow of Customers Model in Figure 3-6, it is clear that the relative attractiveness of the new products to existing one affects the customer migration rate from traditional health care to managed care service. Besides the attractiveness of the new product itself, the relative product attractiveness of the existing business to its competitors also has an effect on the relative product attractiveness of the new business, affecting the rate of inflow and outflow of the number of new business customers from/to both existing business and competitors.

Figure 3-7: Key Links between the Old and New Business



Source: Henry Birdseye Weil and Leon S. White, “Business Transformation: The Key to Long term Survival and Success”, Working Paper Alfred P. Sloan School of Management, May 1994, pp. 6

From the model of Key Links between Old and New Business in Figure 3-7, the profit generated from the existing business is used to invest in the new business in order to improve service quality and efficiency, and increase firm’s capacity, all of which lead to improve in the relative product attractiveness of the new business. Also, the service quality of existing business can enhance or detract the perceived service quality of the new business.

In conclusion, in order to maximize the synergy between the current and the future business for the effective business transformation, the firm should consider the following issues.¹⁷

- An important element of a transformation strategy may well be a deliberate campaign to improve quality in the old business.

- The structural profitability and cash generating power of the core business must be preserved for as long as possible.
- It is essential that the transformation process do not inadvertently undermine staff morale and productivity, because many of the best people leave, which de-skills the company, and work counter the drives for improved efficiency and quality.

This study can be appropriately applied to family business. However, in my opinion, to be more specific to family-owned enterprises, it should also include additional 2 types of assets:

- **Reputation assets** – New businesses or any other family members can leverage the good reputations of the exiting business or successful family members to gain privilege of getting creditability, acceptance, or access to resources such as business partners, financial loans, etc.
- **Business volume assets** – Most of family businesses tend to organize themselves as conglomerate or holding company.¹⁸ They spin off some of their operations as new business entities. These new entities can capitalize the synergy from the existing company by using the business volume as based revenue in order to justify the operation in the early stage. And then they can expand the business in the future – not only serve the companies with in the group but also outside companies.

3.6 Succession Planning

Besides business transformation, succession is another critical factor that must not be omitted in considering long-term survival and success of family-owned enterprises. The succession planning has been the issues that various articles in this field greatly discussed.¹⁹ From the statistics of the world family businesses, approximately 30% of family businesses make it to the second generation, 10-15% make it to the third, and 3-5% make it to the fourth generation.²⁰ The average life expectancy of U.S. family firms is estimated to be twenty-four years, which is also

equivalent to the tenure of their founders.²¹ Most major overseas Chinese firms survive only the second generation.²²

Therefore, the effective succession planning is critical in this case. It is not only about who will take over the business, but also how to prepare the successors to be ready for those positions. The study by Jeffrey A. Barach, Joseph Gantisky, James A. Carson, and Benjamin A. Doochin proposed management-level entry strategies for succession planning, and discussed the pros and cons of each strategy (Table 3-11).

Table 3-11: Comparison of Entry Strategies for Succession in Family Business

Low-Level Entry Strategy	
Advantages	Disadvantages
<ol style="list-style-type: none"> 1. Intimate familiarity with the nature of the business and employee is acquired. 2. Skills specifically required by the business are developed. 3. Exposure to others in the business facilitates acceptance and the achievement of credibility. 4. Strong relationships with constituents are readily established. 	<ol style="list-style-type: none"> 1. Conflict results when owner has difficulty in teaching or relinquishing control to successor. 2. Normal mistakes tend to be viewed as incompetence in the successor. 3. Knowledge of the environment is limited and risks of inbreeding are incurred.
Delayed Entry Strategy	
Advantages	Disadvantages
<ol style="list-style-type: none"> 1. Successor's skills are judge with greater objectivity. 2. Development of self-confidence and growth independent of familial influence are achieved. 3. Outside success establishes credibility and serves as a basis for accepting the successor as a competent executive. 4. Perspective of the business environment is broadened. 	<ol style="list-style-type: none"> 1. Specific expertise and understanding of organization's key success factors and culture may be lacking. 2. Set patterns of outside activity may conflict with those prevailing in the family firm. 3. Resentment may result when successors are advanced ahead of long-term employees.

Source: Jeffrey A. Barach, Joseph Gantisky, James A. Carson, and Benjamin A. Doochin, "Entry of the Next Generation: Strategic Challenge for Family Business", *Journal of Small Business Management*, April 1998, pp. 53

The research, presenting the results from interviews with 30 executives of various types and sizes of family businesses, found out that 80-90 percent of family members do enter the firm through summer jobs or low-level employment. On the other hand, many writers²³ argued that

strategy for the next generation's entry should be that children work elsewhere early in their careers. They believed that working outside is ideal in creating the image of a competent leader, which is important for the transition. In addition, they believed that young successors may not feel a sense of achievement when working in the family environment. However, young successors, entering the firms from outside and transferring creditability, can also make mistakes due to unfamiliar with the culture and operations of the organization, and to regain the creditability after making mistakes is much more difficult than building it day by day.

The study concluded that there is no exact answer of which strategy is better. It does depend on judgment of the business owners on the pros and cons of each strategy and how fit the strategy to the organization. They also emphasized that the importance of succession strategies is their impact on the firm – the founder must determine whether his or her children can play role in the firm. If not, he or she should hire professional management from outside. For example, Japanese family business owner who does not have any capable sons to hand over its business, called the male bride to be successor.²⁴

3.7 Alternative Strategies for Succession

In many cases, business owners find that their sons or siblings, even though they are well educated and have high competence, simply are not enthusiastic or interested about running the business with which they have grown up.²⁵ Sam H. Lane, PhD who leads Lane, Buhl, Fenker & Associates, a consulting firm specializing in treating family business succession problems, said “The succession of the family business is usually the place where everyone gets stuck”.²⁶ The solutions to this problem were proposed by David L. Risdon. He suggested alternative ways for succession of the family business which are:²⁷

- **The Transition Sale** – takes many forms such as (1) “an initial transition, whereby a substantial percentage of the business (anywhere from 40 percent to 100 percent) is sold to a third party.”²⁷ or (2) “an agreement whereby the owner continues to manage the business for some period of time (typically three to five years) and is provided incentives as the business

experiences continued success”.²⁷ The reason for later case is that the buyers want previous owners to continue manage the company until the new management team is comfortable to take their place.

- **The Partial Buyout** – suppose the owner sells 40 percent of the company and still continues to manage the company. The buyer has an option to buy out the remaining share at the price based on valuation of specified multiple of the company’s annual cash flows. And the business owner has the right to put the remaining shares to the buyer (using same valuation) at any time after five years from the date of initial transaction. It is clear that owner is provided incentives to grow and expand the business and at the same time, he or she can transition out of the business in his/her appropriate time.

- **The Full Buyout** – the owner sells 100 percent of the company e.g. sells the firm value at \$250,000 at \$200,000 in cash and earns out based on future profit, which should be anywhere between \$50,000 and \$100,000, over the next three years. The former owner signs a three-year employment contract, in which he/she still receives a salary, and bonus.

4. Company Case Studies

This chapter will discuss and analyze three family-owned businesses in profound details. The main tools to organize are the Three-Circle Model and The Developmental Model of family business. The three family businesses include (1) Sulpicio Lines, (2) The Anonymous Company, and (3) Halo LSI.

4.1 *Sulpicio Lines, Inc.*

4.1.1 Brief Overview

Sulpicio Lines, Inc was found in September 1, 1973 by Don Sulpicio Go (Go Guioc So). The company's core business is in the Philippines' shipping industry. As the top three players in the industry, it provides marine transport shipping for both cargos and passengers. Its main revenue source comes from cargo business. Sulpicio Lines now serves almost all ports in the Philippines with its 18 vessels, 12 cargo and container vessels, 3 tugboats and 5 barges. It is also widely known for its developmental effects in serving secondary and tertiary routes, as initiated by Don Sulpicio.

4.1.2 Company history²⁸

Sulpicio Lines, Inc was found in September 1, 1973 by Go Guioc So, more popularly known as Don Sulpicio Go. He was a self-made man, and Amoy merchant who came to the Philippines with his brothers and sisters in 1919. With his brother, he set up base in Naval, Leyte.

Starting with just one 50-ton sailboat, they would bring their goods to the neighboring islands, going as far as Samar. Sailing opened possibilities for shipping. This materialized in 1946, when he became general manager of Carlos A. Gothong. In 1953, he became its managing partner and

successfully steered it to the top in the 60's. Years later, in 1973, Don Sulpicio ventured on his own.

He put up Sulpicio Lines with his sons, starting with a fleet of 17 vessels, 1 tugboat and 5 barges, or a total tonnage of 16,936. Don Sulpicio exercised discipline and exemplified hard work, often the first to arrive and the last to leave the office. His over 40 years of sailing experience helped him make stable and decisive moves for the company's benefit. He encouraged the full participation of his sons, instilling in them the values of loyalty, dedicated service, fairness, and honesty in all dealings.

He was a philanthropist, extending help to such institutions as the Emergency Rescue Unit Foundation and the Cebu Filipino-Chinese Fire Brigade. Don Sulpicio also believed in education as the key to an individual's success and gave scholarships to poor but deserving students. This, the company does, to date.

Among the top earners in this capital intensive industry, Sulpicio Lines, Inc. now serves nearly all ports in the country, with 18 vessels, 12 cargo and container vessels, 3 tugboats and 5 barges. Its total tonnage of 147,108 is an almost ten-fold growth over that of 1973. It has branches in key cities, office and agencies nationwide and over 2,000 under its employ, either as workers, ship crew, port workers, stevedores, or cargo handlers.

Sulpicio Lines has complete facilities which enhance operation. It has a bevy of heavy equipment for moving container vans in port. It also has towage services and container haulers which transport container vans. Its container yards are all over the country and more than 15,000 vans are currently in transit between the islands. Like any flourishing business, Sulpicio Lines expanded, and branched out to other related endeavors like: copra trading, general merchandising, trucking, fabrication and repair, as well as towage.

The management, so with the rank and file of the company, recognizes the responsibility of providing reliable services and customer satisfaction, and continuously works to provide excellent and progressively better services in all areas of passenger and cargo shipping. The

company remains faithful in its efforts to develop remote ports in the Visayas and Mindanao. It strives to strengthen all aspects of operation with particular emphasis on research and development. Top priorities are the upgrading of its fleet, and the full growth of its market. The company goes on outdoing its performance, strictly monitoring cleanliness, personnel record, meal quality on board, and travel time; four major factors of customer patronage.

One man's dream is now Sulpicio Lines' corporate commitment. The company stands firm on its mission to link the islands in the archipelago. It intends to accomplish as a tribute to Don Sulpicio, its responsibility to bring development to all parts of the country, through efficient, dedicated, responsible and progressive shipping operation.

4.1.3 Company Profile²⁸

Vision

Due to the archipelagic nature of the Philippines, an effective sea transport system plays a very significant and crucial role in the economy. Inter-island shipping is still the single most important and cost-effective means of transporting the majority of our goods and people.

Sulpicio Lines, Inc. envisions to actively participate in the achievement of economic progress by making presently remote areas easily accessible from our major ports. Sulpicio Lines, Inc. sees the pouring of goods and people from the major ports and into these less viable routes as a means of bringing real development to the countryside.

Corporate Philosophy and Values

The corporate philosophy is based on the personal philosophy of Don Sulpicio Go, who envisioned Sulpicio Lines as a family corporation, solidly rooted on work values which he himself instilled in his children. Foremost are the values of discipline, hard work, loyalty, good and reliable service, fairness and honesty in all business dealings.

Management Style

To this very day, Sulpicio Lines, Inc. keeps a 'grass-roots' emphasis on business. Executives involve themselves in the day-to-day operations of the business, giving individual clients direct and personal access to top management. This is reflective of Don Sulpicio's belief that a manager's guiding hand must be felt at the lowest level of business.

The company is managed by Don Sulpicio's eight sons, each taking the reins in various areas of operations. The new and emerging generations of leaders, consisting of the grandchildren of Don Sulpicio, are now helping steer the company into the 21st century.

Major branches

Bacolod, Butuan, Cagayan de Oro, Cotabato, General Santos Davao, Iloilo, Cebu, Manila.

Other offices and agencies

Zamboanga, Tacloban, Palompon, Baybay, Ozamis, Calubian, Ormoc, Catbalogan, Maasin, Calbayog, Dumaguete, Surigao, Masbate, Jagna, Tagbilaran, Iligan, Dipolog, Estancia, Puerto Princesa.

Sulpicio Lines is the only one serving the ports of Naval, Kawayan, Biliran and Maripipi -- all in Leyte; San Jose, Lao-ang, Allen and Lavezares in Samar; and Tandag, Cateel, Bagangga and Lambajon in Mindanao.

Subsidiaries

Sulpicio Marketing Corp. (copra trading)

Solid Marketing Corporation of Cebu (general merchandising)

Container Haulers, Inc.

Sulpicio Machine Shop

Solid Towage & Lighterage Co., Inc.

Support Facilities

SLI has the widest range of support facilities and heavy equipments: Machine Shop, Towage Facilities, Container Haulers (trucking), container yards in all major ports, crane and forklift facilities, warehousing and forwarding services. Presently, the company has over 15,000 container vans moving between the islands nationwide.

Growth in twenty six years

Sulpicio Lines is the youngest and one of the largest inter-island shipping companies in the Philippines.

Fleet

Original: 17 vessels, 1 tugboat, 5 barges

Present: 18 passenger/cargo vessels, 12 cargo and container vessels, 3 tugboats, and 5 barges.

This brings the total tonnage to over 147,000, an almost ten-fold increase from an initial tonnage of 16,036.

Routes

The number has tripled to serve the ever-increasing cargo and passenger traffic. Since the birth of Sulpicio Lines about 26 years ago, its branches are now scattered across:

Employees

Over 2,000 are directly employed and thousands of others indirectly employed.

ISM and ISO 9002 Compliant

Sulpicio Lines, Inc. has acquired a quality system which meets the requirements of the International Quality Assurance Management Standard ISO 9002 (1994) and the International Maritime Organization's ISM Code of "Safe Operation of Ships and Pollution Prevention" on June 18, 1999 and July 17, 1999, respectively. Sulpicio Lines, Inc. is the first domestic shipping company to obtain two international accreditations at the same time.

4.1.4 Strategy²⁹

Due to the emerging possibility of stiffer competition, Sulpicio Lines has begun to place more emphasis on providing best services to its customers. It is very difficult to compete through the low cost service provider strategy due to high expenses in the shipping industry such as fuel costs, maintenance costs and port tariffs. Further, the company would like to be able to price its service with a premium for the value that it adds to its customers' businesses. To emerge as leaders in the service industry, Sulpicio Lines aims to provide unique customer experiences.

Redefining Customer Experience:

Sulpicio Lines has always aimed to provide personalized services to each of its customers. At present, regular customers can easily contact office managers regarding the location of their cargoes, operation schedules and rates anytime via telephone. It is also not difficult for the company to grant discounts to regular customers when they request for it. A door-to-door delivery option has also been extended to customers to save them from experiencing the pier bustle as they have their documents processed together with many other customers. Sulpicio Lines can arrange delivery through their trucking partners that facilitate the loading and unloading of the container thus eliminating the steps that customers need to take to obtain trucking services.

On the passenger service side, customer experience has been improved by an addition of on board services and amenities that include movie rooms, karaoke bar, dance clubs, entertainment center and buffet meals. The company has also alleviated passengers' difficulties in getting affordable public transportation upon arrival by offering a free shuttle service that will take them from the port to the city. This enabled passengers to meet their loved ones at a more convenient place in the city.

Horizontal Breadth:

Aside from transporting services that Sulpicio Lines provides its customers, other services such as trucking, hauling freight forwarding and customs brokering are also offered. A door-to-door delivery takes out the hassle on the client's part to hire trucking services and complete and

process the required landing documents. Freight forwarding and customs brokering includes processing of immigration papers and transferring of shipments to the international ports. Even though the company is only engaged in inter-island shipping, it impacts the export industry since its ships are used for transporting goods to international ports where they are then shipped out of the country.

4.1.5 Competition²⁹

Routes are classified as primary (major ports on a national level), secondary (ports of lesser throughputs in the regional area) and tertiary (feeder routes). The study of competition in the industry can be clearly observed by classifying competition according to the routes and market share by route: routes with only one operator, routes with only one effective competitor, routes with mild competition and routes with substantial competition. Sulpicio Lines, Inc. operates largely in routes where it is the sole operator, routes where there is only one effective competitor and where mild competition is observed (Table 4.1-1). This is due to the fact that the five major players of the industry cater to niche markets and mostly do not directly compete with each other. This resulted to low prioritization of improving operations to provide better customer service in the company since changes as such were seen as unnecessary for profitability.

Other means of transport are emerging in the industry where government legislations have encouraged inter-modal competition. Recent developments resulted to first class and second class passengers shifting towards air travel due to a deregulation of the airline industry. The increasing number of fast ferries has also captured a lot of passengers in the secondary and tertiary routes. On the cargo services side, roll-on roll-off (RORO) services have been gaining popularity. Currently, RORO services are still limited to new routes (not presently being served by any major cargo shipping company).

Table 4.1-1: Competition in Shipping Routes

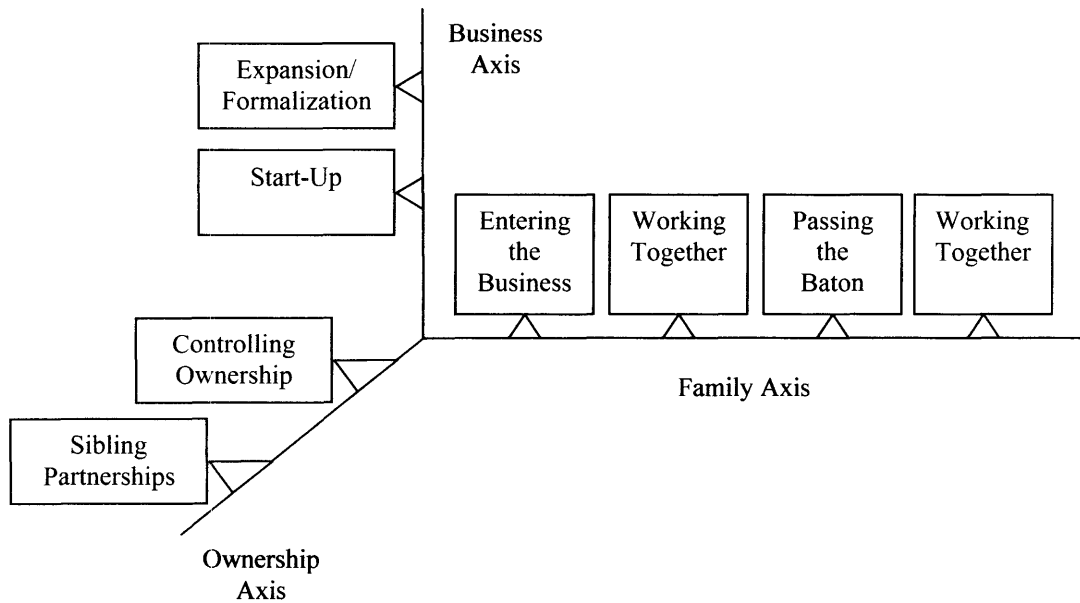
Route Classification	Routes with only 1 operator	Routes with substantial competition	Routes with mild competition	Routes with only 1 effective competitor
PASSENGER				
PRIMARY				
Total number of routes	26	7	14	5
	Negros Navigation 12	Negros Navigation 2	Negros Navigation 6	Negros Navigation 2
	Sulpicio Lines 9	Sulpicio Lines 6	Sulpicio Lines 4	WG&A 2
	WG&A 1	WG&A 3	WG&A 8	Cebu Ferries 1
	Cebu Ferries 1	Cebu Ferries 2	Cebu Ferries 1	
	Others 3	Others 1	Phil Fast Ferry 2	
			Others 3	
SECONDARY				
Total number of routes	27	6	6	7
	Negros Navigation 5	Negros Navigation 1	Negros Navigation 2	Negros Navigation 1
	Sulpicio Lines 10	Sulpicio Lines 3	WG&A 2	Sulpicio Lines 1
	WG&A 1	WG&A 2	Cebu Ferries 1	WG&A 1
	Cebu Ferries 2	Cebu Ferries 2	Phil Fast Ferry 1	Cebu Ferries 1
	Others 9	Others 2	Others 3	Others 3
TERTIARY				
Total number of routes	166	18	21	10
	Negros Navigation 14	Sulpicio Lines 1	Others 21	Phil. Fast Ferry 1
	Sulpicio Lines 14	Cebu Ferries 1		Cebu Ferries 1
	WG&A 1	Others 17		Others 17
	Phil. Fast Ferry 1			
	Others 136			
CARGO SERVICE				
PRIMARY				
Total number of routes	25	10	27	7
	Negros Navigation 1	Negros Navigation 2	Negros Navigation 11	Negros Navigation 1
	Sulpicio Lines 6	Sulpicio Lines 5	Sulpicio Lines 11	Sulpicio Lines 2
	WG&A 3	WG&A 2	WG&A 17	WG&A 1
	Others 15	Others 7	Solid Shipping Lines 3	Others 3
			Lorenzo Shipping 4	
			Others 11	
SECONDARY				
Total number of routes	16	6	15	9
	Sulpicio Lines 7	Negros Navigation 1	Negros Navigation 3	Negros Navigation 1
	Others 9	Sulpicio Lines 4	Sulpicio Lines 7	Sulpicio Lines 1
		WG&A 4	WG&A 7	Others 7
		Lorenzo Shipping 1	Others 10	
		Others 2		
TERTIARY				
Total number of routes	444	38	58	39
	Negros Navigation 3	Negros Navigation 1	Negros Navigation 2	Negros Navigation 1
	Sulpicio Lines 22	Sulpicio Lines 2	Sulpicio Lines 5	Sulpicio Lines 3
	WG&A 6	WG&A 1	WG&A 6	WG&A 3
	Others 413	Lorenzo Shipping 3	Lorenzo Shipping 2	Lorenzo Shipping 1
		Others 38	Others 52	Others 31

Note: The number corresponding to each player represents the number of routes where it operates (out of the total number of routes).

Source: 1998 Annual Traffic Reports of Shipping companies submitted to the MARINA.

4.1.6 Analysis through the Developmental Model of Family Business

Figure 4.1-1: Sulpicio Lines Developmental Model



Family Axis

The founder of Sulpicio Lines, Inc. is Go Guioc So or more popularly known as Don Sulpicio Go, who came from Southern part of China to Philippines with his brothers and sisters in 1919. He started the small shipping business with his older brother based in Naval, Leyte. The business began with a 50-ton sailboat to bring goods such as copra to neighboring islands. Then the business was grown up, shipping not only other stuffs like oil, but also transporting passengers across islands.

In early 1970s, He decided to start up his own independent business. He then sold all his shares in the previous company and started the new venture from scratch. He divided the ships and

boats with his older brother by allowing his brother to choose first. This is because the traditional Chinese culture that the more senior person has higher priority.

Within his own family, Don Sulpicio had total of 8 sons and 4 daughters. Each of them had different educational backgrounds, skills, talents, and capabilities. During the early stage of the business, He did not venture the business alone by himself. He already had 5 sons who were mature enough to help him to set up the business. At that time, many of them were in their twenties and some of them already had work experiences from outside. The educational backgrounds of his heirs were among engineer, lawyer, certificated public accountant, business management, and marketing. At that time, it is unlikely to have highly educated managers in the company. One explanation was that Don Sulpicio valued the importance of education so he encouraged his children to pursue their educational choices. Other reasons were that they had easy access to the education – the education was quite integrated with the religious, Catholic, and that the college tuition was cheap during that time.

The family values and culture are much influenced by the Chinese traditions and cultures. Seniority is very important. The more senior persons have higher priority in the family. And because female siblings will have to leave the family and live with their husbands when they are married out, the family tends to prefer male siblings rather than female siblings in term of hand over the ownership of the business to the next generation. Therefore, in this case, female family members played minimum role in the business.

From Don Sulpicio's eight sons and four daughters in the second generation, the third generation of the family has approximately 50 people. Although the family is very big, they are quite close to each other. Almost every Sunday, the family members gather together.

In term of preparing the third generation to enter the business, the family had little influence on what specific educational areas to pursue. The third generation chooses the courses according to their preferences. It is almost understood that after graduation, they have to join the ranks in the company. Hence, the majority of the third generation backgrounds is business or management, about two thirds, and the rest is engineering education. Most of them had education in

Philippines. However, some of them had education in the U.S. and got management degree from top business schools such as MIT Sloan School of Management and Kellogg School of Management.

Many of the third generation, about eighteen people, have already begun working in the company. All of them are heirs of the eight sons of Don Sulpicio. Parents do not have any influence on which area in the company their children would be assigned. Although, the third generation can offer to serve in a certain position, the CEO, the third oldest son of Don Sulpicio will find and decide the suitable position for each of the third generation according to his/her educational background and interests. Therefore, it is not necessary that the heirs of each of the second generation have to work under their parents' areas of responsibility.

Ownership Axis

Before Don Sulpicio started his own shipping business, he jointly owned the company with his older brother. Then, he sold out all his shares and started his own venture with his 5 sons. This new venture was wholly owned by Don Sulpicio. All critical decisions were made by the board of directors, in which he was the chairman of the board. All his sons, eight of them, held both positions of members of the board and senior vice presidents. Don Sulpicio could be viewed as owner-manager, holding majority of company shares and actively engaging in the business.

After he passed away during 1990s, he handed over the business to his eight sons, but not daughters. The shares of the company were divided among eight sons. The ownership in this stage could be categorized as Sibling Partnerships in the developmental model. Sulpicio Lines has had this control and ownership structure up till now.

Although Don Sulpicio's four daughters were not included in the ownership of the company, he still wanted to keep them close to the family. He granted the monopoly rights to each of his daughters to operate cafeteria in each vessel.

In 1999, Sulpicio Lines received an offer from one of its major competitors to merge the two companies together and do IPO. However, it turned down the deal for several reasons. Firstly, they believed that the Philippines stock market was not reliable; Secondly, the family might lose control of the firm as there were more non-family owners. From this situation, it can be concluded that the family managers tend to focus more on the long-term aspect of the business; and that they want to keep the business in the family.

Business Axis

In the initial stage, Don Sulpicio put up Sulpicio Lines with his five sons, starting with a small number of fleets. All important the business decisions were made by Don Sulpicio during the first generation of the business. For the second generation, all major decisions are made by board of directors, consisting of total eight sons with the oldest son as the chairman of the board. While the third oldest son holds position of CEO, the rest are in the positions of senior vice presidents – each of them is responsible for different fractions of the business. For example, one brother oversees engineering department, the other one supervises accounting function.

Sulpicio Lines has expanded substantially during the second generation and become one of the largest players in the Philippines shipping industry. This success came mainly from the CEO, President, and the VP of Marketing as they initiated an aggressive marketing strategy, while they were able to maintain good customer services e.g. consistent and on time schedules.

Sulpicio Lines, Inc. now serves nearly all ports in the country, with 18 vessels, 12 cargo and container vessels, 3 tugboats and 5 barges. Its total tonnage of 147,108 is an almost ten-fold growth over that of 1973. It has branches in key cities, office and agencies nationwide and over 2,000 under its employ, either as workers, ship crews, port workers, stevedores, or cargo handlers. In addition, Sulpicio Lines has complete facilities which enhance operation. It has a group of heavy equipment for moving container vans in port. It also has towage services and container haulers which transport container vans. Its container yards are all over the country and more than 15,000 vans are currently in transit between the islands.

Sulpicio Lines also expanded its business out of the shipping to the other ventures such as copra trading, general merchandising, trucking, fabrication and repair, as well as towage. However, these other businesses are highly related with shipping business; they were put up to complement shipping and to facilitate movement for staffs and clients alike. Sulpicio Marketing; for example, relieves copra farmers of the transportation burden since it serves as their channel to the oil mills.

The third generation has begun working with the family business since Don Sulpicio was controlling the company. Right now, there are eighteen of third generation actively involve in the business. Many of them hold the positions of assistant vice president. All of them report directly to the CEO. Third generation plays important role in business development since in the Working Together stage, the period when all three generations are working altogether. They bring in new ideas and concepts to be implemented in the organization. They also point out various areas for improvement. For example, they brought the initiative of using internet technology and local area network to link all the major branches and subsidiaries countrywide altogether, which substantially reduced the long distance call costs. One reason of the success in applying new concepts into the organization is that the second generation is open-minded and supports the implementation of these new ideas. They can vision the long-term benefits of implementing the local area network even it requires huge investment up front.

Apart from family-member managers, there are also non-family managers in the company. There are few high management level managers. Most of non-family managers are in the positions that require specialized skills or knowledge, for example, the lawyer, the head of marketing, captains, and hotel management managers who oversee the services within vessels. The rest non-family managers are the branch managers in subsidiary offices. It can be said that there are still few non-family managers who have active role in the organization. However, the third generation realizes the benefits of having outside non-family managers in the company:

“I personally believe that as far as control of day-to-day operations is concerned, the direction our company will take in the future will not be much different from what it is today. This means that control of day-to-day operations will remain in the hands of family members. Nevertheless, we will never close the doors for professionals to be a

part of the company as it is today. As a matter of fact, several key officers of the company today are professionals. We firmly believe that we have very competent members of the family who could lead us in the future.”³⁰

4.1.7 Key Observations from the Developmental Model

The Developmental Model allows us to view not only the development of each dimension simultaneously, but also the interactions and influences among the development of each dimensions. The dimensions of developmental stages of the following observations are sequenced by business, family, and ownership dimensions.

1. Start-Up & Entering the Business & Controlling Ownership

In the early stage of the business, especially for the heavy investment business like shipping, the key challenge was that the firm needed adequate liquidity and funds in order to survive and grow in the future. During the start-up stage, Sulpicio Lines could effectively leverage the synergies of the current businesses to establish the new shipping business. Sulpicio Lines was partly financed by the income from the previous family businesses such as copra trading, general merchandising business. In addition, because of the positive reputation of Don Sulpicio, the company leveraged the reputation asset and was able to get financial loan from the bank.³⁰

The Start-Up stage a family business usually begins the family dimension with the Young Business Family stage. But in this case, in the early stage of the business, Don Sulpicio immediately had 5 sons who were mature enough to help him to set up the business, and some of them already had working experiences. Therefore, the family dimension began with Entering the Business, instead of Young Business Family. In addition, the educational backgrounds of his sons were quite diverse, among engineer, lawyer, certificated public accountant, business management, and marketing, allowing the family to effectively control each function of the business.

2. Expansion/Formalization & Passing the Baton & Controlling Ownership

Most of the time when the family axis reaches Passing the Baton stage, there will be issues about the passing the ownership to the next generation. Often, the consequence of the generation transition is negative.

However, the transition of Sulpicio is quite smooth. One explanation is that the family has strong values and tradition that have been passed on from generation to generation. The family values are much influenced by the Chinese traditions and cultures. Seniority is very important. The more senior person has higher priority in the family as well as in the business than those who are younger. And because Chinese female will have to leave the family to live with their husbands when they are married out, a Chinese family tends to prefer male rather than female siblings, especially in case of handing over the ownership of the business to the next generation. This family value and tradition are well aware among family members and act as rules that everyone has to follow, minimizing the disruptive consequences of generation transition. As a result, the business was handed over to the eight sons, but not daughters. The members of the board of directors are among the eight sons, with the oldest son as the chairman of the board.

Another key challenge is the evolution from the Start-Up stage firm to Expansion/Formalization stage firm, while it was still in the Controlling Ownership stage in the ownership dimension. This requires the firm to change from the organization that has one or few numbers of people, who manage and control all the major decisions, to the organization that has many people, who manage and control various different departments or business functions. Therefore, the company has to delegate some authorities to other people, who may not be family members. Unfortunately, up to now, Sulpicio Lines still has few numbers of non-family managers who are allowed to make important business decisions. Nevertheless, the family of Don Sulpicio has 8 people in the second generation and 18 people in the third generation; all of them work in the company. There are also another 32 people in the third generation, who may join the business in the future. Therefore, the increasing in size of the firm is still manageable by the family members and hence the negative impact to the competitiveness of the company is less.

3. Expansion/Formalization & Working Together & Sibling Partnerships

At this stage, the obvious challenge is the succession of the firm to the third generation. The second generation realized that they cannot get any younger so they have to hand over the family business to the next generation. For the first generation of the firm, it is quite easy to hand over the business because there are only eight people (only sons) in the second generation. In addition, the tradition and culture of the family tends to facilitate and smooth the transition of the company.

However, in case of the second generation, there are as many people as 50 people in the next generation and eighteen of them are now working in the company. For the third generation, the family tradition that female family members are not included in sharing the ownership of the business as they have to leave the family to live with their husbands when they are married, are still the same. However, the tradition that the highest authority of the firm is given to the most senior family member is likely to be changed. The second generation realized that the seniority cannot lead to the success of the business but competencies do. Although women are still excluded from owning the company's shares, it's still very difficult to choose which one of them should be given the ownership because distributing the shares to too many people in the third generation will break the company into pieces. In addition, each of them has different capabilities, skills, talents, and interests. The second generation has to take these factors into account as well.

The succession planning has been discussed within last four years, but up to now there is still no conclusion. Nevertheless, the company did have some actions in order to lessen the impact from generation transition. For example, in 2002, the company set up an Executive Committee³⁰ composed of family members from the third generation to become the future leaders of the company and ensure the smooth transition.

4.2 The Anonymous Company

Due to the nature of the information about family business of secrecy and sensitiveness, I would like not to mention the name of the company as well as the sources of information in order to maintain the information quality of being elaborate and insightful.

4.2.1 Brief Overview

This company was found in the mid 80's by a married couple in the US. Its core business was in the shipping industry. It provided cargo shipping services between U.S. and the Caribbean Region. The firm grew rapidly; by 2002, there were approximately 300 employees in the organization, generating revenue from its asset up to \$80 million annually. After its existence for 17 years, the company was sold out to one of its competitors.

4.2.2 Company history

With his extensive experience in the shipping industry for 20 years, the bright young man and his wife decided to found this company in 1985. The company founded with the initial capital of \$300,000, which is pretty low for such a capital intensive shipping industry. With this minimal amount of fund, the company began with only 10 employees and 1 vessel. Within the first five years, the company grew rapidly; it expanded its businesses in term of both the territory coverage and vertical integration. Its serving territories grew from only 5 markets to 22 markets in various countries and islands in the Caribbean Sea. It forward integrated into agency, terminal and warehousing operation, stevedoring, LCL, and trucking businesses in both the U.S. and offshore. At the end, there were total of 7 cargo ships and 300 employees, operating in 3 offices in the U.S., 5 separate agency companies offshore, and other related businesses such as trucking company, stevedoring and LCL businesses. However, this growth also led the firm into very difficult situations of becoming uncompetitive. After its existence for 17 years, the company was sold to one of its competitors.

4.2.3 Company Profile

Vision

Be the company that provides consistently high quality services with regularly schedule in the place that there is no one can provide such a quality service.

Corporate Philosophy and Values

Corporate culture, directly influenced by the founders, strongly valued the high ethics in doing business. The company strongly believed that the good reputation of doing business was the critical part of the firm's success.

Management Style

The company management style was that the top managements actively and highly involved in almost all levels of the business. As a result, most of the decisions were done by the family members.

Major branches:

There were many branches both inside and outside the U.S., such as the US Northeast, the Southeast and approximately five foreign locations.

Subsidiaries

For subsidiaries in the U.S., the company owned trucking, warehousing, agency, ship operating, and stevedoring companies. For non-U.S. subsidiaries, there were 5 offshore agencies; most of them were in the Caribbean Region.

Employees

The company began its operation with only 10 employees and ended up with 300 employees.

4.2.4 Strategy

For the first few years of the business, the strategy was to provide the best service available in the region and using the strong reputation as growth strategy.

In later stage, the company's strategy was about the business expansion in both service territory and vertical integration, while maintaining the high quality services. This firm expanded into the new market by implementing the same high quality service, provided in the current regions to penetrate the new regions. For vertical integration, the company tried to provide one-stop services to the customers, by moving the other related services, with which the customers interfaced, into the company. It believed that with the total-services strategy, it was able to lock in the customers.

4.2.5 Competition

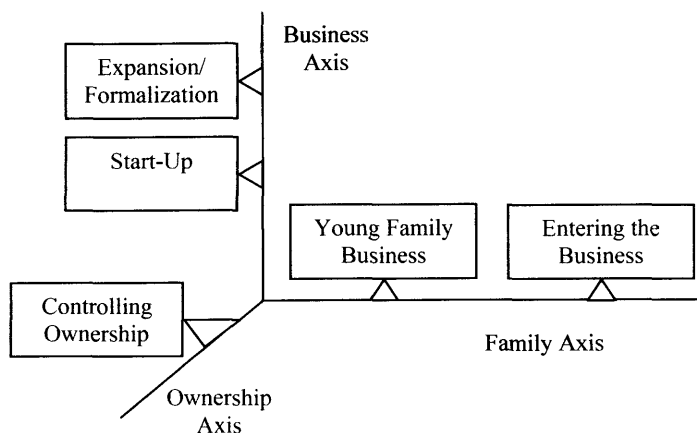
In the early stage of the business, the competition in the Caribbean Sea region was not high because there were few players in the industry. However, over the time, the competition became increasingly intense as the market evolved significantly and became more globalize. For instance, Dominican Republic, a country in the Caribbean Sea region, had been improved tremendously in term of its infrastructure, and human capitals. Therefore, it became easier to operate in this region and the barriers to entry were substantially lessened.

In addition, it had been regulated by the U.S. government that all the shipping firms had to show the shipping rates publicly to all customers; therefore, every shipping operator knew each other pricing strategy. Nevertheless, in 1999, the U.S. government decided to deregulate the industry by allowing firms not to publicly provide the shipping rates. Hence, this made the industry pricing invisible among operators. As a result, this increased the bargaining power of the customer to negotiate on the rates because of the little visibility of the competition.

Another consecutive disruptive force was that the biggest player in the world shipping industry, Maersk, came into this region in 2000. Because the market that Maersk had been served became mature, it looked for new market or territory for growth. As there were not so many companies operating in the Caribbean Sea market, it decided to enter this market. The worst thing was that Maersk imitated all the routes that this company served and it cut the price as much as 25%, forcing the whole industry to enter in the price war game. In the hardware point of view, it was easy for Maersk to imitate. However, in the personal service point of view, it was impossible for such an extremely large company to duplicate. It was easy and convenient for the customers to call and be served by the anonymous company. But for Maersk, customers had to call the call center, where the agents were located elsewhere away from this region and they had little knowledge about the market where the customers operated. Nevertheless, this superior personal interaction with the customers provided by the anonymous company was not enough. Costs to customers were the major concerns. But most of the time, customers gave chances to the company to match the price. It could not do anything but reduce the price to match Maersk's. Maersk operated in this market for two and a half years and decided to leave this region due to its substantial losses. It shut down the operation by overnight without considering the impacts to their customers who heavily relied on the shipping. Ultimately, it caused very serious damage to the whole shipping industry in this region – the industry revenue went down by 40% and the remaining players fell into the price war, operating with the extremely thin margin.

4.2.6 Analysis through the developmental model

Figure 4.2-1: The Anonymous Company Developmental Model



Family Axis

The family is relatively small comparing to the family of Sulpicio Lines. There are 4 people in the family, including one son and one daughter. Although he had no business education, the founder worked in shipping business for 20 years. He had a lot of experiences and contacts in the Caribbean Region. In the mid 80's, he and his wife decided to start up their own company serving in this area. According to the developmental model, it can be said that the family business was in the Young Family Business stage in the family axis. For this married couple, their personalities complemented each other very well. In many ways, the short coming of one person was well matched by the strong characteristics of the other. This helped balance the relationship between work and family life as well as create the workable marriage enterprise.

For the second generation, the daughter, whose educational background was in the area of Business Management, joined the company in Human Resources function. As she had less interest in the business, she played minimal roles in the organization. On the other hand, the son, who joined the company in 1991, was actively involved in the business and contributed to major expansion of the organization. He got his Master degree in Financial Management and Undergrad engineering.

Actually, the family did not really prepare the next generation for the Entering the Business stage in the family axis. There was no expectation from the parents that their heirs had to take over the business in the future. Also, the second generation did not have any intention to work in the family business. But the reason that they joined was that they did not have any work experience and know nothing about the business. From the interview, the son of the family said:

“I found myself handicap at some point after graduation as I realized that I didn't know much about the business. I thought that the most effective way to find out the most about business quickly is to work in the company.”³¹

For the Entering the Business stage, the son of the family was very committed to the company. He brought in the new ideas and perspectives to the organization. For example, previously, the

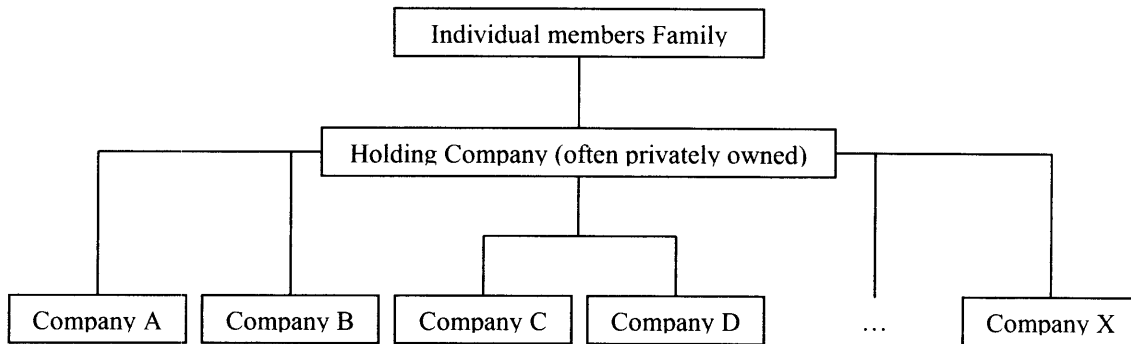
company used the memo system as the means to communicate and control the operations. He tried to introduce the documentation system, in which all the operation procedures were documented as manual books. This helped the company not to heavily rely on any particular employee. However, this initiative was not successful because it was difficult to change the ways people used to work. Another reason might be that there was no strong reinforcement from the top management or the founder. Another example was that he initiated the idea of having the Information technology system in the organization. In addition, he also tried to introduce the equity sharing plan for the senior employees. He believed that through difficult times, the incentives between staff and the owners were out of alignment. Many people worked very hard but the company was not able to pay the bonus due to the tough year; it was very demoralizing. He also believed that by giving some away, we would make the whole thing worth a lot more. This led the company to hire consultants to come in and construct a proposal, but the company was sold before the company could implement it.

Ownership Axis

At the Start-up stage in the business axis and the Young Family Business stage in the family axis, the company was wholly owned by the married couple. Even before the family dimension moved to Entering the Business stage, the parent tried to transfer the ownership to their siblings as much as possible because of heritage tax purpose. Nevertheless, all the company shares were still wholly owned by the family.

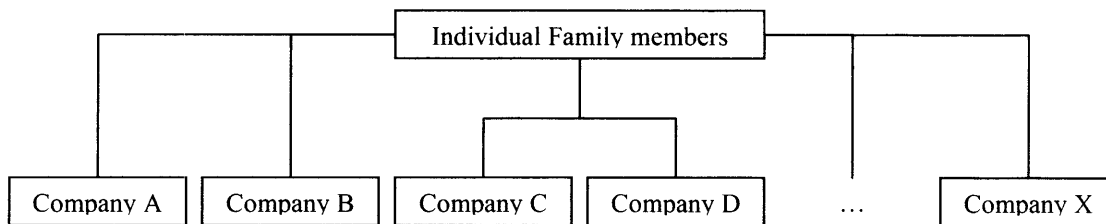
When the business dimension had evolved from the Start-up stage to Expansion/Formalization stage, the ownership structure became more complicated because there were many more companies in the group; for instance, agency, trucking, and warehousing companies. The ownership structure of the anonymous company is more complex than that of the traditional family business, where the family usually entirely owns the holding company. And this holding company possesses the majority of the shares in the subsidiary companies (Figure 4.2-2).

Figure 4.2-2: The Traditional Family Business Ownership Structure



In this case (the anonymous), the structure of the group of companies that owned by the family was flat because the members owned each company directly, not through the holding company (Figure 4.2-3). Each of them held unequally percentage of the shares of each different company. For example, the son was the major shareholder in company A, possessing 60% of shares, while he owned only 3% in company B, comparing to 50% of his father as the major owner, 40% of his sister, and the rest for his mother in Company B.

Figure 4.2-3: The Anonymous Company's Ownership Structure



The shares of each company were scatter and dispersed, which made the family vulnerable to risks of the fragmentation of ownership. This was because each family member could lead these different businesses in the way that they were not aligned with each other, reducing the effectiveness of the economy of scale. However, in this case, although the ownership was fragmented and distributed among family members, the associated risks were low because the number of family members was quite small, and the ultimate control of all businesses was under the founder, especially the father. Therefore, the ownership stage could be categorized as

Controlling Ownership stage, which is not too fragmented like Sibling Partnerships or Cousin Consortium stage.

Business Axis

In the Start-up stage of the business, the company was founded in the mid 80's with small amount of initial capital of \$300,000. It operated with only 10 employees and 1 leased vessel. During that time, the competition in the Caribbean Region was not high because the market environment was very difficult to operate and survive, dealing with many uncertainties from different cultures, ethics, and people. Though, with his extensive experiences in the shipping industry for 20 years, the founder led and managed the company to be able to provide the first best services in that area.

The factors that also contributed to the initial success were that the company came into the right industry at the right time, with the right services and the right strategies. For instance, at that time, no one in these developing countries could effectively manage various uncertainties and was able to provide very consistent shipping schedule between the U.S. and a country in South America. The company was the first that could offer such regular schedule direct services. Moreover, there were lots of competent people, who previously worked with state owned organizations and wanted to have better career opportunities, to be hired. They were very motivated. Thus, with all these combining factors, the company became very profitable and began to expand quickly.

In the Expansion/Formalization stage, the company not only expanded the serving territories from 5 markets to 22 markets in various countries and islands around the Caribbean Sea, but also established other related businesses. It forward integrated to operate and own the terminal operation and stevedoring companies offshore, both of which were very much labor intensive business. It was very challenging for a foreign firm to operate the stevedoring company in such small developing countries because there were many political issues in the countries as well as the company did not have any relationship with local government or people. So it was difficult to establish the business and hire labors over there. However, the company could overcome these

difficulties and was able to successfully launch its offshore operations. Moreover, it opened many agency companies in various countries in order to facilitate customers to ship with the company. In the U.S., it also operated and owned stevedoring company, two warehousing operations, and a trucking company that functioned along the east coast area.

All of the newly established businesses were set up to support the existing main business because the firm believed that moving all other services that customers had to interface into the company would help the firm to log in these customers and increase the customers' switch costs. Another reason for expansion was to move the high cost previously outsourced operations into the company in order to improve the company cost structure.

The company management style was that the top managements actively and highly involved in almost all levels of the business. The board of directors consisted of only family members. There was another management panel called Management Committee that consisted of all family members as well as outside professionals about 3-4 persons who were senior department heads from different critical business functions such as Financial Department. It was very difficult for non-family employees to be in the management committee because there were already so many family members sat in the committee. Thus, most of the decisions were dominated by the family.

For human resource management, there was no hiring standard in the organization. When the firm grew from the Start-up to Expansion/Formalization stage, where the company needed more staffs to grow, the company began to face hiring problems. Since the size of the firm became bigger, it was forced to decentralize the hiring decision to each department. In addition, hiring competent candidate was difficult due to the two factors, which are that (1) there were few people in the U.S., who were expert in the shipping industry; (2) in general, people in South Florida tended to have lower than average education. Consequently, without having the recruiting standard, human resource became real overhead of the firm. As the effort to improve employee productivity, the company had tried to implement the incentive system, but it did not work; therefore, there was no incentive scheme implemented in the organization. Career advancement opportunity was equally treated among non-family employee in the company. The company encouraged competent employees to grow, but slightly different from family members.

When a non-family employee was about to be promoted from one position to another position, he/she had to wait until that position became available. On the other hand, family members could be promoted to the position that never existed in the organization.

Information technology was extremely important to the evolution and the growth of the organization, especially for shipping industry. However, the company did not successfully scale up its IT system to match the growth and the increasing complexity of the organization. There were many more offices established both inside and outside the U.S. as well as new business operations such as trucking, and warehousing companies. The business processes of different types of businesses were distinct and needed to be treated differently. One explanation for this failure was that the firm did not understand the implications of the business processes, which became more and more complex as the firm grew, prior to the actual implementation of the IT system. It was needed to really understand the business processes and optimize them before use the IT to facilitate and support those optimized business processes.

Due to the rapidly and significantly increase in the size as well as the complexity of the business, the cost structure, which previously low comparing to its competitors, became uncompetitive. The management lost control on this regard because they could not have full visibility of what was going on in the company. Moreover, the competition in the market became extremely intense – the industry revenue went down by 40%, while the firm was not ready to battle. Profit and revenue continued to drop, while the businesses become more difficult to control and manage. The family became tired about this industry and then decided to sell the business to one of its competitors. One of the family members said:

“I didn’t really want to be there anymore. The industry was not that pleasant. It was really bad industry.”³¹

4.2.7 Key Observation from the Developmental Model

The Developmental Model allows us to view not only the development of each dimension simultaneously, but also the interactions and influences among the development of each

dimensions. The dimensions of developmental stages of the following observations are sequenced by business, family, and ownership dimensions.

1. Start-Up & Young Family Business & Controlling Ownership

In the early stage of the business, especially for the heavy investment business like shipping, the key challenge was that the firm needed adequate liquidity and funds in order to survive and grow in the future. In this case, although the company began the business with very low initial investment of \$300,000, with the knowledge of the market and extensive experiences of the founder, the company could operate in such the way that cost structure was pretty low, but service quality was the best available in the market. Therefore, it could generate substantial capitals for the future expansion. The strategy that the company used in the early stage was that it leased all the vessels and outsourced other related services to local companies; for instance, warehouse, container repair, stevedoring, and trucking.

2. Expansion/Formalization & Entering the Business & Controlling Ownership

The first key challenge is that the second generation began to work within the company. They came in with different perspectives and ideas from those of the founders. Although the founder or parents opened themselves to the new ideas, they did not really see the values or the benefits of implementing these ideas. For example, the son of the family initiated the idea of having a dedicated-use training room as well as having a complete training program (like a mini university). Although the parents had no objection and agreed with the ideas, in several iterations of budget allocations, the plans were out of the list. This was because training took time to see the results and it's tough to measure the benefits of implementing it. With the industry in a difficult time, it was always hard to justify additional overhead. However, the son still believed in his ideas as he said: "Inadequate training is a downward spiral – save a little in the short run, lose a lot in the long run".

Another key challenge is the evolution from the Start-Up stage firm to Expansion/Formalization stage firm, while it was still in the Controlling Ownership stage in the ownership dimension.

This requires the firm to change from the organization that few numbers of people or family members manage and control all the major decisions, to the organization that both family members and outside professionals manage and control various different business functions.

However, the management practice was not changed correspond to the evolution in the developmental model. The company still used the same management style that the top managements actively involved in almost all levels of the business, while the size of the firm became bigger. Unlike Sulpicio Lines, whose 36 family members working in the enterprise, with only 4 members the family was not able to thoroughly oversee and control the entire companies within the group. In addition, the family did not create the effective mechanism that allowed them to have full visibility of the organization and facilitated them to successfully manage and control the companies. Therefore, the company began to manage by exceptions – because there were so many things going on within the company, the family could get involve only the subjects that became problematic, while ignore the issues that had not yet shown the drawbacks or negative impacts. In addition, this also made the management lost sight of the big pictures because they got into the details of the problems. Moreover, non-family employees and managers did not have authority to make decisions, making them become more frustrated.

In addition to the problem that the company found difficult to attain good candidates mentioned earlier, its human resource policy also did not align with the evolution in the developmental model. As the firm grew, it definitely needed more people. However, there was no hiring standard to make sure that the company got qualified candidates whose background was match with the positions. Therefore, the quality of human resources was limited. Moreover, the company found difficult to find trustworthy and capable senior managers who could scale to the organization as the company grew. For instance, when the company had only 50 people and a trusted person was chosen to become head of certain department. However, once the company scaled up to 350 people, this person became not qualified for this position. Therefore, when the company grew up to Expansion/Formalization stage, it would have the problems of how to replace these people or how to find the ideal person for that job for the future.

Another impact of the evolution from Start-up to Expansion/Formalization stage in the business axis was that the company found difficult to maintain the corporate identity. As there were more people in the organization, the corporate culture of value the ethic in doing business, influenced by the founder, dissipated. For example, the employee, who had worked for 10 years, in the account payable function stole the company's money by forwarding checks to her fake account. Once the company culture, the thing that united people in the organization together, could not be instilled in employees; the company was needed to have some other control instruments to perform the same function as the corporate culture.

4.3 Halo LSI

4.3.1 Brief Overview

Halo LSI was founded in 1997 by Seiki Ogura, an electrical engineer from IBM. The core business is technology licensing in the area of flash memory. The company has invented many patented technologies, which provides fast, and cheap flash memory to end users. It has licensed its technologies to foundries, the factories and manufacturers that produce flash memory, in the U.S., Japan, and Taiwan.

4.3.2 Company history

Seiki Ogura, the bright young man came from Japan to the U.S. for the purpose of higher education. He studied at the University of California, Los Angeles (UCLA), where he received a M.S. and Ph.D. degree in the area of electrical engineering. With his incredible capabilities, he created a record in UCLA by obtaining his PhD within only 2 years. Afterwards, he did Post Doctoral work for another 1 year. Immediately after school, he joined IBM as a technology developer. During 25 years working with IBM, he created many breakthrough innovations, which became the key technologies. In total, IBM collected royalty and licensing fees of over 1 billion dollars from various foundries for his patents. At that time, IBM did not have any policy

to share revenue from inventions with the creators. However, he did receive some rewards and recognition from the company and industry due to his successful inventions. When he retired from IBM, he wanted to start a career as a businessman. He then decided to start his own business venture, Halo LSI. This company was founded in 1997 with help from his oldest daughter who served as an assistant as well as engineer. The first office was in the basement of his house. Over the years, the company has invented several generations of flash technologies of sufficient interest to third parties, so that it can receive licensing revenue substantial enough to expand its office, acquire new expensive equipment and hire more engineers. Right now, the company is in the process of applying the invented technologies to produce the real products to end users.

4.3.3 Company Profile

Vision

The company vision is not like the business-type vision but rather the vision of a technology creator. The vision of Halo LSI is to take the abstract ideas and turn them into something real and useful to the end users.

Corporate Philosophy and Values

In this small company, the corporate philosophy and values are a reflection of the single person, founder and CEO of the company. He values hard work, creativity, and respects the opinions of others. His philosophy is that making mistakes are ok as long as the individual put in his/her best effort. In fact, a consistent lack of mistakes means that there was a lack of aggressiveness and goals may have been set too low. The organization is quite loose, which means there are few rules and regulations. People are expected to work hard, but have autonomy to choose the direction of their technical assignments. Although there are many arguments within the organization, all of them are in the matter of work and help to generate ideas. All these factors align very well with the nature of the business as they encourage creativity in the organization.

Management Style

The founder/CEO of the company is actively involved in all aspects of the company. This is possible due to the small size of the firm and his extensive time commitment. He is aware of everything that is going on within the organization. However, he does not like to tell about what people should do. For example, if an employee does not work hard, he will not tell him to work harder. He will let this person realize this by himself/herself. He also highly respects other people's decisions. If an employee wants to leave the company, he will say "you should leave the company". He never asks this person to stay with the company even this person is important to the organization.

Major branches:

The company is headquartered in New York and also has a sales representative office in the California. There is a related representative office in Japan for dealings with customers in Japan.

Employees

There are 9 employees in the New York headquarters, including 3 family members, the CEO, and his two daughters. All employees are engineers; most of them came from Asian countries e.g. Japan, and Korea. A few of them are American. There is one VP of Sales and Marketing in California.

4.3.4 Strategy

The strategy is "best product strategy" (as described in Arnaldo C. Hax's Delta Model³²), which means the goal is to provide the best technology in the market. Halo LSI leverages the technical expertise and vision of the founder to develop new technologies for flash memory.

4.3.5 Competition

Competitors are those who develop the flash memory technologies that provide the same benefits or functionalities as Halo's technologies. Included in this group are formidable large companies

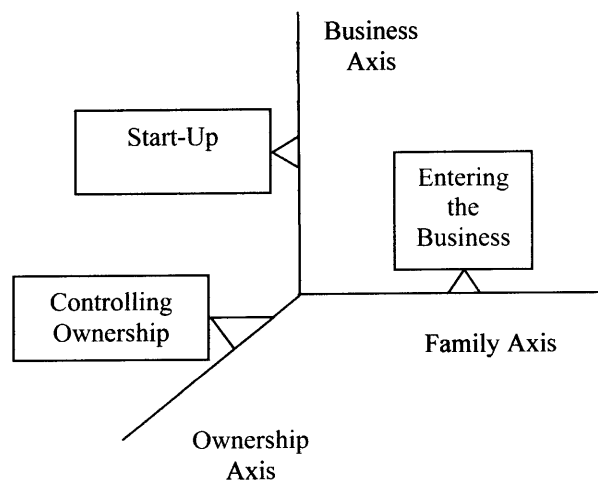
like Toshiba and Samsung, as well as smaller companies with similar technology development business strategies to Halo.

In this market, there are many start-up companies who also develop this type of technologies. Although their technologies have some fundamental flaws in the ideas, some are better funded as they are very aggressive and risk taking, raising couples of millions from VC funds and employ lots of professional management in order to make the tangible products. These companies were able to license to a number foundries due to aggressive sales and marketing efforts. They also look to IPO as a strategy to realize gain on their investment.

In contrast, Halo is more engineering-oriented. The company lacks of sales and marketing skills. The company's differentiating competitive advantage is the intellectual property (initially what was in the CEO's brain) that has been built up by the team over the years. Also the assembled team is highly efficient because there are only 1 or 2 people from each stage of technology development (process, device, circuit design, testing). In bigger companies, these disciplines are usually separated into different groups. But in this case, because they all work together in the same hallway, the CEO can orchestrate communication effectively so that the most optimized, non-overlapping solution can be found.

4.3.6 Analysis through the developmental model

Figure 4.3-1: Halo LSI Developmental Model



Family Axis

There are 5 immediate family members, which include Seiki Ogura as a family leader and the founder of the company, his wife and 3 daughters. Regarding preparation for the next generation to enter in the business, he encouraged and emphasized his daughters to study mathematics and sciences since they were young. He also strongly supported his daughters to pursue higher education in the engineering field. One of his daughters said about her father:

“You can study anything you want if it is engineer. You can also study other things as long as you study engineer.”³³

However, he did not encourage them to study for PhD. because he thought that it was unnecessary. He wished for them to be practical, and gain confidence from doing, rather than from an ivory tower degree. Therefore, the oldest and the youngest daughters got undergraduate degrees in engineering from MIT and Cornell University respectively.

When he first founded the company in 1997, he asked his oldest daughter to join the company. A few years after, the youngest daughter came back from college to join the company as well. Both of them are enthusiastically working in the organization. They are not “protected” by the CEO; if there are personal conflicts among the team members, he does not intercede. He lets his children figure things out for themselves. As he realized that the organization lacked business administration skills, he decided to send his oldest daughter to a business school with the expectation that she will be the future CEO of the company. So she attended MIT Sloan School of Management. He also recognized that in the future the business degree could be important for acceptance by other people, investors, partners and clients.

Family Support is very important and extremely strong. In the front room, there are many family members working very hard to achieve the objective; however, part of the success comes from behind the scene. The mother has an important supporting role to this business family. In addition, when one person has problems, everyone in the family will stop what they are doing to help. For example, when the second daughter got sick, the oldest daughter took a year off from

the college to stay home and help her sister. When the company had too much work, the youngest sister left half way through her master degree to enter into the company.

Ownership Axis

Ownership of the company is mainly controlled by the first generation; however, a small fraction is also held by the second generation. Therefore, the ownership axis is in the Controlling Ownership stage. However, in this company, stock options are also given to the employees for reward and incentive purposes.

IPO is one of the most popular options for start-up firms to grow and get some returns from the initial investments. There have been some investors interested in funding Halo's growth. However, after two years of evaluating different venture capitalists proposals, Halo decided it did not have any interest in the IPO option. The family realized that its style of business could not be considered a real business – from the point of view that it does not aim to maximize shareholder value, but rather the family and workers. Therefore, the company is still self-funded. In order for the employees to realize gain from their stock options, the company has decided to implement a stock buy back program.

Business Axis

The board of directors consists of only family members, Seiki as CEO and the Chairman of the board, his wife, and oldest daughter. The youngest sister who also works at the company is not a board member. All the decisions in the company, both business and technology, are made by the founder/CEO.

When the company was first founded in 1997, it began its first task with a licensing project. The company had a single patent, which was written by Seiki after he left IBM. This idea was for a new type of flash memory, which had higher performance than the existing products. The first project, of which the customer was one of the major consumer electronics companies in Japan, included a licensing fee of half a million dollars, which allowed the company to hire more people

and invest on new equipments and software. Then the company developed the technologies and targeted how to approach the Japanese market, which is the home country of the family. In the beginning, there were several Japanese manufacturers interested in the technology and Halo also received support from the Japanese government.

Unfortunately, the economy in Japan became worse, and the projects were terminated. Japan lost its manufacturing power to lower cost, high quality manufacturers in other countries like Taiwan and Korea. In the period from 1995 to 2000, Japan shut down a lot of manufacturing sites and laid off many workers for the first time in its history. Even though Halo wished to help its home country, because of the tremendous environmental forces, the small company had to shift its focus in order to survive. Actually, at the beginning, many Taiwanese manufacturers were interested in Halo's technologies and requested for licensing them. However, Seiki's choice to help Japan first was a result of his personal ethics and nationalism. He was aware that Japan's manufacturing would lose competitiveness. The decision was not a business-like decision but rather family- or personal-like decision. Two critical years of development and opportunity were lost in which the company needed to reset its progress and new entrants gained momentum.

Currently, Halo has developed various different types and applications of the flash memory technologies to the market. It has licensed its technologies to some foundries in both Taiwan and the U.S. It still continues to be self-funded. Most of the revenue comes from the licensing agreements, which usually involve a few couple millions up front, to cover the engineering costs, tools and equipments for a few years before royalty income begins.

Information Technology is very important to the company. It spends its limited funds very heavily on software Computer Aided Design (CAD) systems. Even though the company is a small company, it spends a ratio of payroll:software of about 2:1. The industry standard CAD tools costs about \$200K for a single set. Recently, renting on a time-based license has become more popular, which helps its annual budgeting. In addition, when the company has money left at the end of the year, it usually spends on the software or equipments. These software and tools can greatly enhance the productivity and output of the team. Also the quality and depth of analysis during technology testing are very keys to success of the technology development.

The company has not had formal human resources management function. This function is shared between the CEO and the eldest daughter. She takes care of the administrative aspects and he does the hiring. The engineers that were hired came from personal contact of the founder. As he is an IEEE fellow, the engineering society fellows, he knows many university professors in various countries. They usually send their best students who want to have chance to work in the U.S. In addition, many of experts in this field are found at conferences. Halo usually tries to keep relationship with these people.

The employees, who work hard and prove dedication to the organization, get better recognition, compensation, and traveling opportunities. However, there is no promotion because the company structure is flat and there are not so many people in the organization. Regardless, most of engineers work hard under these conditions, because they are self-motivated and the work is personally interesting to them.

The CEO also maintains a gap between young inexperienced and experienced employees. For young employees, this strategy is due to the limited financial and personnel resources. The company cannot afford to fill each task position and level. Halo usually hires the people, who are just right after graduation. For the experienced employees, the company hires experts with many years of experiences in this field. The gap represents career opportunities for the inexperienced to grow within the company, encouraging them to work harder, and take more roles and responsibilities in the organization. Because hiring only experts is too costly, key positions are filled with experts, while the rest were filled with young people who are advised by these experts.

With respect to the key experts, most of them usually have 15-20 years of experience, which means they tend to be older with families. Thus, job security is very important; Halo wants to minimize their start-up company risk. Halo makes sure that the project that they are working on is stable and secured, before bringing in the experts. So far, the company has not had any engineering turnover in the past 7 years. This low turnover could be due to the Asian loyalty mentality of most of the workers, and also due to the strong relationships within the company.

Everyone talks to the CEO about his/her challenges in work as well as personal life. Besides work related issues, children or marriage problems are topics that these engineers talk about to the CEO. Therefore, the CEO pretty much knows everybody's mental and emotion stage at all time, which allows him to better manage his group.

Halo had some experiences trying to hire professional business people. One person came into the company to be the CEO, and helped raise funds, but the relationship did not work out. This CEO's working style was very business like, while Halo was deeply rooted in its engineering and family business culture. The family was frightened by the CEO's actions and assumptions. They realized the risk to the company and technology, and asked this CEO to leave the company. This experience made the family realize that they did not like the way business people made assumptions. Therefore, the company decided to send the oldest daughter to business school. A business people who also understood technology as well as the engineering culture family business management style were needed. It should also be noted that Halo had the most success with a Marketing and Sales VP who had both PhD. in this field as well as MBA. One family member said:

“Maybe the lesson to take from this is that the professionals that can understand the family people's values will have the most success gaining trust and communicating effectively.”³³

However much as this VP of Marketing and Sales, contributed to the organization, he was not happy about the company's decision to avoid investment. Being a business person, he wanted to see faster growth for better chance of success and stability. He wanted to license the technology to more foundries but the founder did not agree with the idea. The founder does not want to risk too much from the growth. If the company grew too fast – hire many more engineers to support these foundries, if a difficult time should come, the CEO wanted to ensure that the company can manage to pay everybody. Also, the CEO did not want to risk too many manufacturers' money. He thought that two to three foundries should be enough to prove the technology idea. After that, he believes that the real business will start.

The family has almost concluded that it does not want to become a professional organization. However, in order to capture the value that has been created; a separate company may be established in the future. This company will probably have more professional management and business orientation. This strategy may be good because a business-oriented culture might not be suitable for the engineer organization. In order to encourage innovations as well as market these inventions, the family needs another company that have different culture and mindset for selling the technologies, whereas the existing one is the engineering or innovator company.

4.3.7 Key Observations from the Developmental Model

The Developmental Model allows us to view not only the development of each dimension simultaneously, but also the interactions and influences among the development of each dimensions. The dimensions of developmental stages of the following observations are sequenced by business, family, and ownership dimensions.

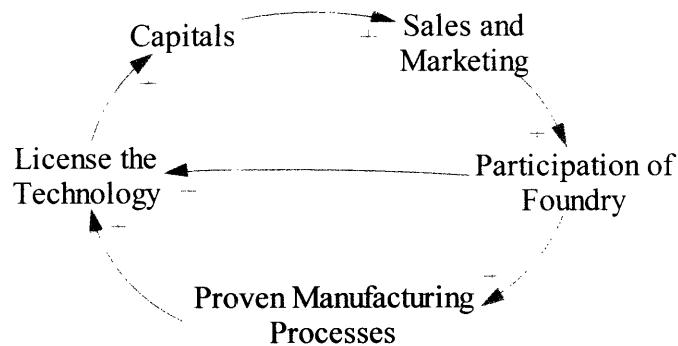
1. Start-Up & Entering the Business & Controlling Ownership

In the early stage of the business, liquidity and capital are extremely critical. With limited funds, the family members work longer hours for lower salary than they could earn at other companies. But at the same time, they enjoy much more responsibility and voice in the company's operations. However, the restricted capitals have caused many difficulties to Halo. Because it decided to do self funding and refuse to receive funds from investors, in many occurrences, Halo finds difficult to compete with the competitors, who are better funded. These rivals raised investors' money and had better sales and marketing, so customers have better perception toward their technologies.

Another problem is that the technology is not mature yet, which means that reliability, yield, and proven manufacturing process have yet to be demonstrated. Halo's technology is feasible based on the theory; however, it has not been proven yet that this technology can be manufactured to become a real tangible product. In order to prove with hardware, a company needs to invest

about \$50M and 1-2 years of process development, of build, test, debug, and build again. The whole process takes time. Therefore, it seems very difficult for Halo to move from Start-up stage to Expansion/Formalization in the business axis. The diagram below demonstrates the vicious cycle of this phenomenon.

Figure 4.3-2: Vicious cycle for Halo’s Business Expansion



The company needs more capital to enhance its Sales and Marketing efforts in order to invite foundries to help test the technology by manufacturing the real product based on Halo’s technology. If the manufacturing is success, and the technology is proven, this will facilitate Halo’s ability to generate more capital from licensing. However, in this case, because the CEO refuses investors’ funding and the company finds difficult to transform itself from a technology-developer company to a product company. This makes the company difficult to grow.

Nevertheless, the definition of success is the key. In the framework of “create-capture-deliver value”, the CEO’s skill is in creating value, but not necessarily in capturing or delivering. His talent is creative technology development to match industry needs. However, he does not follow the mainstream business way of thinking. All family members agree that success of this technology to become product is success. CEO wants success on his terms. He does not want to take investment and jeopardize his integrity or hurt his children’s reputations by losing other people’s money. This attitude could be hindering the company from becoming a big company. Or it could be proven to be a good way to do business if the company does become successful. Only time will tell.

5. Unique Characteristics of Family-Owned Enterprises

In order to clearly understand the dynamics of family businesses, which will be discussed in the chapter 6, I would like to discuss more about the family businesses: common characteristics that found in most family companies, as well as their limitations.

5.1 Characteristics of Family Business that Contribute to its Success/Failure

5.1.1 Willingness to Carry On the Ownership of the Family Business

One well-known characteristic of family firms is the commitment to carry on the ownership of the firms to the next generation. Unlike family-owned businesses, many non-family enterprises are motivated to perform based on profits or sales revenue, encouraging them to focus more on short-term achievements. In contrast, the sense of ownership and the willingness to pass on the business to the next generation make family firms focus more on the long-term objectives rather than short-term ones. From the research on family business done by McKinsey, suggested the same result.

“None of the family members interviewed in this study quoted the quarterly performance of the companies or even their performance over 1 or 2 years. The minimum period mentioned was 5 years, and one to two decades was more common.”¹⁸

Due to their sense of ownership of the business, family-member managers tend to be more dedicatory, honest, and loyal to the organization than non-family-member manager. That can be the reason why many non-family organizations try to implement incentive schemes that based on the long-term objectives such as the company stock performance.

5.1.2 Willingness to Carry On the Values and Traditions of the Family

Another characteristic of family businesses is the powerful commitment to values, passed down through generations. Long history of values and tradition of a family can behave as informal norm or rules that hold family members together. The pride and sense of belonging that come with carrying on a family tradition not only strengthens the willingness to carry on the business ownership as they want to keep the business in the family, but also minimize the conflict within the family. This, in turn, helps smooth the succession process in generation transition.

5.1.3 Unique Corporate Identity

The key difference between family-owned enterprise and non-family-owned enterprise is that family-owned company tends to have more personal touch from the corporate identity than that of non-family-owned company. Family company can provide a warmer environment or has more personality into its corporate culture and values, which people from both inside and outside usually like and are able to feel it, not only customers, suppliers, but also internal employees, who can feel the sense of belonging.

For example, clients of Sulpicio Lines can get in touch with the company anytime – even through the managements' cell phones comparing with the large multinational company, who provides the channel only through the automatic call center system. Li & Fung, the multibillion dollars company, has the corporate culture that is strongly influenced by the family – the company has a strong sense of Chinese tradition. It expects loyalty and rewards diligence for its employees. Managers are rewarded strictly on a high profit sharing model.

5.1.4 Conservative and Risk Averse

Another well-known characteristic of family business is that they are conservative and risk averse. This is because family businesses usually consider the negative outcomes from its

decisions in taking any risk that would be passed to the next generation. McKinsey also found out the same conclusion that “these companies are performance oriented but risk averse, which might make them less successful in boom times but keeps them alive, with healthy profitability, over the very long term.”¹⁸

5.1.5 Fragmentation of the Family

The more family has aged, the more generation it has. Once the family has more people, it is not easy for all of them to spend time together. Each of the family branches tends to have its own activities. Members in the same branch are likely to be more intimate with each other than with those who are not in the same branch. As the family becomes more fragmented, each subgroup tends to focus more on its own interests rather than the family as a whole. Therefore, this amplifies the political forces within both the family and the family business, reducing the ability of the firm to get consensus and promptly respond to the disrupting changes.

However, positive relationship among siblings from different branches also helps reduce the political forces from the family fragmentation.

5.1.6 Fragmentation of the Business Ownership

Fragmentation of the company ownership is typically creates negative consequences to the family business. This factor plays more important role when the family business moves into the Cousin Consortium stage, where the shares of the company are distributed to various family members in third generation. The ownership control is exercised by many cousins from different sibling branches, but no single branch has enough voting shares to control all the decisions. This factor eventually increases the political force in the organization as it become tougher to get agreement in making any decision, and then leads to the decline of the company’s competitiveness.

Moreover, this factor also reduces the willingness to carry on the ownership. The family shareholders do not have adequate voting right to involve or control the business, there is less incentive for these people to hold the company shares. This can lead the family shareholders to trade the shares to outside (non-family) investors. Therefore, the chance that the company is handed over to the next generation is also reduced.

5.1.7 Smoothness of Succession

The succession planning is very crucial for the family business and it has been the issues that various articles in this field greatly discussed.¹⁹ From the statistics of the world family businesses, approximately 30% of family businesses make it to the second generation, 10-15% make it to the third, and 3-5% make it to the fourth generation.²⁰ Therefore, the smoothness of succession is the very critical issue that minimizes the negative consequences of the generation transition, and enhances the long-term survival of the family business.

The smoothness of succession is affected by various factors; the obvious examples are the fragmentation of the family, political forces in both family and business, and family traditions and values passed down from generation to generation. In addition, competent leaders in the family business tend to help smooth the succession process.

5.1.8 Less interest in the business

One reason that can explain the above statistics is that the next generation family members have less interest in the business. During the early stage of the business, the interaction or the level of involvement of family members to the business is very high because survival of the company is very important in this stage. However, once the business has been established for a while, survival issues of the company tend to be less important comparing to the early stage. In addition, there are many more family members in the business, allowing some family members to choose the career according to their interests other than the existing business. That only 10-15 percent of family firms make it to the third generation is partly caused by the third generation,

who wouldn't have any interest in the business by this time. In the case of Sulpicio Lines, they are aware of this issue. From the discussion with one of the family members, who is also in senior management position in the company, she said

“I am aware that most of the overseas Chinese firms are in this position right now. We are trying to avoid this situation and so far we are succeeding. They are brought up with the company, meaning, we have exposed to the different operations of the business as young as 10 years old. It has been instilled in us that we will be taking over the business someday. In this way, we learn to like going into business in the company.”³⁴

5.2 Limitation of Family Business

5.2.1 Limited Ability to Consistently Generate Competent Leader

It is impossible to expect a family to constantly generate proficient successors to lead the family business. While family firms tend to pass on the leadership only to siblings or relatives, non-family enterprises do not restrict so; they open their leadership positions to any highly talented professional to lead the companies. Thus, non-family-owned enterprises have greater possibility to have talented business leaders to run the organization than family-owned enterprises do.

Although the family can generate competent leaders, how many of them the family can create. When the firm grows up and the business becomes increasingly complex, with the limited capacities of few leaders, the company will find difficult to grow.

5.2.2 Limited Number of Family Members, Who Lead the Business

The number of family members who can work in the company is limited because the pool of candidates for family business usually comes from the family members, relatives, or the persons who has relationships with the family.

During the early stage of the business, only single owner-manager and/or a number of family members are able to effectively manage the entire organization as they can control all aspects of the firm in details. However, when the firm grows and evolves from Start-Up stage to Expansion/Formalization stage, the size of the firm increases. The company is required to establish many separately new departments to perform specific business functions; for instance, the establishment of Human Resources, Strategic Planning, or Information Technology departments. With limited number of family leaders, it is difficult for the family to control the entire organization.

5.2.3 Limited Number of Talented Non-Family Employees

Nepotism is the common practice that many family-owned companies usually use in selecting the successor or hiring employees. Many family businesses believe that people who are family members, relatives or whom they know are more trustworthy and more loyalty than those who are not. They also believe that these people tend to have more dedication to the firm than those who are not.

Therefore, family-owned company prefers to hand over the business to family members rather than to non-family members. In addition, the recruiting policy usually depends highly on the relationship with the family.

Family business usually evolves from a small firm controlled by a single owner-manager to a larger firm controlled by distributed-authority outside professional managers in various business functions. The business requires more people to be filled the positions of each function. However, it's quite difficult for family-owned enterprises to attract and retain highly competent employees because nepotism limits career opportunities of these non-family employees and thus deteriorates the incentives to work for the family business. Hence, the quality of human resources is also limited.

5.2.4 Ability to Operate Effectively and Efficiently

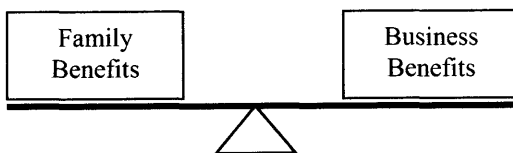
This limitation also comes from nepotism. As many of family firm' employees are hired by the relationship with the family, it is likely that the family enterprise underperforms the competitors that can allocate the right person to the right position. The employees, who are hired by having relationship with family rather than having the required skills and capabilities, cannot perform as effective or efficient as the ones who are experts in those particular fields. In addition, the limitation of the human resources quality, mentioned in section 5.2.3, also negatively affects on the ability of the company to operate effectively and efficiently.

For example, there are many loyalty employees, who have worked for Sulpicio Lines for decades; however, these people are not the best people for those positions. They are hired because they know the family. Right now, Sulpicio Lines are trying hard to improve its operation efficiency as they realized that there is still a huge performance gap between its business operations and the best practices.

In addition, because working style of family company is more informal comparing to non-family-owned organization, the business processes of family business are not very well organized e.g. lack of organization design, or operational effectiveness and efficiency³⁵.

5.2.5 Tradeoff between Family Benefits and Business Benefits

Figure 5-1: Tradeoff between Family Benefits and Business Benefits



Most of the time, the family benefits and business benefits are not aligned and contradicted. If the family focuses more on the benefits to the family, the benefits to the business tend to be less.

One obvious example is Nepotism that mentioned earlier. Nepotism makes the family happy as family members have better opportunities in the organization than outside professionals. However, the business suffers from Nepotism as the quality of human resources is limited.

Another example is that, from the case studies, if Sulpicio Lines keeps continue its family tradition that the most senior family member is the one who will take over the business, while there are other family members who have higher capabilities and could become great business leaders in the future, the future success of the company seems to be restricted by the ability of that senior person.

In case of Halo LSI, although all family members agree that the success of the business is to make the technology become a real tangible product, the CEO wants success on his terms. He does not want to take investment and jeopardize his integrity or hurt his children's reputations by losing other people's money. He is not afraid of risk, but that is not the type of risk that he wants to take. This attitude could be hindering the company from becoming a big company.

6. Important Dynamics of Family Business

After studying from various books and articles around family business management, organizational changes, and business transformation issues, I researched on multiple case studies of family-owned enterprises in both successful and unsuccessful cases through readings from books, journals, and articles, as well as interviewing with many family members and senior managements. By analyzing the gathered information, I found the important dynamics of family-owned enterprises, which can be captured and explained by the following system dynamics model or causal loops diagram. For the next three chapters, this system dynamics model will be used as a main tool to suggest and discuss about keys to transform these family-owned enterprises for success and long-term survival in changing markets.

In order to effectively understand the findings of this study, it's required to be able to read or interpret the system dynamics diagram. For the one who is not familiar with this tool, you can find how to interpret the system dynamics model in the Appendix A.

All the dynamics arise from the interactions of just two types of feedback loops, positive (or self-reinforcing) and negative (or self-correcting) loops.³⁶ From the system dynamics diagram above, the important positive and negative feedback loops are as follow:

Positive Feedback Loops

1. Value & Wealth Creation
2. Diversification or Business Expansion
3. Professionalism
4. Transformation
5. Board of directors
6. Willingness to Represent Each Own Family Branch

Negative Feedback Loops

1. Manageability of family members
2. Organic forces
3. Business complexity

In order to clearly understand the dynamics of family businesses or the interactions between the positive and negative feedback loops, I would like to first discuss about the critical factors that affect these dynamics of family firms.

6.1 Factors that Affect the Dynamics of Family Business

6.1.1 Forces that Pressing the Family Firm to Change

The forces for the organizational change come from both internal and external. Kanter, et. al., suggested the forces that characterized the dynamic of organizational changes. He categorized these forces into three clusters, which are the environmental forces, the political forces, and the organic forces. The environmental forces can be viewed as the external forces to the firm, which mean the firm cannot directly control these forces. The political forces and organic forces are

viewed as the internal forces caused by the firm itself. All these forces can affect the company's relative competitiveness, value and wealth, and thus the longevity of the organization.

Environmental Forces

The environmental forces include all external forces such as the changes in technology, economy, political structure, and competitive environment due to globalization. For example, the technological improvement alters customer expectations because it offers new way to create and deliver value. Deregulation allows new players with totally different business models enter in the market. These forces can reduce the relative competitiveness of the firms to their rivals, thus affecting their value and wealth.

Political Forces

These forces are the forces within the organization. Due to the differences in priorities, and interests, the interplays of individual groups within the organization can reduce the ability to react to the changes, and also impact the longevity of the firm. Managing political forces in family businesses is much more complicated than that of non-family owned companies because non-family-owned enterprises have only 2 components, business and ownership; while family-owned enterprises have 3 intersecting components, business, ownership, as well as family.

Organic Forces

These forces involve with the internal forces that can be threaten the survival of the firm. For example, small start-up firms may be more entrepreneurial and have higher flexibility; while the mature firms become inflexible, bureaucratic and too complex to be managed, limiting themselves to quickly adjust themselves to the market or environmental changes.

An apparent example of these forces that affect the family firms is as follow: When family firms become successful from the dedication and hard working of competent family members, the value and wealth of these firms increase, allowing them to reinvest and grow into the future. However, the prosperity of the market attracts more players to enter in the game. If the

incumbent family firms cannot maintain their competitiveness comparing to the rivalries e.g. the firms become so complex that they cannot be managed properly by family members (organic forces), or if there are far too many conflicts within the organization, reducing the ability of the firms to react to these new entrances (political forces), or if the new players enter the market with new technological improvement or innovation (environmental forces), these new participants are able to provide superior products or services to those provided by incumbent family firms. Therefore, only businesses that can redefine themselves to cope with these changes can achieve long term survival and be able to success over those that cannot.

6.1.2 Professionalism

Professionalism can be viewed in three dimensions, which are (1) the human resource management e.g. the quality of human resources, or the allocation of the right people to the right places, (2) the proper authority delegation to non-family managers, and (3) the efficiency and effectiveness of the business processes and operations.

Human Resource Management

The professionalism of human resource management is about the ability to possess talented and competent employees, to attract and retain these skillful employees, and to allocate the right person to the right position. Roles and responsibilities of each position should be clearly defined. Although training is time consuming process and difficult to quantify benefits, it is very critical to any organization. Training is required to provide workforces necessary skills to well perform their assigned tasks, and to keep them update to the new vital knowledge. Incentives and performance appraisals are very important for the firm to encourage and motivate its people to achieve the firm's objectives.

In addition, the Human Resource Management dimension is highly related to the third dimension of professionalism, Business Processes and Operations because without good quality of human resources, it is difficult to have effective and efficient business processes and operations.

The Proper Authority Delegation to Non-Family Managers

When the firm is still in its early stage, the founder usually controls and makes all decisions in the company by himself/herself. All the decisions and strategic planning are done by intuitions and experiences of this entrepreneurial founder. However, when the firm grows up and becomes bigger in term of size and complexity, the individual founder or only family members are not able to manage all the aspects of the business. The firm needs to have the mechanisms that allow the business decisions to be delegated to non-family managers in order to prevent bottleneck problems, having all issues escalating to the founders or top management level.

However, the decision making process should be relied on facts or data rather than the personal judgments of any individual manager. It helps not only to have better decision making process, but also prevent the business to be depended highly on particular person.

Business Processes and Operations

The professionalism of this dimension involves with the ability of the firm to operate and doing business in the effective and efficient manners. The appropriate information technology system is usually needed in order to make accurate and timely decisions. The documentations of the business processes are also important because the firm should not depend highly on particular experienced employees. These documentations allow not only new employees to learn how to perform the tasks, but also the company to review and improve its business operations.

The professionalism in these three dimensions improves competitiveness and flexibility of the firms to transform themselves corresponding to the changes in their market. It also strengthens the ability of the firms to generate value and wealth through growth, while minimize the negative consequences of this growth.

6.1.3 The Quality of the Board of Directors

The board of directors is particularly important to family firms as it brings in new insight ideas or strategic perspectives from the qualified outsiders to the family business. Even though the family holds all of the shares in the company, the board of directors should include a significant proportion of outside directors. These boards should highly involve in top-executive matters and act as a panel to discuss and formulate the corporate strategy in details.

6.1.4 Education and University Sponsorship

Most of the successful family-owned enterprises value the importance of education as a key success factor.

Many Asian family enterprises encourage their siblings to study in the U.S. or have western educations; for example, Victor and William Fung, the key leaders of Li & Fung, a billion dollar company in Hong Kong, both graduated from Harvard University. In addition, these family companies also provide some financial supports or scholarships to talented individuals who do not have enough funds to continue their studies. Tata Group founded the J.N. Tata Endowment Trust to provide loan scholarships for Indian nationals with outstanding academic records to study aboard for higher educations.

Some family businesses do beyond preparing good educations to the next generations or giving sponsorship to young talented individuals by collaborating with major universities. They sponsor the universities in order to get access to the pools of brilliant applicants. For example, SC Johnson sponsors Cornell University to establish the business school, Johnson School of Management. Tang family, whose main businesses are in Hong Kong textile industry, donated substantial amount of funds to establish the classroom building for MIT Sloan School of Management.

6.2 Important Loops in the Business Dynamics of Family Firms

As I already discussed in section 6.1 about the factors that can impact the family business system, I would like to explain more about the positive and negative feedback loops in this section. From the system dynamics model presented earlier, there are so many factors as well as the feedback loops (both positive and negative) in the system. They are all interacting with one another. In order to make this model more understandable, I would like to highlight each part of the system and discuss it in more details.

6.2.1 Positive Feedback Loops

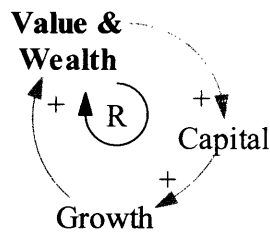
Positive feedback loops tend to reinforce or amplify whatever is happening in the system. In this study, there are 6 important reinforcing loops.

- I. Value & Wealth Creation
- II. Diversification or Business Expansion
- III. Professionalism
- IV. Transformation
- V. Board of directors
- VI. Willingness to Represent Each Own Family Branch

I. Value & Wealth Creation Reinforcing Loop

When the business begins to grow and move from the Start-up stage to the Expansion/Formalization stage, the value and wealth of the firm continue to increase. It can accumulate more capitals and funds for the future growth. Once the firm reinvests and grows, having more assets, it can generate more revenue and profit, which then reinforce to increase its value and wealth.

Figure 6-2: Value & Wealth Creation Reinforcing Loop



With this positive feedback loop, the firm can grow and accumulate wealth indefinitely. However, this is not the case in the real world. There are other factors that will stop or slow down this reinforcing dynamic.

One obvious example is when the firm grows up and be able to generate substantial revenue and profit; this attracts more players to enter in the market. Therefore, the change in competitive landscape, acting as the environmental force, slows down this reinforcing dynamic. There are also negative feedback loops that counter this reinforcing dynamic, for example, organic forces, the complexity of the business, and the ability of family members to manage the firm, which will be explained in more details later section.

II. Diversification or Business Expansion Reinforcing Loop

Business expansion is a common strategy that family businesses usually pursue. They often expand the business into the related area in order to support the existing business. Sulpicio Lines expanded to container hauler business or machine maintenance business in order to support the existing shipping business. Another reason is that these new entities can serve not only its own present business, but also serve other companies.

Diversification strategy is another strategy that most family business pursue in order to achieve steady profitability and survival over shifting business cycles. McKinsey conducted interviews with 11 family-owned businesses. Of the 11, 7 have revenues of more than \$10 billion. Each has delivered growth and profits over recent decades and is financially solid, with low debt-to-equity ratios. It found out that all of these family businesses see themselves as conglomerates, not as

single-business companies. While some have a wide array of unconnected businesses, most focus on two to four main sectors. They all seek a mix between businesses with high risks and returns and businesses that have more stable cash flows.

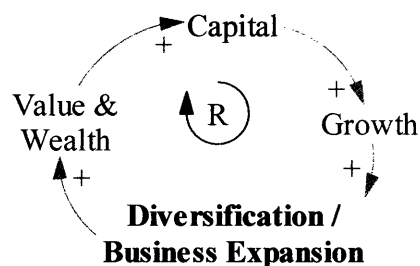
This strategy might not make sense for a purely financial investor according to the two important assumptions, which are (1) we are talking about individual investors who can diversify, and (2) the markets in which these investors function are very well developed like the stock market in the U.S. The case of family business is always an exception on the first condition (nearly by definition, the family has most of its money invested in that firm and the only way for the family to diversify is to have the firm become a conglomerate). Second, the big conglomerate-type family businesses are most common in countries where financial markets are not as developed as in the US, so that it still makes sense for a company to diversify for its shareholders.

The argument here is that these family firms choose to diversify by owning or controlling some businesses rather than by just selling them off and investing the proceeds in the (global) stock market. It is not that the family cannot diversify through the stock market, but that it prefers to diversify through the firm even though such firm diversification is more costly than stock market diversification. The family is not optimizing returns but seems to be willing to give up some returns in exchange for control. Control has other benefits than simply financial returns. One explanation can be that family-owned businesses undoubtedly offer non-economic benefits too: a respected position in society, the pride and the sense of belonging that come with carrying on a family tradition, and the chance for some members to work in the business and for others to pursue shared interests alongside it.

Tata Group is a good example of highly diversified family company. Tata group, led by Ratan Tata, has 80 companies, which categorized in 7 business sectors, which are consumer products, materials, chemicals, energy, engineering, services, and communications and IT. Tata sells everything from coffee, tea, watches, soda ash, and steel, to hotel services and information-technology consulting. Another example can be Hutchison Whampoa, a multinational conglomerate led by tycoon Li Ka-shing in Hong Kong. The company's five core businesses

include ports and related services, telecommunications, property and hotels, retail and manufacturing, and energy and infrastructure.

Figure 6-3: Diversification or Business Expansion Reinforcing Loop



Once again, like the Value & Wealth Creation positive feedback loop, as the family firm continues to grow and is able to accumulate more funds or capitals for reinvestment, it can expand the business to the related business areas or diversify to other different areas for future growth. Thus, this, in turn, strengthens the financial position of the firm, reinforcing to have higher value and wealth.

III. Professionalism Reinforcing Loop

The Professionalism reinforcing loop is one of the most important dynamics that drive the success for family-owned enterprises. The professionalism can be interpreted into three dimensions as described in earlier section, Human Resource Management, The Proper Authority Delegation to Non-Family Managers, and Business Processes and Operations.

Many people think that the success of the family-owned enterprises is depended highly on the competency of the family members. In fact, it is partially true. The highly qualified family members may be able to bring the family organization success in the beginning. However, this may not sustain in the longer term. Due to the limitation of family businesses mentioned earlier e.g. they might not be able to generate capable leaders for next generation of the business, or the firms grow so fast that the business complexity becomes impossible for only the family to manage and control.

if their competitors begin to tap their top-tier customers. Therefore, professionalism also improves the company's ability to transform.

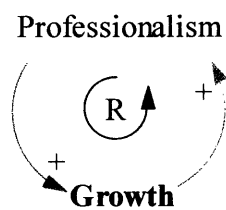
With the improvements in all spheres through the professionalism, the competitiveness of the firm will increase, allowing the company to generate more revenue over its rivals. As a result, this reinforces the company to be able to generate more value and wealth and continue to grow indefinitely.

In order to impose or implement the effective and sustainable policies for achieving long-term success and survival through the professionalism, it is important to discuss about the factors that enhance or deteriorate the professionalism of family enterprises.

Factors that affect the professionalism

A. Growth

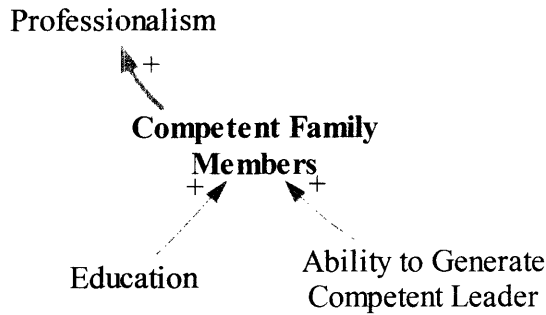
Figure 6-5: Growth, Factor that Affect Professionalism



The growth of the firm tends to reinforce the professionalism of the company. As the firm grows, the company is required to hire more outside professionals, improving the quality of human resources, or to acquire some Information Management systems to do some data crunching, or to establish specific business functions and then delegate authorities to these functions as the firm becomes bigger and more complex.

B. Competency of Family Members

Figure 6-6: Competency of Family Members, Factor that Affect Professionalism



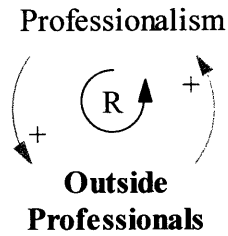
Competency of family members, who join the business, is another factor that strengthens the professionalism.

Ability to generate competent leader is about how to prepare the next generation the capacity to effectively managed and control the business in the future. Don Sulpicio believed that the earlier the next generation involves in the business, the better capacity in managing the company they have. This belief is passed from generation to generation in Sulpicio Lines e.g. the third generation has exposed to the different operations of the business as young as 10 years old. That the children grow up watching their parents run the business through good and bad time makes them internalize their parents' attitude and value about the firm.

Again most of the time, education is a critical ingredient for developing proficient family managers. On the other hand, if the family cannot breed qualified leaders, this factor, in tern, deteriorates the professionalism of the firm. For instance, these family-member managers might not be able to see the value of utilizing IT to facilitate the business operations due to substantial up-front investment, or they cannot see the opportunity to integrate the supply chain – pursuing global supply chain optimization strategy by collaborating with their suppliers, wholesalers, and retailers in the commodity market, where they operate.

C. Outside Professional Managers

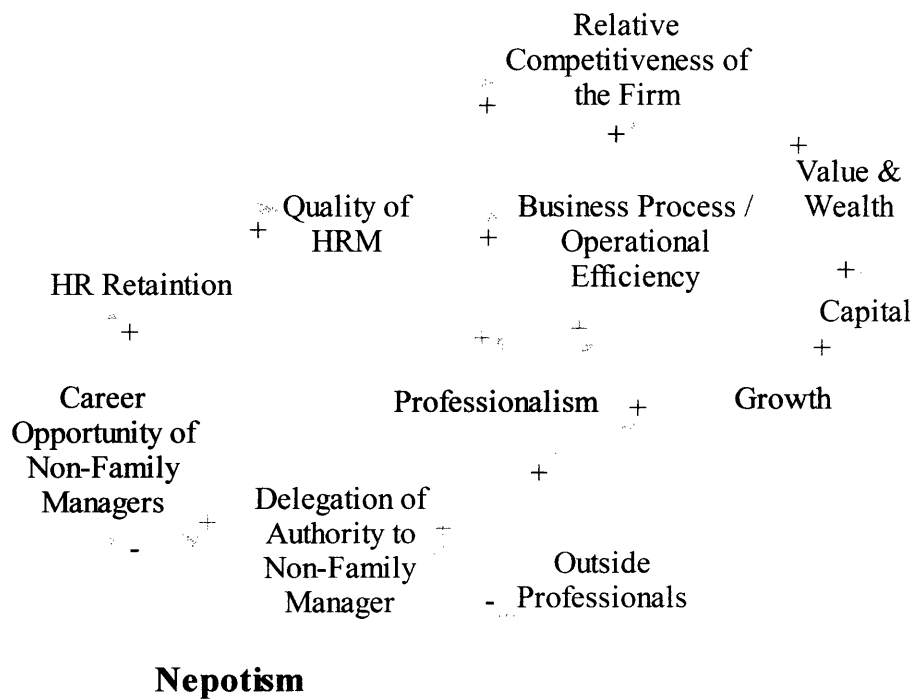
Figure 6-7: Outside Professional Managers, Factor that Affect Professionalism



As discussed earlier about the limitation of a family to generate competent leaders, the company tends to be more professionalism when it has more qualified outside professional managers in the organization. These veteran outsiders can bring in new ideas and concepts to strengthen the firm's competitiveness. Moreover, the professionalism, in turn, reinforces the company to hire more talented outside professionals.

D. Nepotism

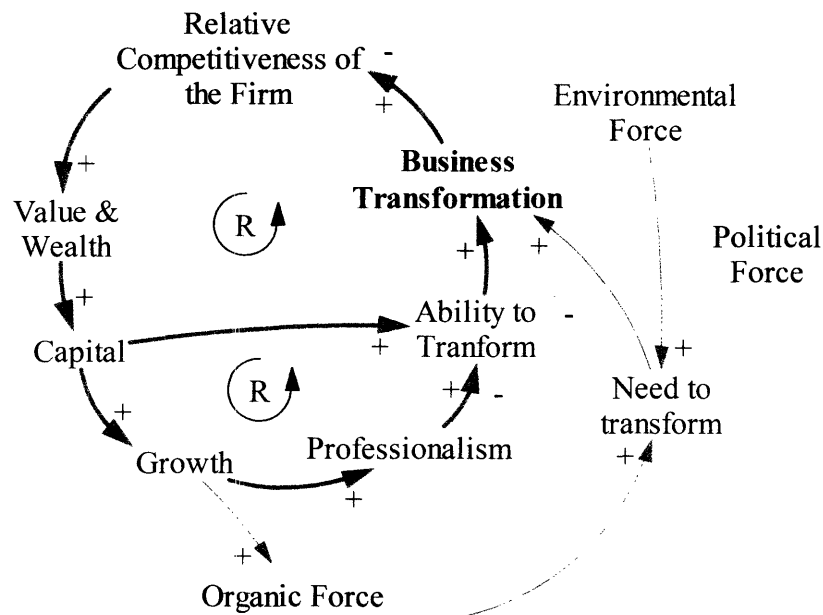
Figure 6-8: Nepotism, Factor that Affect Professionalism



Nepotism is the factor that negatively impacts the professionalism. Nepotism discourages non-family managers to stay in the organization as career advancement opportunities are low. For talented employees, they are able to attract new employers who can provide better job opportunities, while mediocre or low performance employees tend to be left over in the organization. As a result, the quality of human resources goes down, and also the robustness of the business operations. The firm tends to lose its competitiveness over its rivals, causing the reduction in revenue and profit. Thus, the value and the wealth of the firm also reduce.

IV. Transformation Reinforcing Loop

Figure 6-9: Transformation Reinforcing Loop

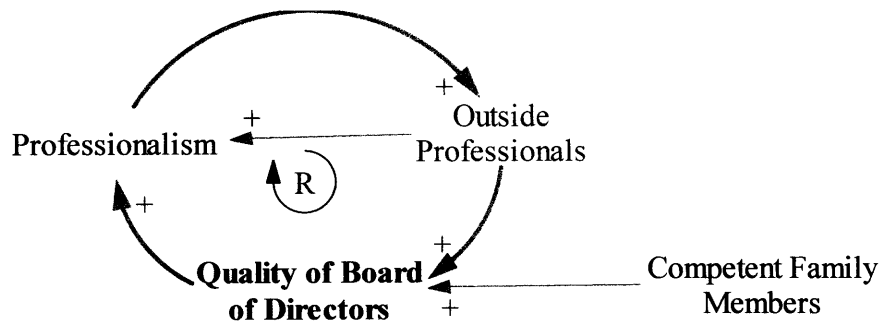


From the above section, once the firm becomes professionalized; the ability to transform and react to changes increases. Therefore, when competitive landscape changes, with the capacity to transform, the company is able to renovate itself in order to regain competitiveness and be able to continue generating value and wealth for future expansion. In addition, the more capital it generates, the stronger financial position it has. Hence, the business transformation reinforces the

firm to be able to sustain its competitive position, and continue accumulating the organization's value and wealth.

V. Board of Directors Reinforcing Loop

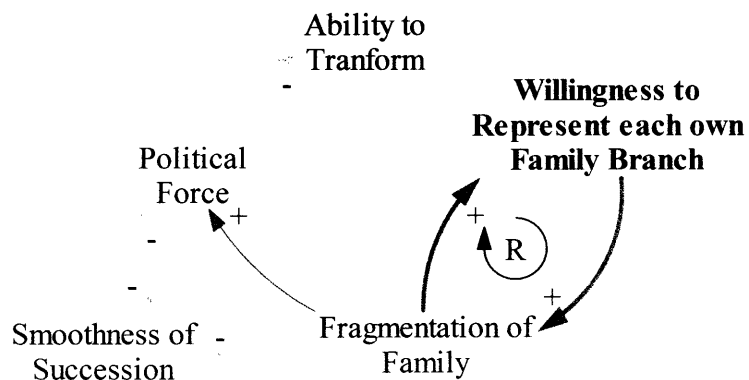
Figure 6-10: Board of Directors Reinforcing Loop



The board of directors is another important factor that can enhance the professionalism because all the key strategic decisions of the firm are made in this level. With the support from the top level, it becomes easier to implement some strategy projects to increase professionalism e.g. implementing an information system and eliminating all redundancy works. The quality of the board of directors is also affected by the number of qualified directors from outside, and the competency of the family members, who sit on the board.

VI. Willingness to Represent Each Own Family Branch Reinforcing Loop

Figure 6-11: Willingness to Represent Each Own Family Branch Reinforcing Loop



This positive feedback loop results in the negative consequences to the long-term survival and success of the family firm. The Willingness to Represent Each Own Family Branch is an effective catalyst to the fragmentation of the family. It causes the family to be more fragmented, which, in turn, reinforces each family branch to focus more on its own benefits and interests rather than the family as a whole. Differences in interests and interplays of individual family branches obstruct the business to make timely decision. These political forces impact the relationship within the family as well as deteriorate the ability of the business to react to disruptive changes.

6.2.2 Negative Feedback Loops

Negative feedback loops counteract and oppose the changes in the system. They also balance back the effects of the positive feedback loops mentioned earlier. Three important negative dynamics are identified in this study as follow:

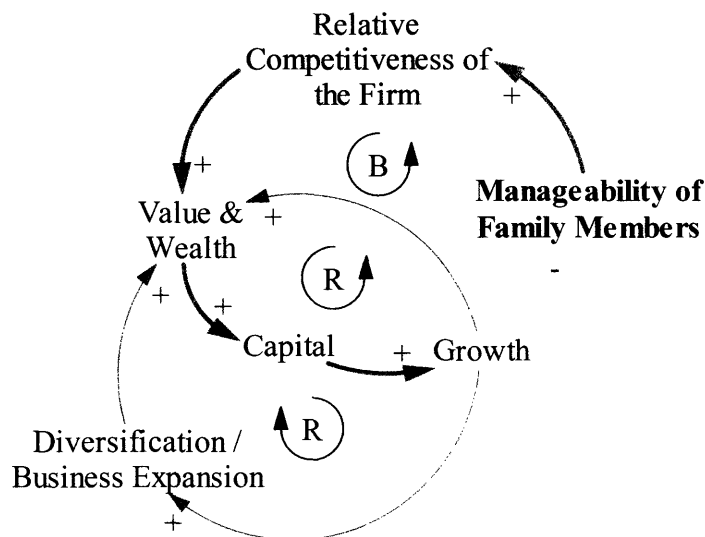
- I. Manageability of Family Members
- II. Organic Forces
- III. Business Complexity

When a firm becomes more successful, it can generate adequate resources, which can then use to reinvest for future growth or diversification. These reinforcing loops can make the firm to endlessly grow and increase its value and wealth. Nevertheless, no firm can grow forever; there must be some other factors that inhibit or slow down this growth. Once the firm continues to grow, the size of the firm continues to increase. More business units are required and added into the organization. Thus, the firm inevitably becomes more complex and difficult to manage.

I. Manageability of Family Members Balancing Loop

This balancing loop has the strongest impact when the family business is managed and controlled only by the family members or all the major decisions are depended only on the family members.

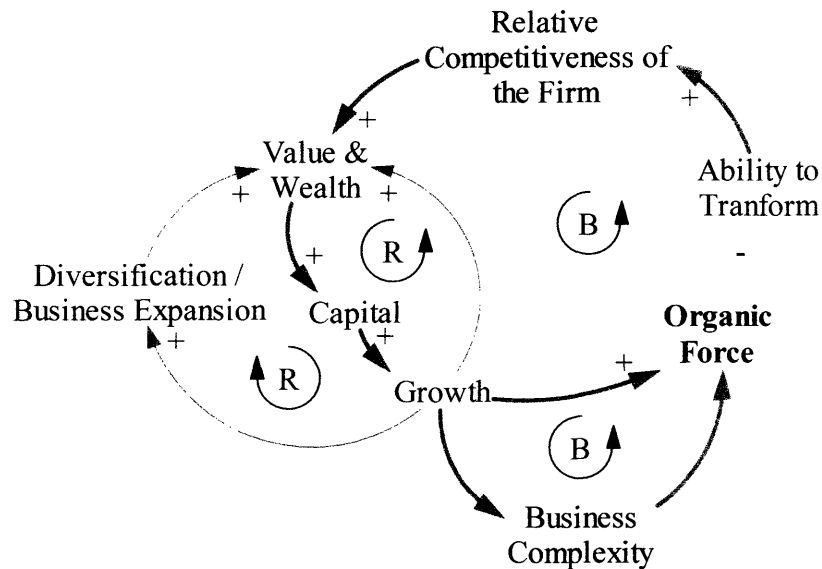
Figure 6-12: Manageability of Family Members Balancing Loop



This loop is activated when the number of family members, who works in the business, cannot grow fast enough to match the increase in size and complexity of the business. Hence, over time, the ability of family members to effectively manage and control the business continues to go down. Although family member-managers are able to manage and control the business in the beginning, they may overlook or miss some critical aspects in managing the organization later on. Thus, this can deteriorate the competitiveness of the firms, and can lead to the shrinkage of the value and wealth of the family business. This dynamic then balances back the effect of the growth, reducing the size and complexity of the firm to the level that the family members are able to manage.

II. Organic Forces Balancing Loop

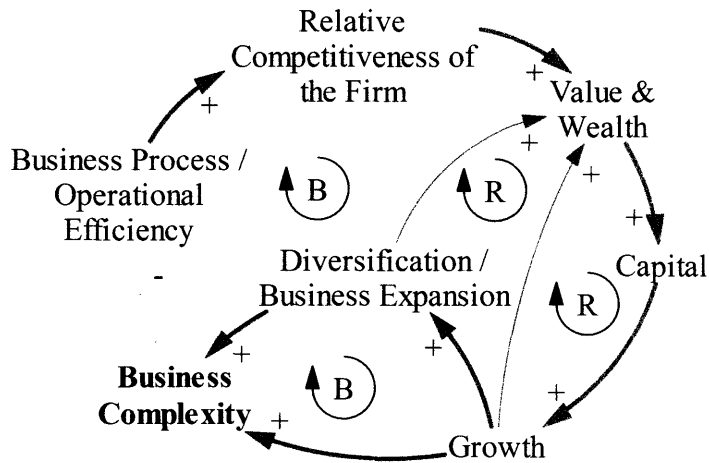
Figure 6-13: Organic Forces Balancing Loop



As more functions and departments are added in the organization, it is required to have more steps and procedures in order to perform tasks within the organization, especially for the tasks that need coordination across functions or business units. This makes the firm lose the flexibility and become more bureaucratic in operating its activities. Business complexity is another factor that empowers the organic force because it makes the company becomes inert. As a result, this organic force balances back the effect of the reinforcing loop by reducing the firm's ability to adjust itself to the changes, thus reducing the relative competitiveness of the firm. It can lead to lose ground to its competitors, which then reduces its value and wealth. Less funds and resources inhibit the firm's ability to grow.

III. Business Complexity Balancing Loop

Figure 6-14: Business Complexity Balancing Loop



Again, when the firm continues to grow or diversify its business, not only the size of the firm is increased, but also the complexity of the business. The more complexity of the business, the less visibility of the managers to realize inefficiencies in the business processes and operations. The firm cannot operate as efficient as it should, which lessen the competitiveness of the firm comparing to its competitors. Then, value and wealth is dropped, balancing back the growth of the business.

7. Typical Dynamics Scenarios Found in Family Business

This section will talk about the typical scenarios both success and failure of family businesses using the system dynamics model in chapter 6 as the main discussion tools. To make the argument easier and more understandable, I will use the company case studies as examples in each scenario. The 3 common failures of family-owned enterprises are as follow:

7.1 Failure Scenarios

1. Lose business due to the family dynamics
2. Lose business due to the negative impacts from the growth
3. Lose the business due to the environmental forces

7.1.1. Lose Business due to the Family Dynamics

Daesung, founded in 1947 by Kim Soo Keun, is a big energy company in Korean that is facing the difficult situation due to the family dynamics. This situation was described in the article on Asian family businesses in the Far Eastern Economic Review³⁷ as follow:

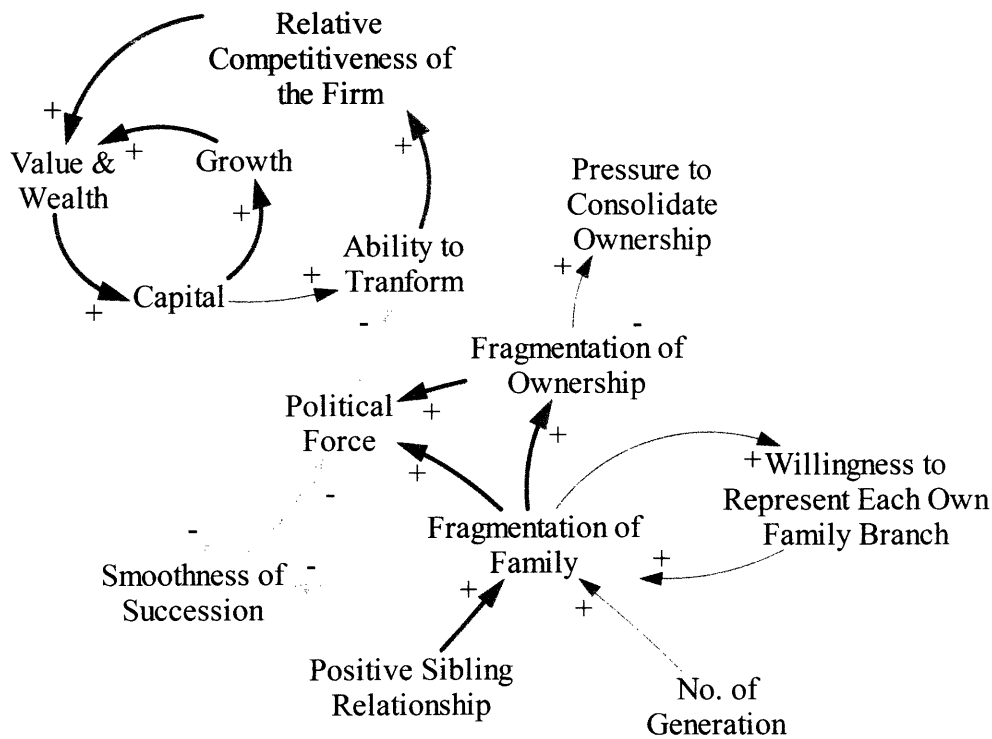
It took 50 years for the brothers' father, Kim Soo Keun, to build a lowly charcoal-briquette manufacturer into a global energy concern. On his deathbed in early 2001, he assigned a role within Daesung for each son. But within months of his death, his feuding children had torn the group apart. Now Young Hoon, 51, and Young Dae, 60, run pieces of the former empire, each aiming to one day consolidate the conglomerate under his control. Young Min, 58, another brother, also runs remnants of the group.

“We have three heads, just like in Caesar's time,” says Young Hoon, referring to the triumvirate that ruled Rome before Julius Caesar consolidated his power over the empire.

The feud has badly damaged Daesung. Millions of dollars in profits and market capitalization have been lost, while the smaller units remaining now lack the scale to compete as they once did. "Divided, we can't take on the big projects," says Young Hoon.

Daesung's fate highlights a looming crisis in corporate Asia: ageing chief executives who fail to plan their succession, causing disputes that often result in long-term damage to companies -- especially if deep-seated family tensions keep the wounds raw.

Figure 7-1: Lose Business due to the Family Dynamics



Daesung has gone through the first generation of the business to the second generation. In this case, the number of generation increases, while the positive relationship among siblings is weak; the fragmentation of the family definitely increases. The fragmentation of ownership among the 3 brother, Young Hoon, Young Dae, and Young Min, which came from both family fragmentation and the unsuccessful succession plan of their father, led to the political forces in both within the family and the business. It became more difficult for the firm to get consensus in making business decisions or combining efforts to compete with its rivals. All these factors led to

the reduction in the ability to transform and thus the competitiveness of the firm. As Daesung lost the scale to fight with its opponents, this would eventually lessen Daesung's value and wealth, and shrink the company's growth.

7.1.2. Lose Business due to the negative impacts from the growth

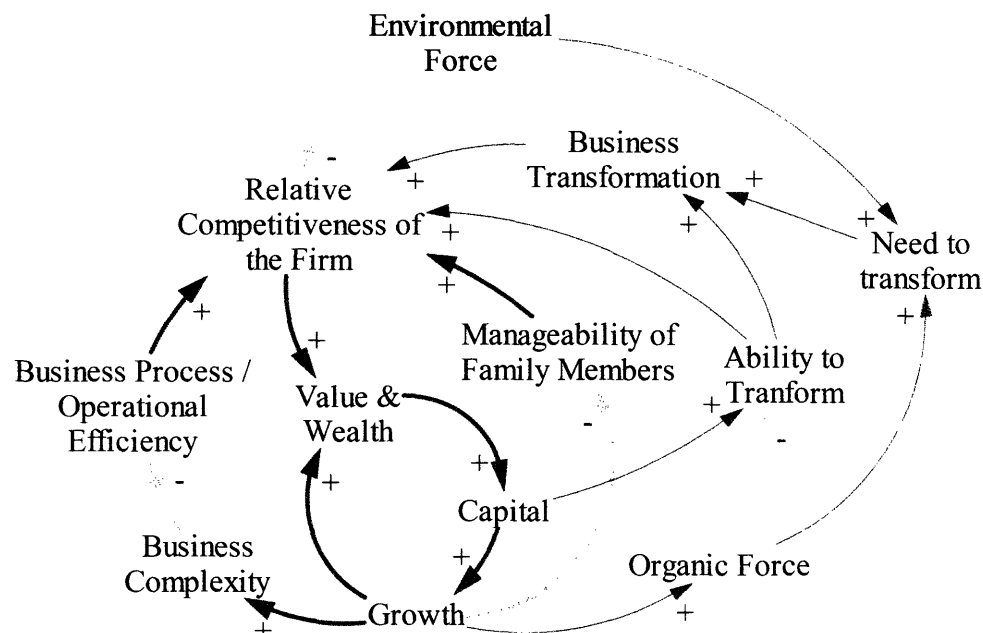
The anonymous company, discussed in the chapter 4.2, had faced the growth problem and eventually failed, being bought by one of its competitors. In the early stage of the business, the company was founded with tiny amount of initial capital. It operated with only 10 employees and 1 leased vessel. With the strong capability of the founder, the company became successful rapidly. In the Expansion/Formalization stage, the company not only expanded the serving territories from 5 markets to 22 markets in various countries and islands around the Caribbean Sea, but also established other related businesses both outside and inside the U.S.

As the size and the number of businesses increased, it became more difficult to thoroughly manage the entire organization. However, the management style that the top management or the family actively involved in almost all levels of the business, did not transform to match those changes. Therefore, it triggered the Manageability of Family Members negative feedback loop to become active. Moreover, this balancing loop was also accelerated by the fact that there are only 4 people in the family so it was difficult for them to thoroughly oversee and control the entire organization. This forced the company to begin managing by exceptions e.g. got involve only in the issues that became problematic, while ignore the potential issues that had not yet shown the negative impacts. In addition, this also made the top management lost sight of the big pictures because they got into the details of the problems.

The business processes also became more complex as there were more companies or subsidiaries in the organization. Therefore, information technology was extremely important to the evolution and the growth of the organization, especially for shipping industry. However, the company did not successfully scale up its IT system to match the growth and the increasing complexity. There were many more offices established both inside and outside the U.S. as well as new type of

business operations such as trucking, and warehousing. The business processes of different types of businesses were distinct and required to be treated differently. One explanation for this failure could be that the firm did not understand the implications of the business processes prior to the actual implementation of the IT system.

Figure 7-2: Lose Business due to the negative impacts from the growth



Besides IT issues, the company also faced the organizational issues. The main organizational challenge in the U.S involved the expansion into multiple physical locations. At headquarter, the company organized along functional lines (documentation, customer service, trucking, accounting, etc) with the Vice Presidents as the heads of each functional area. When the company expanded its services to other locations in the United States, each location had to be able to carry out all of the functions provided by the headquarters office, but on a smaller scale. The new subsidiaries offices would have a total of about thirteen people and one strong General Manager reporting to the President. The problem was that no one could decide who the individuals performing the functions in the satellite offices should report to. The V.P. in charge of the functional area had to have authority over them in order to manage the function effectively. At the same time the local G.M. had to have authority over them to maintain the effectiveness of his/her local office. When something went wrong, the G.M. could blame the

V.P. for interfering in his/ her office, or the V.P. could blame the G.M. for directing individuals contrary to departmental policy or process.

There are two extreme types of players in the shipping industry. The first type is the huge multibillion dollar companies that have enormous capacities and scales. They are very capable and operate very professionally. The services are good with the valuable price. On the other end, there are very small family shipping businesses that provide extremely low price but also extremely poor services. The ship is small and dirty; the schedule is so irregular. With these two ends, the anonymous company operated in the middle. It could provide the high quality services like the big players, while the cost was similar to those of the smaller firms, leading the company to become very successful. However, due to the rapidly and significantly increase in size as well as the complexity of the business, the cost structure, which previously low comparing to its competitors, became uncompetitive. The management lost control on this regard because they could not have full visibility of what was going on in the company. It was difficult for the management to figure out where the increasing costs came from. With the additional impacts from the environmental forces that the government deregulated the industry as well as the biggest player, Maersk, entered to the market and initiated the price war, it was even more difficult for the company to compete and survive. As a result of the decline in the Relative Competitiveness of the Firm, the value and wealth were deteriorated, causing the company to be sold to other shipping company.

7.1.3. Lose the Business due to the Environmental Forces

Hubbard Shoe Company³⁸ was the first family business of the Katz family, whose the second and third generation founded the very successful shoe maker company, Rockport.

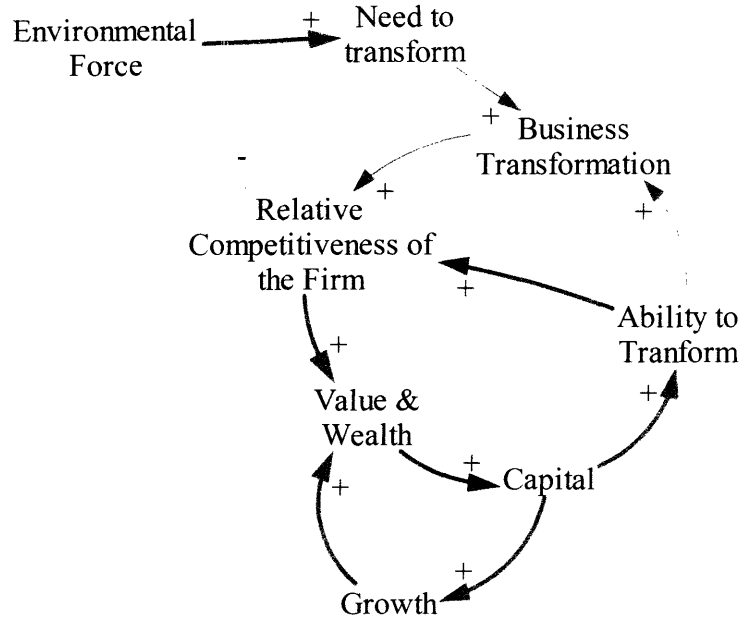
With his previous career in a shoe company in New England, Samuel Katz, the first generation of the family, decided to venture in this business on his own. He founded Hubbard Shoe Company in 1928, buying materials and subcontracting the manufacturing to local factories. As the business grew rapidly; by 1933, it purchased the second factory in East Rochester, New

Hampshire – the two factories employed over 700 workers. With this high expansion rate, Hubbard eventually faced the growth pain. By that time, Saul Katz, the oldest son who graduated from the University of Pennsylvania's Wharton School of Business in 1938, was asked to join this family business.

During the period of 1945-1970, the business of Hubbard began to decline with two major market trends. First, the shoe industry had traditionally been extremely competitive because of its relatively low barriers to entry. During the war time, the demand for shoes e.g. navy shoes, winter ski boots were very high and thus, it was easy to sell the products. However, the period after the war, the demand for the products reduced substantially, while there had been many players in the industry, leading to fierce competition in this market. The second industry trend was the increasing volume of imported shoes. Between 1955 and 1962, the value of imports rose from \$11 to \$60 million. It was the environmental context that Saul Katz struggled to keep the family business alive.

By that time, one of its rivals divested the factory in Marlboro, Massachusetts, Diamond Shoe factory, due to these unpleasant industry trends. As the product line of Hubbard's second factory was especially vulnerable to imports and began to falter, Saul closed down this East Rochester factory and decided to acquire Diamond factory, seeing that Diamond had better-quality product and an attractive customer base. However, because Katz had to focus on running the original factory profitably and he lacked of professional management to help him run the business, he was not in close touch with the newly acquired plant. Although, the company had been once forced into bankruptcy and Saul Katz was able to manage to get Hubbard out of bankruptcy in a month, in 1970, he eventually decided not to run the business in its impaired state, allowing the creditors to liquidate the company.

Figure 7-3: Lose the Business due to the Environmental Forces



Because Hubbard was just a smaller independent company, that the large shoe producers moved toward vertical integration with retail outlets to control the distribution channels, was the force that reduced the relative competitiveness of Hubbard. The revenue of Hubbard went down significantly because of inability to compete with larger competitors and also the floods of imports that seized substantial share of the market. Moreover, Saul did not have adequate professional managers who could help run another factory, while he ran the original factory. As a result, the previously accumulated capitals were used up by unsuccessful acquisition and the company stuck with large amount of debt. In this case, Hubbard had very less ability to transform itself in order to regain its competitiveness, causing the firm to fail.

7.2 Success Scenarios

For the success instance, three common scenarios of family-owned businesses are as follow:

1. Succeed due to the excellent preparation for the next generation to lead the business
2. Succeed due to strong commitment to the family tradition and values of dedication, Loyalty, and Hard working
3. Succeed due to effective business transformation

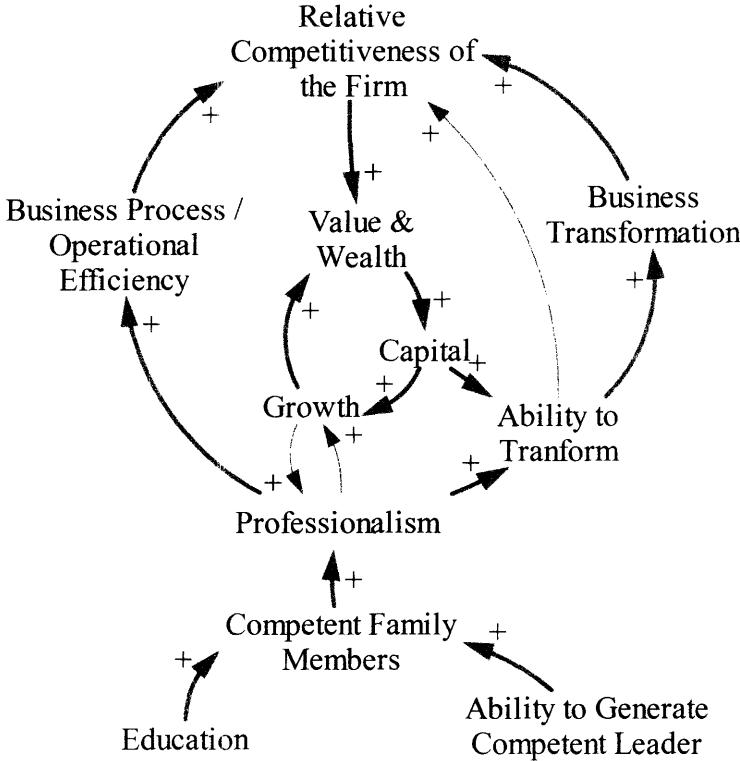
7.2.1. Succeed due to an Excellent Preparation for the Next Generation to Lead the Organization

Li & Fung³⁹, a multi-billions dollars company, began the business in very traditional way as a trading company in Hong Kong. In the early stage, it traded porcelain ware, antiques, and handicrafts. Over time, the company began to expand its product trading range, including its sourcing network. However, the remarkable expansion of the company was largely come from the two brothers, Victor and William Fung. They were sent by their father, Fung Hon-Chu, to study in the U.S. Victor got Ph.D. in Business Economics from Harvard, whereas William got MBA degree from the same university. After they came back to Li & Fung, they tried to westernize the organization. They used the company case studies to convince their father to professionalize the company.

The one of the most important things that has contributed to the success of the company up to now was that they transformed a trading and sourcing company to be global supply chain integrator. As the supply chain integrator, Li & Fung does not own any factory for producing the products; they integrate and organize the production of the products by bringing together the lowest cost, highest quality final product component from various sources throughout the world. By this approach, Li & Fung can organize the manufacture of the products in the most cost effective way. Right now, although approximately 40% of the company is owned by the two

brothers, the company is called as professional organization rather than the family-owned company.

Figure 7-4: Succeed due to an Excellent Preparation for the Next Generation to Lead the Business



Due to the excellent preparation for the next generation, after the two brothers, Victor and William Fung, came back to the company, they started to review the firm’s organizational and administrative structure. Internal system had been formulated to ensure efficiency and control. Hence, the Business Processes and Operations became more effective and efficient, resulting in the increase in Relative Competitiveness of the firm. The firm can generate more value and wealth, and capital to reinvest for future growth. With the stronger financial position of Li & Fung, it improved the ability of Li & Fung to transform itself to be a global supply chain integrator – Li & Fung could invest heavily on information technology to integrate suppliers, factories, customers, and its offices world wide altogether. Thus, the competitiveness of the firm increase tremendously from this transformation as they can achieve a very contradicting two objectives, providing low cost, but high quality products to its customer. With its new

competitive capability, Li & Fung can generate more Value & Wealth, which then reinforcing to more capital and growth.

7.2.2. Succeed due to Strong Commitment to the Family Tradition and Values of Dedication, Loyalty, and Hard Working

Sulpicio Lines can be a good illustration in this case. Part of the success of Sulpicio Lines came from that Don Sulpicio had up to five highly competent family managers (Entering the Business in family axis) at the Start-Up stage of the business axis. At that time the competition was not so high comparing to these days, having talented managers greatly enhanced the relative competitiveness of the company, activating the value & wealth creation reinforcing loop as the start-up point of the firm success. However, with only this reason, it's quite difficult to succeed and survive through the second generation, and move on to the third generation.

The major part of the company long-term success and survive for more than 30 years are the commitment to the family tradition and values, which have been passed down from generation to generation. Don Sulpicio exercised discipline and exemplified hard work, often the first to arrive and the last to leave the office. The corporate philosophy is based on his personal philosophy. He envisioned Sulpicio Lines as a family corporation, solidly rooted on work values which he himself instilled in his children. Foremost are the values of discipline, hard work, loyalty, dedicated and reliable services, fairness and honesty in all business dealings. From the interview with one of family members in the third generation, he said:³⁰

“The key success factors that contributed to the growth of the company can be attributed to the discipline and hard work of the company's owners as exemplified by the company's founder. He also instilled on his children the value of honesty and integrity, thus leading the company to be one of the biggest shipping companies in the Philippines.”

In many occurrences of family firms when the family axis reaches Passing the Baton stage, there are some issues about the passing the ownership to the next generation. Often, the consequences

of the generation transition are negative. In the case of Sulpicio Lines, the transition was pretty smooth. This was because the family values, strongly influenced by the Chinese culture that united the family together. These family values and tradition are well aware among family members and act as family rules that everyone has to follow. Therefore, this minimizes the disruptive consequences of generation transition. In addition, these values are still carried on to the third generation of the family, as indicated by the following interview from another third generation:⁴⁰

“We do not really see the family business in parts, we see it as whole; career paths are made in line with company objectives – it’s always centered on the betterment of the family business and not for selfish reasons. If my cousins and I wanted to be more successful, we wouldn’t have bothered staying in the company. In this family business, every cousin is treated equal and we were always taught to treat each cousin as if he/she is a sibling.”

The family unity (or less family fragmentation) encourages the strong will to carry on the business. From the following survey questions regarding to the survival of the company, the answers indicate solid commitment to pass on the ownership of the business to the future generation.

Question: What is your opinion on the fact that: From the statistics of the world family businesses, approximately 30% of family businesses make it to the second generation, 10-15% make it to the third, and 3-5% make it to the fourth generation. Most major overseas Chinese firms survive only the second generation. There is a popular Chinese saying that the third generation dissipates the family fortune that the first creates and the second helps maintain. Is that true in your case?

“I personally hope it won’t dissipate even after the 3rd generation. We (the 3rd generation) are doing fine and get along well, largely to the credit of the presence of the 2nd generation. I am not one to ignore the trends that you mentioned. I do know for a fact that someday the family will have no choice but to “professionalize” the business by taking in

7.2.3. Succeed due to Effective Business Transformation

Rockport⁴¹, the third family business of the Katz family that had ventured in the footwear business since 1928, is a fine example to demonstrate how transformation can make the firm succeeded even in the intense competition industry.

After the failure of Hubbard Shoe Company, founded by Samuel Katz the first generation, Saul Katz began the second family business, Highland Import Company. This company was a separate entity spun off from Hubbard as Saul saw the opportunity of producing shoes in Brazil and importing back into the U.S. The early products of Highland came from the idea based on the successful Walter Dyer moccasins, handmade in a small shop in Rockport, Massachusetts, from very unusual imported leather. So Saul decided to name the product as “Rockport”, but this name was appear only on the order form, not on the product or package. The use of Rockport as a brand name was initiated by his son, Bruce, the third generation of the family.

Before the establishment of Rockport Shoe Company, Bruce Katz, the third generation of the family who did not have any interest in the footwear business, was working on a variety of odd jobs in California to meet his minimal financial needs. When he was about to run out of money, Bruce returned to Boston to look for more work that might provide him adequate funds to buy a boat, which he planned to sail around the world. As he came back to Boston to see his father, he saw a lot of surplus old shoes that had been left because of canceled orders by the customers. He then decided to sell these shoes only until he had enough money to finance his boat. These shoes were sold quite well, allowing him to collect enough funds for his boat within only 13 weeks. Nevertheless, with his new inspiration of the 4-year-old black Mercedes Benz, he determined to continue selling these surplus shoes and boots with the confident that within 14 weeks he could generate enough money for the car by expanding the selling territory.

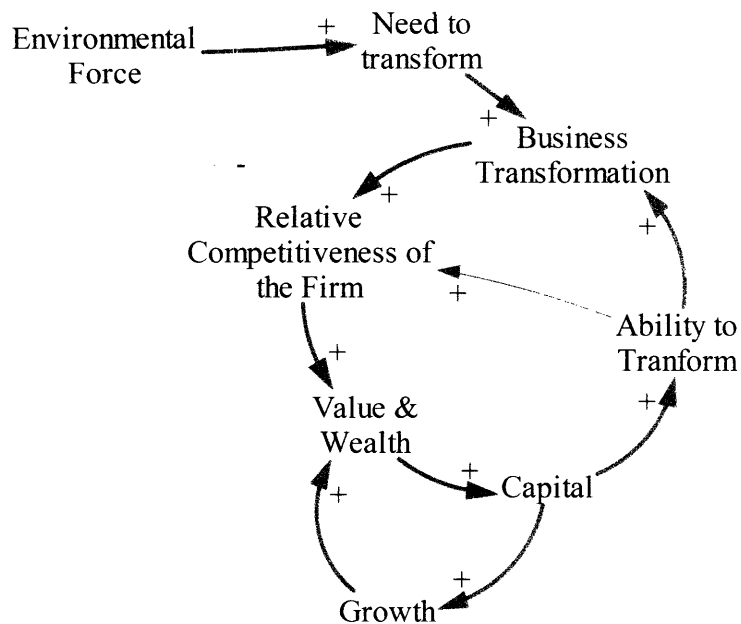
As the business grew, Bruce began to make a substantial amount of money. He then decided to become more involved in the industry. Along the route that he went out selling his products, he saw a pair of shoes that were imitations of the moccasins he had been selling. When he asked the

dealer what they were, the reply was “these are kind of Rockport-type shoes”. Bruce Katz was stunned to hear this name because his father’s products had name only on the order form but not on the products or the packages. He continued to research more about this type of shoes. He found out that many people liked this type of shoes but they had no idea what they were wearing. Some people commented “I want to tell my friend how to get a pair, but I did not know how to tell him because there is no name or anything”. He realized that he can make a great fortune by putting the brand, “Rockport”, on the white plain box. He came back and convinced his father to join his idea. In 1971, the Rockport shoe company was found. The first products based on Rockport brand name were introduced in 1973.

As a result of the first transformation of marketing innovation initiated by Bruce Katz, the company became very successful, generating revenue up to \$3.6 million in 1977. However, the success of Rockport encouraged its rivals to imitate the product and shared the pie. In addition, at that time, fitness activity became more popular, leading to the boom of the running shoes business. Even for consumers who did not run or jog, running shoes began to replace casual shoes as the most common form of leisure-time footwear. Bruce Katz realized that Rockport’s success required that the company’s casual shoes compete with running shoes in comfort and lightness. He and his father decided to engineer such a shoe product.

It took two and a half years to develop and launch the new product called “the RocSport”, which were the first real high-technology shoes. Its success led the company from this point forward to design shoes that were technically sophisticated – in part for their consumer utility and in part to help prevent other companies from imitating them. In 1986, Rockport employed approximately 400 employees and generate annual sales revenue up to \$96 million. Then the family decided to accept the buying offer from Reebok International for 118.5 million in cash, with Bruce staying as president to retain other key members of Rockport’s management structure.

Figure 7-6: Succeed due to Effective Business Transformation



From the case above, it is clear that the first transformation of the marketing initiative allowed the company to capture more value out of its moccasins type of shoes – when people refer to this type of shoes, they will look for the Rockport brand. Thus, the relative competitiveness of the firm increased, allowing Rockport to generate more revenue and growth. The more capitals it had accumulated provided Rockport the higher ability to transform e.g. more flexibility to invest or do some R&D. For the second transformation that Rockport first used advanced materials and technologies in tradition shoes to create light weight comfort shoes, was the big move of the company as this permitted the company to jump far ahead of its competitors. Imitation became much more difficult as it required sophisticated materials and technology to produce the same kinds of products. With this transformation, the competitiveness of Rockport leapt far more than those of its rivals; this could be viewed as the key factor that contributed to the success of the company to these days.

8. Key Success Factors in Transforming for Success and Long-Term Survival in Changing Markets

The strategies for business transformation, focusing on capturing the synergies between current business and the business in the future, can enhance the possibility of successful transformation. The family firms can utilize these key assets of the existing business for the future one. For example, the Sulpicio Lines can exploit the reputation asset created by successful family member, Don Sulpicio, to acquire financial loans for reinvestment rather than use their own capitals, which are generally limited for family-owned company. Or in case of the anonymous company, it leveraged its excellent reputation of the best service provider to expand its market to the nearby islands.

However, in order for family-owned enterprises to maintain their success and achieve long-term survival, pursuing these strategies is not adequate. As mentioned earlier, there are 3 forces that press family firms to change: environmental forces, organic forces, and political forces. In many occurrences, family businesses fail because they cannot redefine themselves fast enough to catch up the speed of the changes, inhibited by the organic or political forces within the organizations. Or they do not know when or how to transform due to the lack of knowledge and expertise. In other cases, they just simply cannot see the needs to transform.

Therefore, a family business can lessen the chance of transformation failure by **minimizing the impacts of these 3 forces**. To achieve this objective, there are 3 combining approaches that can be applied.

1. Be aware of the negative feedback loops and take correction actions
2. Corporate Governance
3. Professionalism

8.1 Key Success No. 1: Be Aware of the Negative Feedback Loops and Take Correction Actions

The objective of this approach is to prevent or at least minimize the impacts from the organic forces, resulting from the company's growth, by focusing on the negative feedback loops, the dynamics that counteract and oppose the changes in the system. When a firm becomes successful, it can generate adequate resources, which can then use to reinvest for future growth or diversification. According to the effect of positive feedback loop, the firm is able to grow exponentially. However, the company's success and growth will eventually trigger the negative feedback loops to become active in the system, balancing back the company's value and wealth. From the previous chapter, three important negative dynamics are identified as follow:

1. Manageability of family members
2. Organic forces
3. Business complexity

Therefore, it is important to be aware of the activation of these negative feedback loops, which can be done by realizing its effects on the organization. All the negative feedback loops mentioned above can cause the following issues:

- The number of family members or outside professional managers cannot grow fast enough to match the growth and the increasing size of the organization. Hence, over time, the ability of the management team to effectively manage and control the business continues to go down, causing the management team to overlook some critical aspects of the organization.
- As more functions and departments are added in the organization, it is required to have more steps and procedures in order to perform tasks within the organization, especially for the tasks that need coordination across functions or business units. This makes the firm lose the flexibility and becomes more bureaucratic in operating its activities.

- As the business becomes more complex, especially from diversification, the firm turns out to be unknowingly inefficient comparing to its competitors because complexity lessens the visibility of the management team to effectively run the organization. Complexity also causes the firm to be more inert. Benchmarking with top competitors can help the management to realize the effect from these negative feedback loops.

8.1.1 Suggested Correction Actions

The sustainable correction action is to professionalize the family-owned enterprise, for example, recruit highly competent professional management team to oversee the increasingly complex business. (Professionalism will be discussed in the next subsection.) However, doing so takes long time and the company may not be able to survive if the forces are very disruptive and fast, like those in the failure scenarios mentioned earlier. For the short- to medium-term correction actions can be as follow:

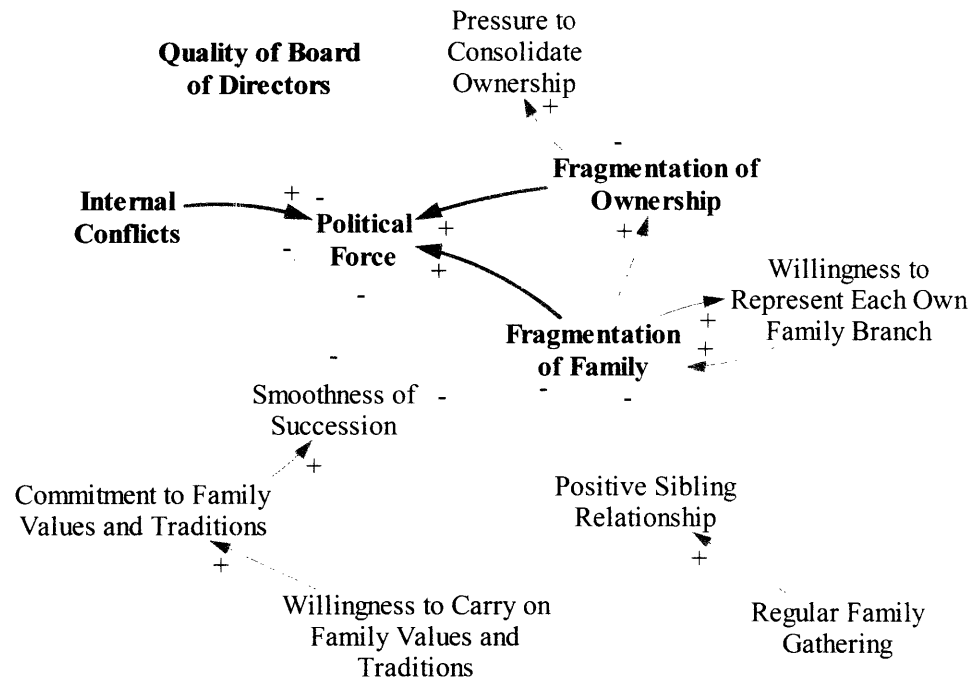
- Simplify the organization to the manageable level – This can be done by eliminating unnecessary businesses or functions that do not generate adequate economic values to the organization; for example, shut down the unprofitable businesses.
- Focus on the core businesses that are important to the future of the company – The company should prioritize and refocus on the core businesses that will contribute to the future success. The market or industry trend can be good indicator for choosing the survival business; for instance, eliminate all the businesses in the commodity market or those in the mature market, while focusing on the new emerging market with high growth prospect.

8.2 Key Success No. 2: Corporate Governance

The objective of this approach is to prevent or at least minimize the impacts from the political forces within the organization. Political forces of family businesses can come from 3 directions,

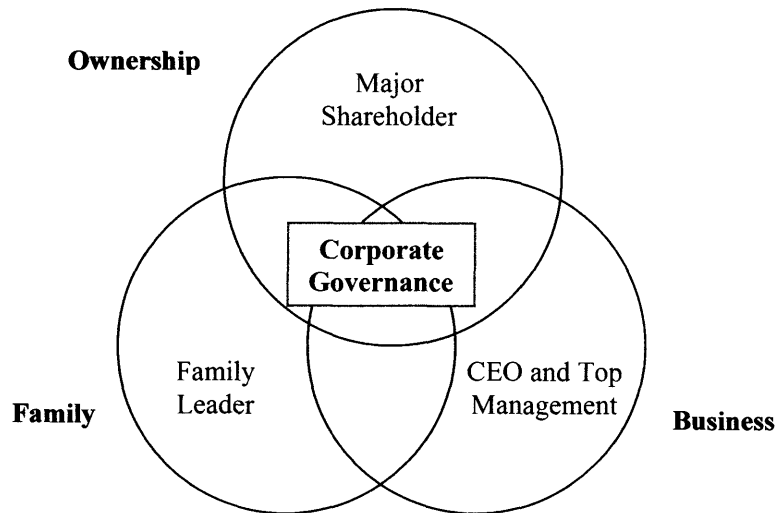
which are (1) Fragmentation of Family, (2) Fragmentation of Ownership, and (3) Internal Conflicts within the company.

Figure 8-1: Sources of Political Force



The Three-Circle Model can be used to explain the sources of political force in the Figure 8-1. Each of the sources of political forces comes from each component in the Three-Circle Model, Family, Ownership, and Business. Therefore, in order to effectively minimize the political forces, all three components should be managed at the same time.

Figure 8-2: Corporate Governance as a Key Success for Business Transformation



In each component in the Three-Circles Model in Figure 8-2, the leaders should manage to minimize conflicts within their scopes. Family leaders should develop family rules or instill the family values and tradition in family members and empower the commitment to family values in order to pass them on to the next family generation. Regular Family Gatherings also informally strengthen the family relationship and unite the members together. For example, in the case of Sulpicio Lines family, that they gather together every Sunday allows them to have better understanding among themselves, especially for the third generation that has up to 50 people, to learn how to be patient when someone is angry, and to give and take help among themselves. This helps reduce the Fragmentation of Family as well as the Willingness to Represent Each Own Family Branch (Figure 8-1). Smoothness of Succession tends to be improved due to less family fragmentation. At the same time, the major shareholder should align opinions and encourage getting consensus among other shareholders of the company in order to agree on the directions of the company. Also, the top management has to manage to reduce internal conflicts among different departments and business units.

However, in case of family business, most of the time, family members are owners as well as managers who actively involve in the company. Therefore, there are still the intersection sections left that are needed to be managed; as a result, Corporate Governance comes into play.

Corporate Governance in general usually involves with the linkage between the ownership and the management of the firm. However, governance of the family business is more complicated than that of non-family enterprise because these companies have only 2 components in the equation, business and ownership, while family-owned enterprises have 3 components, which includes family as the third component.

Corporate Governance in this study means **the management of the intersection areas, where the three components of family business interact among one another** – consider not only the linkage between ownership and management, but also the connection with the family dimension. Corporate Governance becomes more important when the organization become larger and more diverse; for example, the company evolves from privately owned enterprise to mix-ownership enterprise, and ultimately to publicly-owned enterprise. The larger the firm, the more complex issues around Corporate Governance. The same logic can be applied for family business. Once the family has aged, the more generations involve in the business. As the stage in the ownership axis in the developmental model evolves e.g. from the Controlling Ownership to Sibling Partnerships and then to Cousin Consortium, there will be more complicated issues around Corporate Governance. Issues around Corporate Governance are as follow:¹⁸

“The family addresses issues such as the composition of the company board and how it should be elected; which key board decisions require a consensus, a qualified majority, or interaction with the shareholder assembly; the appointment of the CEO; the conditions in which family members can (and cannot) work in the business; how shares can (and cannot) be traded inside and outside the family; and some of the boundaries for corporate and financial strategy.”

One example of Corporate Governance done by Sulpicio Lines is as follow:

“The parents have no say on which area their child would be assigned to. The CEO of the business gets to decide where each shall be assigned. The 3rd generation (us) can offer our services to a certain area but, in the end, it still leaves to be considered by the CEO.”⁴⁰

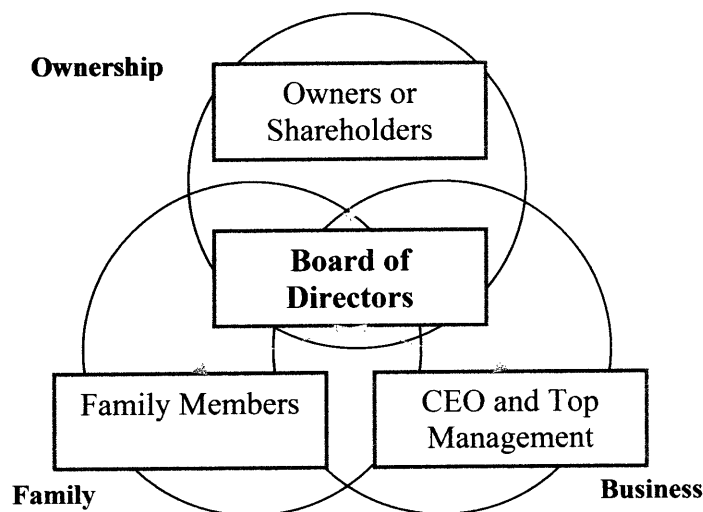
It is clearly that Corporate Governance function done by the CEO, the second generation of the family and the owner of the company, helps minimize the political forces in the organization. It not only eliminates the Willingness to Represent Each Own Family Branch (Figure 8-1), but also forms the family norms or values, which can be passed on to the next generation. This commitment to family values and tradition will support the smoothness of the succession, while reduce the fragmentation of the family.

Another example of Corporate Governance from the study by McKinsey¹⁸: Half of the families had decided not to have their members involved in management at all. One leader said, "Our key factor of success is that we hire the best people in the market, and if they turn out not to be the best, we fire them. We would not be able to do that if we had family members in management."

Board of Directors

In order to effectively manage the intersection portions of the family business e.g. among family, ownership, and business, there must be the mechanism that performs this function. Board of directors is very critical in this case as it not only links between the owners and the managers as found in general Corporate Governance, but also links the family members into the system.

Figure 8-3: Board of Director as a Corporate Governance Function



The board of directors should include the participants from all components of family business. As far as the business is concerned, the CEO should be included on the board. In addition, as discussed earlier, the board of directors helps bring in new insight ideas or strategic perspectives from the qualified outsiders to the family business. Therefore, in order to have an effective board, the directors should include a significant proportion of outside directors. Example of board's roles¹⁸ can be that board of directors is very active in managing the business. The chair and the vice chair typically spend at least half of their time interacting with other board members, top management, and the family, which is kept informed about the business through newsletters, informal gatherings, and regular reports.

Effective Corporate Governance does not eliminate all the political forces within the family business system. But it can reduce these forces and enhance the Ability to Transform of the family firm by improving the effectiveness and harmony on the needs, agreed goals, and rules/policies among all stakeholders within the system.

8.3 Key Success No. 3: Professionalism

The objective of this approach is to prevent or at least minimize the impacts from all forces from both within (Organic Forces and Political Forces) and outside (Environmental Forces) the organization.

Many people simply think that the success of the family-owned enterprises is depended highly on the competency of the family members and the diligence and hard working of these talented family members. In fact, it is partially true. The highly qualified family members may be able to bring the family organization success in the beginning. However, this may not sustain in the longer term. Due to the limitation of family businesses mentioned earlier, they might not be able to generate capable leaders for next generation of the business or the firms grow so fast that the business complexity becomes impossible for only the family to control. In addition, it is noticed that the Competent Family Members variable (Figure 8-4) is not included in any reinforcing loop, which means it is not sustainable in the long run. Therefore, the family business is

vulnerable to the failures from various the negative-impact forces. For example of the Hubbard Shoe Company, although the second generation graduated from Wharton School of Business, he could not manage the company to survive during the crisis because of having inadequate professional managers to help him to manage the large size of the company.

As discussed in early chapter, Professionalism can be divided into three different dimensions, which are (1) the human resource management, (2) the proper authority delegation to non-family managers, and (3) the efficiency and effectiveness of the business processes and operations. Tata Group, a very successful diversified conglomerate, can be an excellent example in this case.

Tata Group has been the oldest, largest and most respected group of companies in India. Tata Group is currently controlled by the third generation of Tata family, Ratan Tata. The group is extremely diverse; it has up to 85 companies, which categorized in 7 business sectors, which are consumer products, materials, chemicals, energy, engineering, services, and communications and Information Technology. Tata sells everything from products such as coffee, tea, steel, and automobile to services like airline, hotel, and IT consulting. In 2003, the conglomerate's total revenue reached \$11.21 billion.⁴²

With such a huge size and complexity of this highly diversified group of companies, the difficulties in managing the entire organization definitely exist. However, Tata Group is still able to manage and control and even looking forward to diversify its businesses into new emerging areas.⁴³ One reason can be the corporate philosophy or values of giving back to the country and considering the welfare of other people rather than focusing on the benefits to the family. These tradition and values established and instilled by the first generation of the Tata family, Jamsetji Nusserwanji Tata have become deeply ingrained in Tata Group as one of the foundations on which the group has been built.

Jamsetji Nusserwanji Tata laid the foundation of the House of Tata by starting a private trading firm in 1868 and then he expanded the business to the textile mill in 1874. With his goal to encourage India's industrial and intellectual development, Jamsetji endowed a fund for deserving students for their higher education abroad. He envisioned a national system of education, a

premier institute for research and education in the fields of science and technology, medicine, philosophy and the arts. In 1898, Jamsetji announced an offer to set aside 14 of his buildings and 4 landed properties in Bombay for an endowment to establish a university of science. As a result, the Indian Institute of Science was opened in 1911, many years after Jamsetji's death.

Tata Sons is one of the most important companies in Tata Group as it is the principle investment holding company of the entire group. It holds approximately 35-40% of the shares in each of 85 companies across different type of industries. J.R.D. Tata, the second generation of the Tata family, was elected chairman of Tata Sons in 1938. He was a great visionary businessman with tremendous personal charisma. He was key the person who greatly contributed to the success of Tata Group to these days.

He initiated Tata Administrative Services (TAS), the group's human resource department for recruiting talented individuals for management career acceleration within the Tata companies. He believed that TAS could provide a pool of talent people as a group resource by selecting and growing some of the best young Indians, and providing them opportunities for professional growth. These talents are drawn annually from the best business schools in the country.

During the 53 years that he led the Tata Group, he pioneered the group's involvement in the airline business, oversaw the early development of the Group's activities in chemicals, commercial vehicles, computers and software services. In addition, he successfully led the group's growth in the areas of steel and other established business lines.

For the third generation leader, Ratan Tata, the son of one of J.R.D.'s cousins, was selected to be the chairman of Tata Sons in 1991. He introduced various business initiatives and restructuring programs within the group. For example, he plans to promote TAS as a "premium career" and elevate the program's status among up-and-coming business leaders through media exposure, including high profile TAS coverage in business publications. Ratan hopes to redefine and develop TAS as a group resource by enlarging the program and increasing the mobility of the TAS participants among group companies. This group resource, around 120 today, is allocated to over forty companies and is a binding force for the vast and diversified Tata Group. Most

companies today allow a degree of job rotation for career growth. TAS is perhaps the only employment brand in Indian that consciously recruits for lifelong mobility, across companies, industries and functions, in order to impart that macro view of business which is critical in developing young persons for general management. As a group resource, a TAS manager has his/her career as canvas India's largest business house with the widest range of business interests on which to plan and build a lifetime career of professional and personal growth.

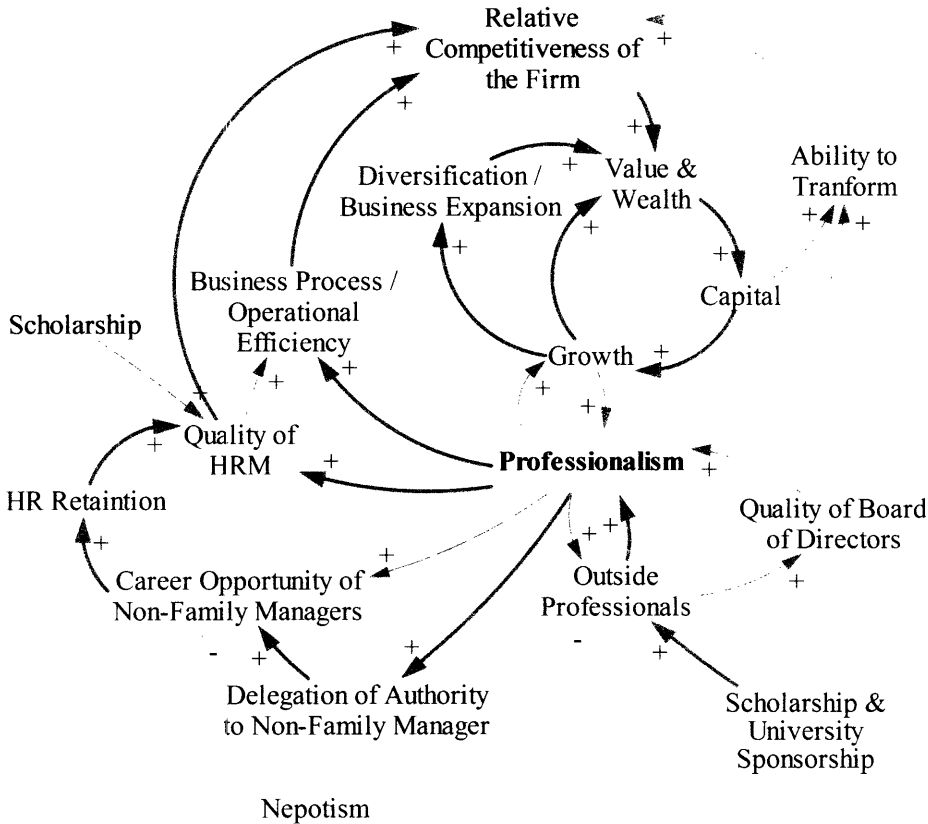
Moreover, he also initiated the group branding, giving Tata group a stronger collective identity Group Executive Office is another management mechanism introduced by him with the purpose of expanding the restructuring efforts, overseeing new Tata group ventures, and acting upon recommendations from McKinsey.

As discussed earlier regarding to the trade off between family benefits and business benefits in Chapter 5.2.5, instead of focusing on the benefits to the family, Tata focuses more on business benefits, which aim to return the profits from its operations back to the country. It is surprised that Tata Sons, the holding company of Tata Group, is owned by Tata family only 1%. The majority of shares, approximately 67%, are owned by philanthropic trusts endowed by Jamsetji's sons, Sir Dorab Tata and Sir Ratan Tata, and other charitable trusts. These trusts have sponsored and promoted a number of public institutions in the fields of science, technology, medicine, social service, rural welfare and the performing arts. The rest of the shares are held among many financial institutions. Although the ownership of the company (Tata Sons) is mainly possessed by the charity trusts, to which the gains from the businesses go, the control of the Tata Group (through Tata Sons) is possessed by the group executive board, chaired by Ratan Tata, the third generation of the family. Nevertheless, it is clear that the greater part of revenue or profits, generated from several of Tata businesses, go to the Indian nation, rather than to the Tata family.

As benefits to the family are not the focus, Nepotism is minimal in this case (Figure 8-4). Most of the 85 companies in the Tata Group are publicly held companies, in which most of key positions are delegated to outside professionals, enhancing career opportunity of non-family employees. Tata also has strong relationships with various top rank universities in India such as Indian Institute of Science so that it has access to pools of qualified professionals to run the

businesses. The positive reputation of Tata Group of helping the country attracts good people to join the company. In addition, TAS, the group human resource department, provides greater career opportunities, offering management career acceleration program, within the Tata companies to young talented individuals, who can greatly contribute to the achievements of the organization.

Figure 8-4: Professionalism as a Key success for Business Transformation



From Figure 8-4, the more outside talented professionals in the company, the higher level of professionalism. Thus, the quality of human resources increases, activating the reinforcing loop to produce more value and wealth to the company. With the current corporate strategy of diversifying to the new emerging markets, Tata leverages its accumulated capitals to expand in various new areas such as telecommunication and information technology, which have high growth potential about 20-25% comparing to the existing traditional businesses with the growth

only 10%⁴³. Again, this triggers the Diversification / Business Expansion Reinforcing Loop to active in the system, allowing the company to generate more capital and grow.

Therefore, in the case of Tata, the value of benefiting the whole society is the key motivation that drives the company to be more professionalized, opening up the company to non-family members and hiring the best talented people to run and grow the businesses.

Nevertheless, with this corporate strategy, Tata Group becomes a highly diversified group of companies, which is eventually complicated and difficult to manage. It can cause the negative feedback loops to active in the system. However, the professionalism reinforcing loops are so strong that they minimize the effects from these balancing loops. For instance, with 270,000 outside professionals working in the Tata Group, the impacts from the Manageability of Family Members balancing loop are eliminated. With the best qualified people that Tata attracted and retained, Tata implemented various business control mechanisms as well as transformed the company to be tighter and leaner organization, minimizing the impacts from all the forces from both within (Organic Forces and Political Forces) and outside (Environmental Forces) the organization. For example, Tata Sons decided to sell off loss-making companies e.g. Tata Oil Mills Company Ltd. and favored a merger of Tata's three electric companies. Moreover, it ruled that all the companies in Tata Group have to be either no. 1 or no. 2, or otherwise get out of this business.⁴³ As an effort to minimize the effects of Political forces within the organization, Tata implemented the group branding in order to have a stronger collective identity. Each company that subscribes to use the Tata brand will benefit from the centrally promoted Tata brand; however, it is required an annual contribution related to each company's net income in order to meet costs of development, promotion and protection of the unified Tata brand. In addition, participating companies are required to follow the Tata Business Excellence Model (TBEM) framework which would ensure uniformly high standards of quality and ethical business practices.

With all these strong reinforcing loops active in the system, Tata Group still continues to grow and diversify its businesses and be able to generate significant amount of revenue up to \$11.21 billion in 2003, equivalent to 2.4% of India's GDP.

8.4 Key Success No. 4: Prevent Organization Inertia or Rigidity

Besides the problems that family businesses cannot redefine themselves fast enough to catch up the speed of the changes, inhibited by the organic or political forces, or that they do not know when or how to transform due to the lack of professionalism, in many incidences, the failure to transform is caused by that the company waits too long before attempting to transform. This makes the inertia of the organization deeply rooted in business processes and the culture of the firm so it becomes more difficult for that company to change its capabilities to address the new problems.

The study by Clayton M. Christensen and Michael Overdorf suggests that there are three factors that affect what an organization can or cannot do. These factors are sources where the capabilities of the company reside, which are (1) Resource, (2) Processes, and (3) Values or Culture. They also mention that the organization capabilities start in resources, then move to processes and finally integrated in the company values and culture. When the organization's capabilities reside primarily in its human resources or people, changing capabilities to address the new problems is relatively easy. But when the capabilities have come to reside in the processes and values, and especially when they have become embedded in culture, change can be extraordinarily difficult.⁴⁴ This problem is particularly strong in the case of family business, where the organization is strongly influenced and dominated by the family as well as its beliefs and values.

Similar concepts are suggested by Donald Sull that when changes occur in companies' markets, they often fail to respond effectively because these organizations tend to persist in established pattern of behavior or stuck in the modes of thinking and working that have brought success in the past. He calls this phenomenon as active inertia.⁴⁵ From his study, he found out that the main reason for companies' failure is not an inability to take action but an inability to take appropriate action, which caused by active inertia. For example, many family businesses respond to the decline in the companies' competitiveness by diversifying to focus on another business area

rather than transforming the organizations. The diversification makes those companies become more complex and difficult to manage, without changing the companies' fundamental flaws.

Another example can be Laura Ashley, a family business founded by a married couple in Wales. Laura started the business with her husband, Bernard, in 1953 as a way to re-create the mood of British countryside. The company's garments, designed to evoke a romantic vision of English ladies tending roses at their country manors, matched the market demand very well. The business grew quickly from single silk-screen press in Laura and Bernard's London flat to a major retailer with a network of 500 shops. When Laura died in 1985, Bernard kept the company on the course of his wife had set. However, as more women entered the workforce, they increasingly chose practical, professional attire over Laura Ashley's romantic style. At the same time, with the trade barriers falling, fashion houses were rushing to move production offshore, dramatically reducing their manufacturing costs. In contrast, Laura Ashley continued to pursue the outdated designs and the expensive manufacturing processes that had served it well in the past. Nevertheless, the company did not suffer from its inability to take action. By late 1980s, recognizing the need to react, the board of directors, chaired by Bernard, brought in new CEO to develop and carry out a restructuring plan that would increase sales and cut costs. The new plan set off flurries of activities, but none of them went far enough in recasting the company's strategy, nor refreshed the company's tradition and values to bring the company in line with the marketplace. It remained unclear whether Laura Ashley was a brand, a manufacturer, a retailer, or an integrated fashion company. As a result, Laura Ashley went through seven CEOs in a decade, while the company's decline continued.

In order to effectively prevent the inertia, it is important to first understand the sources of the corporate inertia. Donald Sull categorizes the sources of active inertia into 4 forms which are (1) strategic frames become blinders, (2) processes harden into routines, (3) relationships become shackles, and (4) values turn into dogma. For the next step, the companies have to break free from the assumption that their worst enemy is paralysis. They need to realize that action alone does not solve the problem. Instead of rushing to ask, "What should we do?" managers should pause to ask, "What hinder us? Or what are the roots of the problems?" These questions will lead

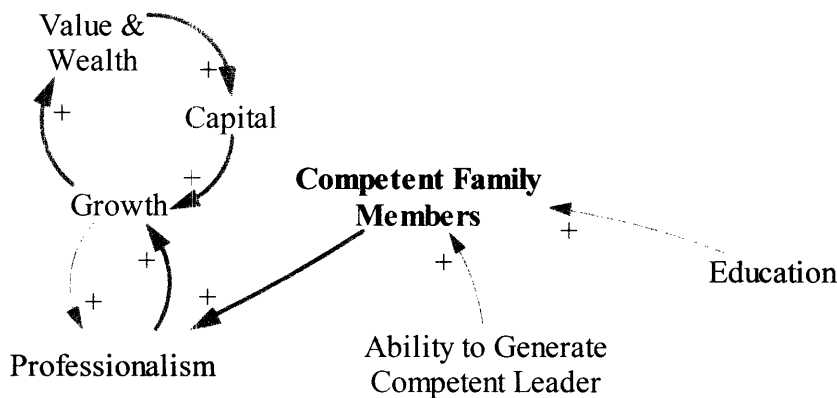
to focus attention on the proper things whether they are the strategic frames, processes, relationship, or values. Therefore, the company can address the problem more appropriately.

8.5 Prerequisites for Success

In all successful family businesses in the study, there are some common characteristics that can be regarded as fundamental requirements for their achievement.

8.5.1 Competent Family Members

Figure 8-5: Competent Family Members as a Prerequisite for Success



In many cases of successful family businesses, it is important that the company must have at least one competent family member, who is able to lead the company to a certain level of value and wealth. This person can be the first generation as the founder of the company, or the second or later generation of the family. This person is the one who turns on the reinforcing loops, allowing the firm to grow into the future.

Suggested Entering Strategy to the Family Business

In order to have talented qualified family members, who help run the business, the preparation for the next generation of family members is very important. Provide access to the education is

the fundamental thing but the most critical part in achieving this objective. Besides education, work experiences also important for building competency for the next generation leaders. As discussed earlier in the Chapter 3 regarding to the study, by Jeffrey A. Barach, Joseph Gantisky, James A. Carson, and Benjamin A. Doochin, about entering strategies to the business for the next generations, there are two common strategies which are (1) Low-Level Entry strategy and (2) Delayed Entry strategy. Because each strategy has different advantages and disadvantages, the study concluded that there is no exact answer of which strategy is better. It does depend on judgment of the business owners on the pros and cons of each strategy and how fit the strategy to the organization.

However, from my finding in this research paper, I found out that the **family should select the entry strategies based on the level of professionalism** (in all three dimensions: human resource management, the proper authority delegation to non-family managers, and the efficiency and effectiveness of the business processes and operations) of the company. Family firms that have high professionalism should encourage their successors to work in various areas within the organization providing them a wide range of experiences to effectively lead the organization. The family businesses that have less professionalism should allow the next generation to work outside the company in order for them to learn structured business and management practices, which they can bring into the family organization.

For example of SC Johnson (SCJ), the huge conglomerate family business in the U.S. It sells a wide variety of household chemical products in over 100 countries. This privately held, family-owned company competes in six categories: Home Storage, Shave Preparations, Insect Control, Air Care, Home Cleaning, and Auto Care, and controls well-known brands in most of these categories. Each of the five generations of family leaders have held a variety of roles within the organization before becoming chairman, giving them a broad base of knowledge and the best preparation to understand and lead the company. This includes current SC Johnson chairman Dr. H. Fisk Johnson as well as his sister, Helen Johnson-leipold who leads Johnson Outdoors Inc and brother Curt Johnson who leads Johnsondiversey Inc.⁴⁶

But, in case of the anonymous company, the son of the family decided to join the firm directly after school by himself since there was no preparation from his parents. Nevertheless, he realized the importance of preparation for the next generation. He said that the family provided access to different experiences within the company was good but the family should have tried to provide the experiences outside the company somewhere else in the value chain in order for successors to see things from different perspectives, or in the totally different area that have good management practices that can be brought into the company. One comment he said was:³¹

“If I worked for IBM or Merrill Lynch that have very structure management system and hiring process, I may have learned some things from that sort of environments so I can bring that into the company.”

8.5.2 Information Technology System

Although the companies in this study are in different industries, they all indicate that Information technology is extremely important to the success of the firm. Information system helps maintain the flow of the information and communication within and outside the company. In this era, competition becomes more difficult as many more firms leverage the power of IT to be more efficient and effective. Not only that, IT allows companies to operate in the very challenging and complex business model, which has once been impossible to be implemented; for instance, mass customization. Therefore, the company that did not adopt IT will be left out and lack behind.

8.5.3 Avoid Nepotism

Once again, Nepotism is the factor that has great impacts on the professionalism. The impacts are depended largely on the size of the organization. If the size of the firm is big, the impact will be less. This is because the bigger the firm, the more career opportunities for non-family managers. However, if the firm is mid-size or small, the impact will be huge; therefore, the company should avoid this business practices.

9. Conclusions

Many people simply think that the success of the family-owned enterprises is depended highly on the competency of the family members and their diligence or hard working. In fact, it is partially true. The highly qualified family members may be able to bring the family organization success in the beginning. However, this may not sustain in the longer term because of the limitations of family businesses mentioned earlier in Chapter 5.

In order for a family-owned company to sustain its success and achieve long-term survival, the negative impacts from both internal and external forces must be minimized. This can be done through the 3 combining approaches which are:

1. Be aware of the negative feedback loops and take correction actions
2. Corporate Governance
3. Professionalism

Besides the negative consequences from these three forces, another source of transformation failure is that the company waits too long before attempting to transform, which makes the organization inertia deeply rooted in business processes and the culture of the firm. This problem is particularly strong in the case of family business, where the organization is strongly influenced and dominated by the family as well as its beliefs and values. Therefore, it becomes more difficult for that company to change its capabilities to address the new problems. The other cause of failure is that although the company realizes the need to change, it rushes forward to take action based on the persistent on modes of thinking or working that have brought it success in the past. The past successful actions bring active inertia, and active inertia, in turn, brings failures to the company. The key to prevent the organization rigidity is to first understand the 4 sources of the inertia, which are (1) strategic frames become blinders, (2) processes harden into routines, (3) relationships become shackles, and (4) values turn into dogma; and then to focus attention on these sources of the active inertia in order to take an effective correction action.

Nevertheless, in all successful family businesses in the study, there are some common characteristics that can be regarded as fundamental requirements for their achievement, which are as follow:

- Competent family members
- Information Technology
- Avoid Nepotism

One observation is that the companies that can become very successful are the companies that can professionalize itself ahead of both the disruptive changes and other players in the industry. They transform themselves before the time when they need to. For example, Li & Fung was professionalized by the two brothers, Victor and William Fung, since 1972; by that time the market condition was good and the competition was not high. On the other hand, the companies that try to transform during the crisis are likely or have higher possibility to fail because the transformation usually takes long time. Therefore, the company that can be ahead of the game rather than playing in the game is likely to win and earns big rewards.

However, the success of a family business is not just only financially rewards; it includes having the non-economic benefit to the family as well. Outsiders may wonder why the family should bother with all the hard work. They can just sell the company and let each family member invest the proceeds on capital markets. But family-owned businesses undoubtedly offer non-economic benefits such as a respected position in society, the pride and the sense of belonging that come with carrying on a family tradition, and the chance for some members to work in the business and for others to pursue shared interests alongside it. Therefore, the success of family business is the success of both the business as well as the family.

Appendix

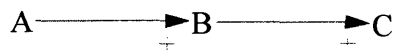
A. How to Interpret the System Dynamics Model

In order to clearly understand the causal loop diagram, it is important to know how to read these system dynamics diagrams.

Two Ways of Interpretation

A system dynamics diagram can be interpreted in two directions, which are the increase and decrease of the initial variable. The initial variable in these examples is variable A.

Figure A-1: Two Ways of System Dynamics Model Interpretation

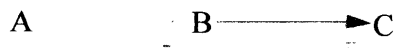


For example from Figure A-1, (1) the increase in variable A will cause variable B to increase, and thus variable C to increase. The second way of interpretation can be that (2) the decrease in variable A will cause variable B to decrease, and thus variable C to decrease.

Arrow Sign (Positive and Negative)

The sign of each arrow indicates the direction of the effect. Positive sign means same direction, while negative sign means opposite direction. One negative arrow sign (or odd number of arrow sign) will cause different direction outcome from the initial variable, while two negative arrow sign (or even number of arrow sign) will cause the same direction of the initial variable.

Figure A-2: Single Negative Arrow Sign of System Dynamics Model



The interpretation from the Figure A-2 can be as follow: (1) the increase in variable A will cause variable B to decrease, and thus variable C to decrease. Variable B decreases because the arrow is negative, which means opposite direction from variable A. Variable C also decreases like B because the arrow sign from B to C is positive, which means same direction. The second interpretation is that (2) the decrease in variable A will cause variable B to increase, and thus variable C to increase. Variable B increases because the arrow is negative, which means opposite direction from A. Variable C also increases because the arrow sign from B to C is positive, which means same direction with B.

Figure A-3: Double Negative Arrow Signs of System Dynamics Model



From the Figure A-3, (1) the increase in variable A will cause variable B to decrease due to the negative sign. The decrease of variable B will cause the variable C to increase. Again, the same logic can be applied to the second interpretation. (2) The decrease in variable A will cause variable B to increase due to the negative sign. The increase of variable B will cause the variable C to decrease, getting the same direction effect with variable A.

B. Questionnaire for MIT Thesis Research Interview

Thesis Topic

Key success factors in transforming traditional family business for success and long-term survival in changing markets.

Abstract

Most of family-owned enterprises start their operations in the traditional businesses such as manufacturing, trading, or providing services. Some of them are very successful and become major global players in the industries, for example, SC Johnson, Corning, and Li & Fung.

However, technological changes often have impacts on the behaviors of the market. New technology can add tremendous capacity for a firm to pursue economy of scale or it can reduce marginal cost to zero. Moreover, in the globalization era, multinational companies expand their business territories by entering to the new markets. They exploit the advance in technology, which allows them to provide better products/services than those of local firms. Technology becomes key driver for the increase in competition in the market because the firms that adopt the technology tend to have competitive advantage over firms that did not. It also drives customers to demand more comprehensive products and services.

In order to survive and be forefront in the industry, these family firms need to transform themselves or adopt some technologies to enhance and regain their competitiveness. Not all companies realize the importance of doing so or know how to do so. But still, there are some companies that are able to transform successfully. This thesis will analyze keys to success for these family businesses in transforming themselves to maintain competitiveness in changing markets.

On this MIT research, I will use the 3-circle model as a mean to discuss on the family business issues.

Overview of 3-circle model⁵

Any of individual of family members can be placed in one of these 7 sectors in the model (see *figure 1*). The one who has only one connection to the firm is placed in either sector 1, 2 or 3. This person is family member, owner or manager of the family business. For people in the overlapping sectors, they have at least two or three roles in the family business. For instance, people in sector 4 are family members and also own the company; people in sector 6 are those who work in the company and hold a proportion of company's shares.

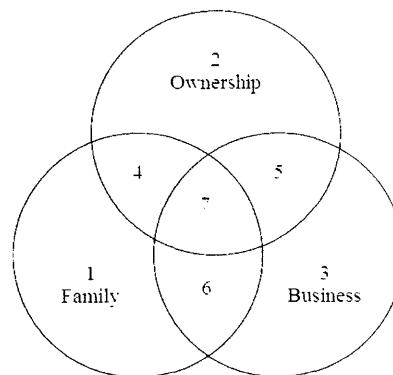


Figure 1: Three-Circle Model of Family Business

This model is very insightful to identify and understand the dynamic within the firm e.g. interpersonal conflicts, role dilemmas, and priorities. For example, people in sector 5 tend to work for long term success of the company, while people in sector 6 may focus more on short term gains of the company. People in sector 1 may want their children to work in the company in order to give their children chances, on the other hand, people in sector 3 may want to hire qualified person from outside, who can contribute more to the company.

Discussion and Questions

I. Discussion on the history of family business through the 3-circles model.

Sample questions for discussion: How do the family members currently fit into this framework? Has the picture changed over the past ten years? Is so why? What is the most likely scenario for the next five years, and why? How have the roles of the family members been affected by changes in the business, changes in the markets, new technology, new family members entering the business, leadership succession, etc?

II. Business Policies and Practices

1. What kind of organization structure do you have and how is the board of directors structured?
2. What do you think about your current company's strategy? Does it fit with the current competitive environment? What else that the company should do and what should not?
3. What are the core capabilities required to be success in this industry and how you attain and maintain these capabilities?
4. What are the competitive advantages that make the company better than competitors? How the company obtains these competitive advantages?
5. What is your opinion on the role of IT in your business and how important of IT to your business? How can you acquire the required technology for your company?
6. How do you plan for human resource in the organization? How do you attract and retain competent candidates?

III. Business Transformation, Expansion, or Diversification

1. What are the major forces or motivations that cause your company to transform, expand, or diversify? What is your diversification strategy?
2. From the above question, can you give me a little bit background of this transformation / diversification e.g. who initiate the idea and where is they in the 3-circle model?
3. What are the major challenges during the transformation / diversification and how you overcome them?
4. What are the key factors that contribute to the success of the transformation and why do you think so (ex. Synergies)?
5. Is there any internal factor that hinders or obstructs the success of the transformation / diversification? And what are they?

6. What are the key success of professionalize process? What are the major obstacles and key success factors?
7. What are the major business initiatives that the firm has implemented so far and what are the results (can be both positive and negative results)? For example, branding campaign.
8. In your opinion, what attributes of family business contribute to the success and what hinder or obstruct the success of these major business activities?

IV. Family Business Issues

1. What attributes of family businesses that facilitate or hinder the success and survival of the company in the future?
2. In your point of view, what are the limitations of the family business? How to overcome?
3. Family business tends to hand over the business to family members. How do you plan the company's succession plan? How about career opportunity for non-family manager?
4. How the company prepares the next generation family members to become future leaders?
5. What is your opinion about the idea that the family business should allow professional managers to control day-to-day operation, while family managers should be just business owners or control the company at the board level? What are the reasons?
6. How your corporate culture looks like? Is there any characteristic that makes it different from those of non-family businesses? Is the culture important to the company success?
7. During these days, IT becomes more and more important; however, it is still a big challenge for many traditional Chinese family businesses. What is your opinion on this statement?

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