KELLOGG CENTER FOR FAMILY ENTERPRISES
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2003 Kellogg Family Business Conference

Best Practices and New Ideas
May 20–21, 2003

2003 Kellogg Family Business Conference

Sponsored by
Kellogg School of Management
Northern Trust Corporation
Duff & Phelps, LLC

KELLOGG CENTER FOR FAMILY ENTERPRISES

Kellogg has a special interest in family enterprise. The initiative came from M.B.A. students about five years ago, when they formed a club and proposed that Kellogg offer a course. Four years ago the center was formed and an M.B.A. course, “Family Enterprises: Issues and Solutions” began.

The center now has several objectives:

1. To support Kellogg students and alumni who have an interest in family business
2. To provide public programs that are distinct and explore new and different topics from those otherwise available
3. To contribute to the knowledge of family business through research, publications and cases
4. To collaborate with Kellogg’s international partner schools in family business education
5. To stimulate awareness and research by other Kellogg faculty of the special issues and opportunities for family firms.

The Center for Family Enterprises deliberately refers to enterprises as our interest in order to include family foundations, family offices and family investment companies, as well as family controlled operating firms.

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Best Practices and New Ideas
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Family companies are 20 percent more profitable than non-family companies.

Family companies are 25 percent more philanthropic than non-family companies.

Family businesses last longer than other kinds of businesses despite having more complex challenges.

Kellogg School of Management   Northern Trust   DUFF & PHELPS, LLC

2003 Kellogg Family Business Conference

Best Practices and New Ideas
May 20–21, 2003

GREETINGS

Dear Friends,

We are pleased to present the proceedings from Kellogg's 2003 Family Business Invitational Conference of May 20th and 21st. The purpose of the Conference is to bring together the best ideas for families in business with leading business families. The purpose of this report is to document these new insights and examples and to share them with a wider family business audience.

This is our second annual conference and proceedings report. Through these efforts we hope to help foster a community of dedicated and thoughtful business families. We believe this report will interest those reflecting upon some of the most pressing issues facing families in business today. A number of solutions utilized by some of the most forward thinking families in enterprise are presented.

Inside you will find valuable information on:

Outstanding new research on family business performance and successful practices

Issues and trends in valuing family businesses

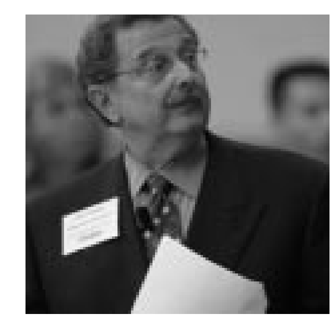
Insights into the thinking of the successor generation represented by Kellogg students

Best practices of three highly successful family enterprises

The 2003 Kellogg Award for significant contributions to the field of family business

A new case study written specifically for the Conference

Lloyd Shefsky



John Ward

We are particularly grateful to our co-sponsor partners, Northern Trust Corporation and Duff & Phelps, LLC. Their generous support of the Conference and of our aims sparks a great deal of our research, our case writing, and our publishing of information on family business. We could not do this without their gracious help. We look forward to our continuing collaboration with them as we work together to strengthen and nurture a vital family business community.

Best Wishes,

Lloyd Shefsky
John Ward

Northern Trust Corporation
50 South La Salle Street
Chicago, Illinois 60675
(312) 630-6000

Northern Trust

William A. Osborn
Chairman and
Chief Executive Officer

July 8, 2003

Greetings to the Business Owner Community:

Thank you for making this year's Family Business Conference a tremendous success. Northern Trust was pleased to continue its sponsorship of a forum that celebrates and nurtures closely held businesses. We hope the Best Practices presented and shared will help you reach your next desired level of success.

At Northern Trust, we strive to help our family business clients reach their goals. Your participation, along with the opportunity to collaborate with John Ward, Lloyd Shefsky and our new co-sponsor Duff & Phelps, makes us part of a best practices team that helps determine what issues family businesses are dealing with and thinking about.

We look forward to next year's program and to continue building a source of information, connections, friendships and solutions.

Best regards.

Bill Osborn

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• CHESTER A. GOUGIS
President, Chief Executive Officer

DUFF & PHELPS, LLC

July 16, 2003

Dear Business Owners and Colleagues:

Family owned business represent the core of the U.S. economy. Duff & Phelps LLC is very proud to be a sponsor of this important conference, which focuses on best practices and new ideas for this important business sector.

Duff & Phelps LLC has been a trusted financial advisor to family businesses for over 70 years. Part of our role in helping our family business client achieve their goals is making sure that they are aware of the best and newest ideas in dealing with all of the unique challenges facing family businesses.

We look forward to continuing to work with Northern Trust and Kellogg to help bring this program to family business. We hope this conference gave you a better understanding of the unique and critical family issues facing your company.

Best regards,

Chet Gougis

Corporate Advisors Since 1932




Contents

MODERATOR: David Blowers
President
Personal Financial Services
Northern Trust Corporation

PANELISTS: Charlie Farver
Chairman
Pella, Inc.

Steve Waichler
President
Follett Family Council

Clay Mathile
Chairman
CYMI Ltd., Family Office

Best Practices From Business Families

Panelists offer special examples of family business practice. Topics include ownership education, philosophy, family councils, offices and foundations, and preparing for the sale of the family business.

Best Practices from Business Families

THREE SUCCESSFUL FAMILY BUSINESSES SHARE BEST PRACTICES

David Blowers:
We have three highly successful individuals from highly successful family businesses to talk about their best practices. Similar themes cut across each of their presentations – themes around vision and mission for their families, around leadership and family education, governance and family values, as well as themes that touch on culture, coherence, involvement and fun. Our three panelists are Charlie Farver, chairman of Pella Windows, Steve Waichler, president of the Follett Family Council, and Clay Mathile, chairman of CYMI, the Mathile Family Office. Charlie represents the third generation at Pella, Steve is a fourth generation member of the Follett Family Council and Clay is first generation of CYMI.

Charlie Farver is our first speaker. He and other members of the owning family have worked for many years to clarify the roles and responsibilities of family owners at Pella. They have succeeded in developing a philosophy of family ownership that works for their organization and company and have created educational opportunities for the next generation of family owners.

CHARLIE FARVER, PELLA WINDOWS

Background
I want to share a few ideas about the Pella process and touch on three broad areas: how we got here, our family governance system, and our business governance system.

Pella manufactures high quality products for the "fenestration" industry, which means windows and doors. We have 10 manufacturing facilities in four states. We are primarily a domestic company with some business in Canada and a limited world market. We are really proud of our world-class team of people, which is something we have worked on from the very beginning of our company in 1925.

"We have been honored over the last four years to be named to the Fortune 100 Best Places to Work list, which we feel affirms our commitment to our culture, our values and our people."

We have been honored over the last four years to be named to the Fortune 100 Best Places to Work list, which we feel affirms our commitment to our culture, our values and our people. In fact, this year we were number 12 on that list, which is also remarkable for a manufacturing company.

Our company was founded in 1925 by my grandfather, Pete Kuyper. He bought an innovative company that made rolling window screens and brought it back to Pella, Iowa. In the late '30s we started making windows. We continued a systematic steady growth through the next several decades. But in the '90s we began to grow rapidly, not only through organic growth, but also through acquisition. Our industry is just beginning to consolidate and so far we have been fortunate to be a predator as opposed to the prey.

Early Leadership

Our company has always had a strong team concept in its leadership starting with my grandfather, my father and my uncle. We suffered two cataclysmic events in 1980. My father had already retired and Uncle Stu was running the company at the time, then both he and my Grandfather Pete passed away in that same year. We had no family members prepared to run the business but, fortunately, we already had a strong outside board of directors in place. We were also fortunate to have a strong individual within the company and we promoted him to the position of CEO and thus began our journey of transition from a family owned and family managed company to a family owned but professionally managed company, which is how we are still operating today.

Compensation, Profit Sharing and Philanthropy

Another key element of the Pella process is our company's focus on sharing. Our compensation packages are very competitive. We are a professionally managed company and we want to be able to compete for top talent, so we work with a number of compensation consultants to make sure that our packages are competitive. As a result, we have a world-class team of managers and a world-class team of outside directors.

"My grandfather started a profit sharing plan in 1952 and through it we share a significant portion of our profits with all the employees in the company."

My grandfather started a profit sharing plan in 1952 and through it we share a significant portion of our profits with all the employees in the company. We have paid into that plan every year, and every year we have been fortunate enough to have steady sustained growth. Profit sharing provides a significant benefit to our employees when they retire. We also have a strong commitment to the communities in which we operate. We have a family foundation, a company foundation and what we call a company caring fund. The foundations contribute to each of the communities in which we operate, with the local management teams empowered to make distributions that they feel will have the most impact in the community. We also have a matching gift program. Our company caring fund is specifically targeted to employees of the company who have a particular need or emergency.

Governance

One of the keys to our success is communication. If anything, we over communicate. We have two specific family meetings yearly. One is an annual shareholder meeting, in which the shareholders, our board and our management team get together for about three days to focus primarily on business issues. Then, we have a family meeting every August, which consists of the shareholder group, their spouses and their children. The focus here is on fun with just a little bit of work. In recent years we have started generational meetings. As a member of the third generation, we meet twice a year beyond these two annual meetings while our fourth generation has been meeting up to four times a year. We have found that it is important during these meetings to have some unstructured time, because those are the times when the real issues come to the forefront. In addition to that, the director of our shareholder office and I try to meet individually with each shareholder or each shareholder family twice a year on a one-on-one basis. We update them on the state of the business, but more importantly once again that is a time to listen.

Stewardship

"We like to think of our business as an heirloom which we pass on from generation to generation."

We like to think of our business as an heirloom which we pass on from generation to generation. We compare it to passing along a grandfather clock or a Faberge egg or something that is very fragile and has to be nurtured, cradled and respected, and we try to get successive generations to think of our business in this regard. We also try to lead by example. Interaction with our employees is very important so we sponsor some wonderful events every year, one of which is our annual Christmas party where we honor years of service and perfect attendance. We have people who have worked in our company for over 50 years. My grandfather, interestingly enough, never missed a day of school from kindergarten through high school graduation so he thought that would be a great concept to perpetuate. Early on he started awarding anybody who had perfect attendance with the company with a $100 savings bond. We now have between 60-70 percent perfect attendance annually in our hourly ranks.

"We now have between 60-70 percent perfect attendance annually in our hourly ranks."

Shareholders and Leadership

Our company is different from others in that as a shareholder, you do not have the opportunity to seek a career within our company. You can't work there. Over the years we have found that there are many more down sides than up sides when family members work in the business, so we encourage shareholders to go out and establish their own careers or foundations. They can bring that back to the family company later through the board. We have two family board seats, we have two family observer positions in our board and we have always had a family chairman. Ours is really a position of ownership and governance as opposed to an opportunity for management.

One of the things we are working very hard on right now is the development of our fourth generation and the potential leaders from that group. We gave them a charter to define the process whereby they would become potential fourth generation leaders and surprisingly enough, they designed a much more rigorous process than we third generations would have had we been doing it for them. In addition, within the last two years we have developed our shareholder office, which has been a terrific intersection point for communication between the family and the company.

Business Governance

Our board makeup is six independent non-family members, two family members, and two management people. We meet four times annually. Our outside board members normally come on for three three-year terms. We want to keep getting fresh ideas into that boardroom, but at the same time we want to have enough longevity to gel into a cohesive group.

To keep these segments separate—family, governance and management—we draw these very distinct lines in the sand. We encourage our shareholders to air their issues or ask their questions either through me or through the family office. We have direct interaction with our board, our family, and our management team. If a family member has a specific issue or question, we encourage him or her to take it through the governance system instead of asking a specific manager about it. In a professionally managed company, the managers have to know that there is a level playing field and that there is not going to be shareholder interference. The professional manager's job is to manage the company, the board's job is to govern, and the family's job is to support that whole process.

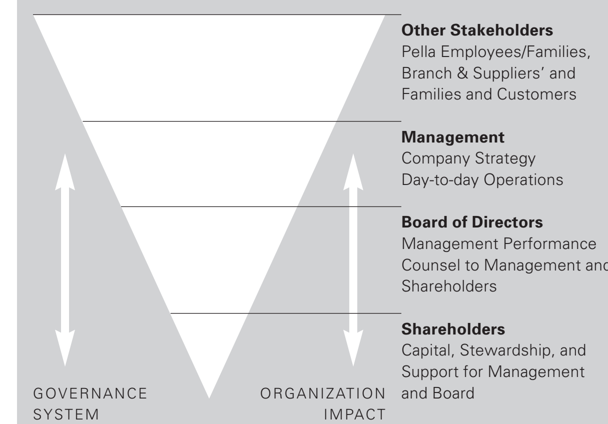
"The professional manager's job is to manage the company, the board's job is to govern, and the family's job is to support that whole process."

To that end, we've put all of our voting stock into a voting trust. The trust has two trustees who vote the stock on an annual basis to elect the board. The trust has duration of 10 years and normally when we get into about the sixth year of the trust we begin the process of reaffirming and renewing it for another 10 years.

An Exit Strategy

We also realize that this isn't going to be a good fit for everybody in the family, so it is important to have an exit strategy. If there are shareholders who really don't feel like they fit, then there needs to be a way to get out. We have a defined valuation for shareholders who want to sell out and we have payment terms for the company to buy the stock. We want a fair value to the exiting shareholder, but we also want to be fair to those staying within the company who are going to continue to have the responsibility of keeping all these wonderful people employed and all these opportunities going forward.

Shareholder Responsibility



The actions or lack of actions of a few have significant consequences to the organization and its stakeholders

As owners, it is important for us to realize that we have all these different stakeholders and all these different constituencies and the ultimate responsibility of that really falls on the shoulders of the shareholders. We can be the 900-pound gorilla if we want to be, but we never really want to do that. If we're not firmly planted, if we don't have a strong foundation, we can very easily upset this balance.

Clear Roles

The role of each constituency – team members, management team, board and shareholders is clearly defined. We like to characterize it as a system of checks and balances that encourages productive discussion and debate at each level, but ultimately results in consensus and determined action.

Audience Questions

Please define team concept.
We look at this as one of our competencies and it is specifically defined within our company. We started the process in the early '90s when one of our outside board members brought this concept to us. We are continually challenging processes, bringing members together in teams to tear apart an assembly line and put it back together, to tear apart a specific process and put it back together. We use it at the board level; we use it at the family level. The idea of team concept requires continuous improvement and involves as many constituents as we can from different disciplines in trying to make ourselves better.

Could you elaborate on the fourth generation's plan for self-development?
If a member of the fourth generation would like to throw his or her hat into the ring to be a potential family leader or board member he or she first sends a formal letter stating that intention. We then put together a mentoring team made up of one outside director, one management team member and one family member – not from the asker's immediate family – and then we design a specific program for that person, probably over a five or 10-year period, to introduce different areas of the business and raise the level of understanding of the business. In addition, he or she probably would attend each board meeting.

You have described your business as a family heirloom. How do you teach stewardship and balance that with a need for the business to take risks?
We talk a lot about risk. We think we are probably not being good stewards of a company if we are not taking enough risk so we are pretty risk oriented. As a shareholder group we are probably more risk oriented than the management team is and one of the throttles on that is this profit sharing program that has become so ingrained and so much a part of our company. We have a high level of productivity from all of our employees. Sometimes there is a feeling as owners that we probably don't take as aggressive a risk as we might because we don't want to risk the opportunities of our stakeholders. It is a delicate balance.

Could you talk to us about what it was like working for a customer that knew you from your family, and what you learned from that experience?
It was a terrific experience. I am more slanted to the sales and marketing side. I love being in touch with customers, finding out why they like our products, why they don't. I had a neat experience one day in Lowe's. I was in the store and I was looking over at the window and door aisle and I saw this person roll out a competitor's door. Right in the same area is a big Pella door display. After the customer left I went over and said to the one of the guys behind the desk, "Why did that customer buy that door?" He took me over and he showed me our screen and he showed me their screen. I would have bought the other door too. And this has reminded me that we need to really talk to and stay in touch with our customers.

Are your trustees family members?
Our trustees are family members. They happen to be my cousin, Pete and me at this time. We each designate an alternate trustee in the event that there would be an untimely death of either one of us. As part of our transitioning process, each third generation family member is going to give some voting stock to the fourth generation. We are going to use this as an opportunity to renew the voting trust. While the fourth generation will not be obligated to put this voting stock into the trust, we certainly hope that they all will. At that time we will choose new voting trustees.

David Blowers:
Our next speaker is Steve Waichler. Steve is the president of the Follett Family Council. Follett is a very large, old and successful family business and family itself. They have a family council that has played a very important role in shaping both the family's and the business' governance systems. We are delighted to have Steve here this morning to talk to us about some of the things that they have learned through that process and also about some of the challenges they've faced.

STEVE WAICHLER, FOLLETT FAMILY COUNCIL

The Council's Evolution
Follett Corporation is a fourth generation family company. We had $1.7 billion in sales last year. We serve the education market in the U.S. and Canada as distributors, wholesalers and retailers. We are a large and growing privately held company with a rapidly increasing number of shareholders. The family has over 200 descendants across five generations alive today. There are four main family branches that began in our second generation. These branches vary in size today from 30 to 70 members. We have 12 third generation branches, 39 fourth generation branches and over 100 family members in our fifth generation. When the fifth generation starts getting married, there is really going to be major branching.

In the last decade, we went through a process of succession from our third to our fourth generations. This process really drove our governance evolution and led to the development of a family council. Our family's succession is happening and has happened in three areas sequentially. It began with family succession on the board, was followed by family succession in management, and is currently ongoing in family ownership. Our governance evolution is also an ongoing process and is driven by emerging functional needs. Some of these needs are created by our growing business. Some of these needs are created by family succession in these three areas. For governance to work it has to adapt to functional needs and it also has to reflect the embedded family culture.

> "For governance to work it has to adapt to functional needs and it also has to reflect the embedded family culture."

In 1990, we were a third generation family board that was composed of cousins and spouses. It was a fairly large board that included both management and non-management family directors and was primarily led by family management. It included women shareholders who held rotating seats. We had a seat for each of the four, second generation family branches, and the women from those family branches rotated in two-year terms onto the board. Many of these women were the actual descendents of the family and significant shareholders, and they helped to provide an ownership link with our board. Our board also fulfilled a cultural transmission function. At that time, members of the family were brought onto the board after they had come into the business and worked in the business for a certain amount of time. It was a kind of right of passage, and in 1990, the first few members of the fourth generation had already been brought onto the board in this process.

The Need for a Family Council

> "The underlying question that we were trying to answer was: how are we going to bring the fourth generation onto the board and into governance?"

We started our discussions about a family council in 1989. We had learned about the challenging stage of family business development that we were in, and we started thinking that maybe we needed to have a family council. The following year the board started looking at succession on the board, and they formed an ad-hoc committee with the specific purpose of developing a plan for board succession. The underlying question that we were trying to answer was: how are we going to bring the fourth generation onto the board and into governance? Unlike the third generation, it was a very large generation and the highest percentage of this generation was not in the business. In order to bring this group into greater contact with the business, we founded a family council in 1991. This council was in turn empowered to nominate four rotating seats on the board. The size of our board was expanded again. We had a lot of discussion at the time about the right size and composition of our board. This change was really driven by the desire to involve the fourth generation in governance and we made this change with the recognition that this was an evolutionary process – that this was not the board or the council that we were going to have forever.

The Council's Organization
Initially, we started out with a very inclusive family membership definition. You didn't have to be a shareholder. We included all spouses, adopted descendents; we had a broad definition so that we could bring in the whole family. All family members that were over the age of 21 could participate in a family assembly once a year. The council was elected at this family assembly. There were 16 members to the council and we had an informal goal of spreading representation across the four second generation family branches. The council elected its own officers and also voted to recommend four of its members to the nominating committee of the board.

Branch Representation
Almost from the first day it was created the council has been evolving. First we formalized our family branch representation. We initially wanted to move away from branch representation, but this did not really reflect our embedded culture. There were many family members who had the expectation of branch representation. We were also faced with the differing sizes of those branches and their different levels of participation, so in order to get broad representation we found that we had to formalize it. This formalization, though, did lead to some problems. We had a very complicated structure. We had term limits and we had qualification restrictions both in terms of the council and in terms of the board, and what we found was that this led to a very limited candidate pool, particularly for those family council members who were to serve as directors. While all this was going on in the council, our board was beginning to face the prospect of management succession.

Succession
Our women family directors asked for a committee to develop a succession process. A committee of the board initiated a facilitated process to prepare for succession. They hired a facilitator. The facilitator came and worked with our family doing interviews and then facilitated a large family meeting. Out of this our governance structures were revisited and a plan for a succession process was developed. Our board and council structures were changed again. In first establishing our council we were driven by board succession, while our subsequent governance changes were driven by management succession.

> "The first thing that we did was to downsize our board and add independent directors."

The first thing that we did was to downsize our board and add independent directors. The initial goal of this was to create more objective succession decision-making processes. This also reflected our desire to have a smaller, more professional board. The council representation was changed so that it represented the 12 third generation branches, with each branch selecting two council members. The selection process was no longer formalized. There wasn't a vote. Each family could decide how to select their representation. Initially, the council recommended the slate for inside directors, and the thought was that the nomination of family directors would come from our family council. Subsequently, though, the director nominations process was returned to the board because we saw that nominations were a board function and we wanted to pursue best practice.

The Council's Functions Evolve
Originally, our council activities were very closely linked to the board. This was because of the selection and participation of council directors, but it also reflected the way that we structured our meetings. The board meetings were on Fridays and the council meetings were on Saturdays and attendance at the two meetings was virtually the same. We were preparing our family members to be directors in the council so a lot of the council time was spent in training. The council also functioned to organize meetings, including family meetings, and we conducted a fair amount of committee work early on. Today, our model is evolving towards a more event driven shareholder relations model and less of a representational body.

Many Challenges Face the Council

Future Challenges of the Family Council
Drop in participation levels challenges functional model
Future dramatic increase in family size
Future dispersal of ownership interests
Impacts of business growth, complexity, and challenges
Must continue evolution of council to address current needs

The first challenge that we have experienced is a drop in participation levels that tests our functional model of being a representational body. We have low participation in council meetings. I think we had a certain amount of meeting fatigue in our family. There were just too many meetings and too much business content. We also got to the point where our board and management succession were done and we were facing a change in what the functions of the council would be. We are moving from a short-term to a long-term orientation, and the needs we are beginning to face are really driven by our next succession cycle.

The first driver of all of our future challenges is the dramatic increase in our family size. We have a very large fifth generation that is coming of age and they need orientation. Marriages will double the size of that generation in about 20 years and then we will also face the challenge of orienting adults who are coming from outside the family. The sixth generation will follow closely on that and our family size will explode, as will our diversity and geographic spread. This will be a huge challenge for us.

The second main driver of our future challenges is the future dispersal of our ownership interests. We currently still have a small group of key shareholders. Our voting stock concentrates control in older generations and family management can still work directly with these individual shareholders today. Ownership succession for us has lagged the board and management succession, and it is an ongoing and continuous process. Over time our future ownership dispersal will likely create new functional needs for our council. Right now we are facing the need to have more effective large group shareholder relations.

One of the complicating aspects of ownership in the future is that along with individual shareholders, we are starting to see more and more shareholding vehicles. Shares are held in trusts, partnerships and LLCs. Over time, we will have greater variety in the size of share holdings and the larger holdings will likely be held less by individuals and more by these holding vehicles, which will often be collectively managed. I think we will see these emerging and becoming more like institutional investors.

Another driver of our future challenges is the impact of business growth, complexity and challenges. We anticipate our business will continue to grow and develop and we think that it is important that our ownership remain responsive to the business, its needs and its strategic challenges. On the business side, we are modeling best practice to be more like a public company. On the family council side, we will have to continue our evolution to address the current needs of ownership. The structures that we will use will continue to evolve and change. Currently, we view our council as a voluntary association, however, I think it is likely in the future that we will evolve toward more formal structures, as we get larger in size. The important thing is that we remain willing to change.

"Currently, we view our council as a voluntary association, however, I think it is likely in the future that we will evolve toward more formal structures, as we get larger in size. The important thing is that we remain willing to change."

Adaptation will be the key to our success and this adaptation must have a dual focus. We have to produce the necessary short-term outcomes of shareholder relations while thinking long-term and keeping focused on the next generation's succession. We also have to keep resources available for our council and the most essential of these resources is human leadership. We need to be focused on the family.

Key On-going Council Functions

Key On-going Functions of Our Council
Build family coherence
Provide for family education and fun
Draw-out and transmit family culture and values
Provide the business and board with a link to the family
Support the development of effective shareholder relations
Create value for the family and the business

Finally, I would like to list some of the key on-going functions of our council. Whatever our functional model becomes, the purposes remain pretty much the same. We have to build family coherence. We have to provide for family education and fun. We didn't provide enough fun in the past. We have to draw out and transmit the family culture and values. We have to provide the business and the board with a link to the family, and we have to support the development of effective shareholder relations. If we can do all these things effectively, then we will create value for the family and the business through our family council.

An effective family council can support the creation of three kinds of value: shareholder value, social value and personal value. Creating shareholder value is absolutely essential for our family. To do this, a family council has to keep family shareholders informed, active and engaged. We have to instill the patient long-term commitment to reinvest that has kept our family business going. We can create social value by building a business that supports many stakeholders and by instilling the idea in the family that we are making a contribution to society through the business. We can create personal value for our family members by promoting education and personal growth through council programming and participation and by telling the stories of the family business, its success and its values. These are the things that personally connect individuals to the greater whole of their family business.

Clear Objectives and Goals

"Assisting an effective transmission between generations is the primary way that a family council can add value."

The objective of our council is not only to create these kinds of value, but also to transmit them. The goal is to maintain family continuity and enable our family business' strategic advantages over time. The family council's purpose is to ensure transmission of the family business to the next generation. Assisting an effective transmission between generations is the primary way that a family council can add value. To do this, its functional model must reflect the embedded culture and it must remain adaptive and continue to evolve in response to the needs of the ownership family and the business.

Audience Questions

Do you have a buy/sell agreement for family members and if so, how do you value the shares of the stock and have you had a transaction among the shareholders?
We just instituted a liquidity program. We were using a formula method of valuation for gifting purposes up until this last year, since those were the only transactions that happened. Then we started a liquidity program, and when it was put into place we took our dividend program and we started thinking of it as a liquidity program. We are using part of our dividend program to buy back shares that are based on an outside valuation.

How did you go through the process of evolving? Were there discussions among the family; was there a shared recognition that things had changed?
I think it is kind of interesting to contrast Charlie's family and our family, because Charlie's family has all these rules and they have a very defined structure. It may be that we are so much bigger that it is very difficult to work that way, but I think we also have an ad-hoc culture where we would rather not talk too much about how we are going to solve a problem until we have the problem. Sometimes, we don't have the laid-out process like other families do and sometimes there is a little bit of muddling really. But we meet, and it is a combination of having large meetings, where everyone comes together, and having individual family managers and leaders go out and talk to shareholders.

David Blowers:
Our next panelist will talk about his experience of preparing a company for sale, and also building a family office and a family foundation. He has a wonderful story to tell in regards to those three issues. Clay Mathile is Chairman of CYMI and he was responsible for building one of the great branded companies in America. He bought Iams, the pet food company, when it had a half million dollars of sales and he sold it in 1999 to Procter and Gamble, for over $2 billion. At that time the sales had risen to over $900 million. It has been extraordinarily important to Clay and his wife, Mary, and his family that they create the family office in order to keep the family together and assure coherence for the future.

CLAY MATHILE, CYMI, LTD., FAMILY OFFICE

Growing the Iams Company
CYMI is our family office, which in the Greek alphabet are the initials for Clay and Mary Inc. In 1962, Mary and I got married and between 1963-1973 we had four children. In 1970, I joined a little company in Dayton, Ohio called the Iams Company founded by a man by the name of Paul Iams. He was a genius, had a phenomenal formula, but he had a product that dogs wouldn't eat and a package that consumers wouldn't buy. We had some work to do. We didn't make much progress between when I joined the company and 1975. Sales were at half a million in 1970 and we were only doing a million dollars in sales five years later when I bought into the company. This was not very good because the '70s was a time of high inflation.

In 1978, we learned how to package the product and we started to learn how to sell. We built a new plant and the interesting thing about this was that we built a plant to do $50 million in sales when we were only doing four million. Thank God we did, because later things really took off. 1982 was a big year for us because Mary and I bought the rest of the company. The founder decided that he wanted to retire and he offered me an opportunity to buy the rest of the company at a very favorable price.

Chronology of Success

In 1983, our sales were $20 million and we put together our first strategic plan. Anybody that knows me knows that strategic planning is absolutely how we run our business. We run our family business, we run our family office, we run our family foundation with strategic plans. Our first strategic plan called for us to go from $20 million to $100 million in five years. Most people thought we were crazy but in 1987 we hit $100 million.

"Our first strategic plan called for us to go from $20 million to $100 million in five years. Most people thought we were crazy but in 1987 we hit $100 million."

In 1985, before I would allow my daughter to join the company, I hired a family business advisor who convinced me that I ought to send her out for five years to learn the ropes and get experience elsewhere. I did, and as so often happens you send them out and they don't come back. She went to Chicago, found a young man, got married, and earned a master's degree. That same year we made our first sub-chapter S election so we could start distributing some of those dividends back to the family to help increase our liquidity. In 1986, I put together an outside board with executives from several other corporations. They were structured around functional excellence; it was a great outside board. I was not too convinced of that though in 1990 when one of the board members brought up the subject that it was time for us to hire somebody from outside to run the company. The first time they ran that by me I flinched a little bit but I came to realize the difficulties of having the intertwined roles of entrepreneur, CEO, and owner. Instinctively we separated those functions. It was probably one of the best things that I ever did.

We established the Mathile Family Foundation from the distributions that were coming out of the sub-S election. I think our first year we gifted $1.5 million to the foundation. In 1993, the kids were getting older and starting to ask a lot of questions and again we faced whether we were going to bring them into the business. To help us we hired two family business consultants. We established the family council. We also set up CYMI, which was nothing more than a partnership that was started to invest our excess profits.

"We have five children, so we put a percentage of the company stock into five GRATs with the idea of teaching our children how to manage money and how to live with money."

In 1995, we formed a G-2 committee and the second-generation committee was really important because it allowed the next generation to meet without mom and dad to talk about some issues with the advisors that were sensitive to them, to their generation. We also set up a Grantor Retainer Annuity Trust, or GRAT. We valued the company for gifting, not selling. We have five children, so we put a percentage of the company stock into five GRATs with the idea of teaching our children how to manage and how to live with money. There was a full intention that the distribution of profit, in those days it was about 20 percent of operating profit from the Iams Company, would go into the GRAT and each of the family members would participate. We made our children the trustees of their own GRATs and we are working now to try to help them effectively manage this great amount of wealth that they have.

Time to Sell, a Family Decision

In 1997, we had determined that none of the children were going to come into the business and as a family decided that we were going to sell the company. I wanted to make absolutely sure that my children had a vote or at least had a say so before I sold the company.

"I wanted to make absolutely sure that my children had a vote or at least had a say so before I sold the company."

In 1999, we sold the company to P&G for $2.3 billion. It was the largest cash acquisition that Procter and Gamble ever made. We started that process in 1997 and at first Procter and Gamble was not in the mix. Unbeknownst to me they had been studying our market for about two years.

Governance

We established a governance committee of the family council in the year 2000 and my eldest son, Tim, is the chair of that. He and I actually co-chair the governance committee, which in turn began the process of finding outside directors for these two entities that we operate. In 2001, we found it a little bit awkward to have the family foundation and the family office under one head so we separated the family office and the foundation and set up two boards. This same year the GRATs matured.

"In an effort to begin involving the next generation, we set up a little G-3 committee in 2001."

In an effort to begin involving the next generation, we set up a little G-3 committee in 2001. Our oldest grandchild is now 12 years old. The G-3's get together and they choose the family Christmas ornament that we will be giving out.

We selected two outside board directors in 2001 as a result of the governance committee and family council activities. We completed our first real strategic plan for the family office. I became the chair of the family office and Mary became the chair of the family foundation, while I am president of the family foundation and she is the president of the CYMI office.

In 2002, Mary and I told our G-2's that each family branch would be represented on each board–family office and family foundation–and that it was up to the branches to decide their own representation. I think in this generation it makes sense to encourage them to get involved and I'm very impressed with the work that the second generation is doing on these boards. We had our first board meeting with our outside directors in 2002 and I am excited about the idea and what they are bringing to the board.

"The board of CYMI consists of two G-1s, five G-2s and two non-family members. We plan to add one more non-family member. We've got the strategic plan in place."

We have a family council that meets three times a year, composed of G-1s and G-2s. The education committee is active right now with our grandchildren. The board of CYMI consists of two G-1s, five G-2s and two non-family members. We plan to add one more non-family member. We've got the strategic plan in place. We've got a board in process for the Mathile Family Foundation and, of course, we have a strategic plan there too.

One other noteworthy thing happened in 2002. Iams became the number one pet food brand in the United States under Procter and Gamble.

VISION, MISSION AND VALUES

THE MATHILE FAMILY
Vision
A Family United Forever
Mission
To be responsible stewards of God's many gifts by growing together through mutual love and commitment to our Family values

The family vision, mission and values are printed on a card and we give them to all the family members, we give them to all the family employees and anybody who wants to know about this family. Our strategic visioning committee put this all together with an outside facilitator and what we came up with is: "A family united forever. Our mission is to be responsible stewards of God's many gifts by growing together through mutual love and commitment to our family values. Our values include, but not limited to: mutual respect, honesty and integrity are basic elements of our family and business relationships. We can't achieve our Vision and Mission without these."

CYMI FAMILY OFFICE
Vision
Best total solutions for each and every generation.
Mission
To help perpetuate the family's unity and responsible stewardship by providing developmental and personal services.

The vision of the family office is to be the best total solution for each and every generation and the mission is to help perpetuate the family's unity, which is tied back to the family vision, by providing developmental and personal services. The key family issues right now are education for the next generation and how to do a better job of client services. We are dealing with leadership succession because the president is approaching 60 and we always have some employment development opportunities.

MATHILE FAMILY FOUNDATION
Vision
By working together we hope to create a well-managed, entrepreneurial foundation – dedicated to helping children reach their full potential and educating future generations of the family in how to share their privilege.
Mission
Helping children fulfill their potential.

The vision of the foundation is: "By working together we hope to create a well-managed, entrepreneurial foundation dedicated to helping children reach their full potential and educating future generations in how to share their privilege." Our mission is to help children fulfill their potential.

I believe there is no higher moral or ethical thing to do in a free enterprise system than to put your capital at risk to create jobs for other people. I want to thank you as entrepreneurs, as business owners, for what you do for this society.

Audience Questions

Did P&G try to pay you in stock?

No. One of the things those of you who have a sub-S company probably know is that when you are acquired you get a step-up in assets. That step-up in assets to Procter & Gamble was worth a huge premium. And the timing couldn't have been better for me to take cash because when we did the transaction P&G stock was $109 and it went as low as $55. A cash transaction made the best sense for us.

Did any of your children ever work in the business?

The children worked in the business on weekends, in the summers, but they always had fairly low-level jobs.

What is the focus of your family foundation?

The focus of the foundation is to help children primarily in three areas: in education, in basic human needs, and in helping young mothers of young children. The largest amount of money is going into education.

Do you miss being an active entrepreneur or do you still consider yourself to be an entrepreneur in a not-for-profit way?

I don't miss it too much, but this is a new ballgame for me. I think there are some huge opportunities for entrepreneurs to get involved in not-for-profit, to get involved in philanthropy. Your creativity and your ability to see niches and solve problems within markets and within niches are exactly what are needed in the not-for-profit area. There are many organizations out there but many important needs are falling through the cracks too.

Do you still have a relationship with Mr. Iams and how does he feel about all this?

Mr. Iams is now 87 years old and we stay in touch. I usually go and see him at least twice a year, but he had a stroke in the last couple of years. One of the things that we did because it was the right thing to do, and it was good for the business, was to institutionalize him in our company. He is the founder and one must never, never forget the founder of your company. The vision that he had and the risk that he took and the creativity that he put in should never be forgotten, whether it is a family member or a non-family member. We used to get him to sales meetings. We had him come back to do tours of plants and dedications of new research facilities. In fact, the research facility at Iams is called the Paul F. Iams Technical Center.

The following questions were directed to members of the panel as a group.

Charlie, what gave rise to your decision not to allow family to work in the company and to use voting trusts?
Charlie: One of the things we ask is how do you keep the family involved? It seems we are sort of holding them off with one hand and beckoning them in with the other. It is a pretty difficult balance but we have enjoyed great success with the professional management concept so we are trying to demonstrate to the family that this is the best way for us to perpetuate the company.

Clay, your company went from a private to a public stature. Have you had a lot of feedback from your former employees, and has it been an easy transition for them?
Clay: I think that what we tried to do at Iams, and I think that Charlie's company has done it extremely well, is to empower, to push decisions down to the lowest possible level within the organization. We had a company university help train our employees so they could take on that responsibility. I think that it is a little frustrating for people who had that experience and who liked it, to now have to check everything out with the corporate headquarters. We had quality improvement teams in plants that were empowered to spend $5,000 in capital without any approval above them. You don't do that at Procter and Gamble. But one of my old time employees said it best. He said, "If working for Iams was a nine on a scale of 10, Procter & Gamble is an eight." I think that is probably typical of how most people feel.

How do you manage succession and the selection of your outside directors?
Charlie: As I mentioned, when we bring a new board member in we say in general that we are looking for them to serve three three-year terms, although every director is elected annually. We give them an expectation, but then we also say that we'd like them to consider at the end of their terms, if we have the need, that they might stay on a year or two, which gives us some flexibility.

Steve: We don't have term limits for our board at this time. It is really more a function of the needs of our business. I think as long as our directors are functioning well and fulfilling the needs they were brought on for then they will continue to serve but that is an area we will eventually be looking at.

Clay: Initially we didn't have limits. But in 1991 when we turned the board over, we put in limits. As far as the structure/selection of the board, on the first board I used a consultant to identify individuals and the second board I used a headhunter to help me find them. It worked fine either way.

Steve, you've singled out women as having rotating seats on the board. Is there significance for that and if so, what sort of role do they have right now?
Steve: Like a lot of family businesses that are older there is definitely a cultural bias to having men go into the business and I think our family is unique in some ways because in our second generation there were four brothers who all came into the business. Many of their children were women so their husbands came into the business, meaning a lot of our third generation management was formed of in-laws. As ownership of the company came down through the family, those women, while they weren't culturally brought into the business, were owners of the business and they also were seen to be stewards of the family culture. The board was used in that third generation as a vehicle for them to both be informed about the business and inform business decisions with the family values. We are aspiring to have greater diversity in our management and our board on a gender level.

In your family businesses what was the catalyst that made you realize that developing an external board was an important step to take?
Clay: You need to have somebody to talk to. You have to have somebody to share your concerns with. You can't do it with your employees and you really can't do it with your family, at least I couldn't. Having peers is the most important thing in having an outside board.

Steve: I think the initial triggering point was succession. We wanted to have an objective decision making process on succession. We didn't want it to become a family issue; we wanted a professional process.

Charlie: We had situations where we were growing, moving into new markets, markets we were unfamiliar with, so we went out and looked for individuals who had world-class experience in those areas. In addition, I suggest that you can use your board so much more effectively if you really do engage them. The early part of our board meeting is just for the board, and then we bring in the entire management team. We bring in all of our vice presidents, so we have 15 or 20 people in the room and they have the advantage of listening to the board's comments first hand. This is not filtered through anyone else, so there are some very engaging discussions.

Clay, did you have profit sharing, and when you sold, did you divide any of that money among the employees?
Clay: We had a bonus system that was designed on meeting the business plan. We had a long-term incentive plan for the senior management group in lieu of a stock option program. When we sold the company we took a significant amount of money and we shared it with everybody. The senior management people were vested immediately in their plan, so they got cash. We set up a formula for every level in the company and then we took longevity and rank into account and across the board made a gift to every employee. The hourly employees received one month's pay for every year of service. I felt good about it and I think that is important. I drive by that place every day on my way to the family office and I don't want to be worrying about the people inside, wondering if they are happy.

David C. Blowers
David C. Blowers is president of PFS Illinois, which includes all of Northern Trust Corporation's personal businesses in Illinois. In this capacity, he is responsible for all personal and private banking, trust/fiduciary and commercial banking services, which the bank provides through its main Chicago complex and 20 financial centers in the metropolitan area.

Most recently, Dave served as president and CEO of Northern's Illinois North Region in PFS. Prior to that, he had spent his entire career on the institutional side of Northern where he held such roles as general manager of the bank's London branch, regional manager for Northern's large corporate ERISA and commercial banking business in the Eastern region of the United Sates and deputy general manager of Northern Trust's Hong Kong branch. He also ran Northern Trust's large corporate banking and trust activities in the Chicago marketplace for six years.

Dave received an M.B.A. degree in finance from Kellogg Graduate School of Management, Northwestern University, and a B.A. degree in government from Lawrence University. He is a member of the board of managers of the YMCA of Metropolitan Chicago, a trustee of Network Chicago, the public television and radio stations in Chicago, a director of the Friends of Prentice and a director of the Lake Forest Symphony. He is also a member of the Kellogg Alumni Advisory Board, the Fellows Association of Leadership Greater Chicago, The Economic Club of Chicago, Chicago Commonwealth Club, Exmoor Country Club, and the London Capital Club. Dave and his wife, Luann, have three children and live in Lake Forest, Illinois.

Charlie Farver
Charlie Farver joined Pella Corporation in 1974 at the company's Chicago based subsidiary, Pella Window & Doors. In 1976, he joined Pella's distributor in Denver, Colorado and became its president in 1980 when Pella Corporation purchased the distributorship. He served as an associate director of Pella Corporation from 1979 to 1985, when he was elected director. He became co-chairman in 1992 and chairman in 1998. Charlie received a B.A. in economics, cum laude, from Colorado College and an M.B.A. in Marketing from the University of Denver.

He is president of Inter Development Corporation, an investment and real estate development company based in Pella, Iowa. He serves as a trustee of the Pella Rollscreen Foundation, P.H. and E. Lucille Gaass Kuyper Foundation and is a member of the board of trustees of Central College. Charlie is involved in numerous development projects and charitable endeavors with an emphasis on improving the Pella community.

Steve Waichler
Steve Waichler is currently president of the Follett Family Council, which serves the ownership family of Follett Corporation, a fourth generation family company. He assisted in writing the board governance guidelines and committee charters for the board of directors of the Follett Corporation as well as the drafting of family council by-laws.

Steve is also a free-lance writer and editor, currently writing extensively about family business. He was recently published in the book *"Sharing Wisdom, Building Values,"* a collection of letters from family business owners to their successors. Prior to his work in the family business field, Steve lived and worked abroad for extended periods in the 1980s. After graduating from Stanford University with a degree in creative writing, Steve did translation work in France, and traveled extensively by bicycling in Europe and Africa, writing fiction and travelogues. He now lives with his wife and daughter in Chicago.

Clay Mathile
Clay Mathile is best known for leading the Iams Company through nearly 30 years of explosive growth. With an unyielding devotion to employees and customers, he helped redefine the premium pet food category through his emphasis on Iams' nutritional value. Revenues during this period grew from $10 million to nearly $1 billion. He sold Iams to Procter & Gamble in 1999.

Clay remains very active in local community affairs and in national business and education endeavors. He serves as chairman of CYMI, Ltd., a family owned investment firm, and as president of the Mathile Family Foundation.

MODERATOR: Barry Merkin
Clinical Professor of Management and Strategy
Kellogg School of Management

CHAIRPERSON: Jay Owen, Jr. '03, *DODI Management, Itasca, IL*

PANELISTS: John Nelson '02, *Spatz Laboratories, Oxnard, CA*

Andrea Paiz '03, *La Fragua S.A., Central America*

Carrie Meek '04, *Meek's Lumber, Sacramento, CA*

Jamee Field '04, *Old Mountain Company, Lake Forest, IL*

The Next Generation's Perspective

Kellogg students from business families describe and reflect on the next generation's choices, career paths, patterns of participation and contributions to their family businesses. Student panelists are members of the Kellogg Family Enterprise Club.

The Next Generation's Perspective

THE NEXT GENERATION'S PERSPECTIVE

Jay Owen:
The panelists are all members of the student run Kellogg Family Enterprise Club, which was started by students several years ago. The club has three objectives. The first is education, as well as creating an awareness of family business issues. Second, it is a social outlet for students, most of whom either come from family businesses or intend to work in family businesses, or are entrepreneurs themselves. Third, the club provides opportunities to network with fellow Kellogg alumni who are in the family business community.

Like the other panelists today, I am from a family business. I am a third generation member of a business that was started here in Chicago by my grandfather. It was a supermarket business called Dominick's, which we sold in 1995. It was a business that I spent some time with growing up. I worked in the stores, as well as the headquarters, and developed a very deep understanding of what the business was about. After I graduated from college I consulted for supermarkets around the world, and the year prior to coming to Kellogg I worked in our family office managing many of the private equity investments that the family makes. I have decided that after finishing at Kellogg I will not be going back to the family business.

The objective of the panel is for the next generation to share with you their experiences, their perspectives and some of their thoughts as they earn their degrees here at Kellogg. The other objective is for members in the audience of the senior generation to ask questions of our generation and to begin to create a dialog and an understanding between the current and the future generations. We hope that issues like succession planning will become more openly discussed between the generations. Panelists will share some of the practices that are going on within their respective family businesses, plus share their plans after they graduate from Kellogg.

Professor Barry Merkin:
As moderator, I want to discuss inflection points. It is a phrase Andy Grove has made very popular in his book *"Only the Paranoid Survive,"* [1] which is an interesting phrase in itself. Basically he defined inflection points as those times in life when changes are particularly powerful, profound, often permanent, and create an enormous change in the future. Clearly, the decision of whether or not to enter a family business is exactly one of those inflection points; it is a decision that is powerful, profound, often permanent and hugely impacts the future.

Another example is the question of where young people go to college. This is a huge inflection point. There are those, and I am one of them, who believe it has a huge influence on one's future including such things as career, income, marriage, studies, friends, hobbies and values. Parents often believe quite strongly, and quite correctly, that they have much to contribute to choosing a school, while children often feel just the opposite. And quite strongly. With each unable to understand the other, parental attempts to help can fail and even become counter-productive at a time when much help is needed.

"To productively participate in two of life's inflection points, college decisions and family business decisions, parents need to understand what is going on in their children's heads, but getting it from them is very complicated."

Some time ago, I had the good fortune to spend about 10 years interviewing students for Brown University. This meant spending hundreds of hours talking to young people and trying to understand what is in their heads and hearts to determine if we thought they would be comfortable in the Brown culture and whether they could make a contribution to the Brown community. Later on, when it came time for my own children to start this college adventure, we had less stress, I believe, because of the insight gained from my unusual interviewing experience.

To productively participate in two of life's inflection points, college decisions and family business decisions, parents need to understand what is going on in their children's heads, but getting it from them is very complicated. There can be emotional issues, factual arguments, perception differences and instances with people speaking without listening. Perhaps the best source for better understanding might be to talk to other young people who will be more candid without the over riding parent-child emotions. While this is the best source, it is usually not possible.

At conferences such as this, for example, you can learn much from each other about things like marketing, or strategy, or taxes or globalization. But a genuine understanding of the next generation's perspective is far more difficult.

This student panel presents you with a fascinating opportunity to get information quality that I don't think you are going to learn elsewhere. These are remarkable young people. They have agreed to be open about their personal emotional and intellectual feelings. They are very articulate. I have spent hours with this group and it has been a real thrill for me to watch how much they have learned from each other, which is very much the Kellogg culture. It has been humbling, to say the least, to realize how much I have learned from them. Our goal today is to see how much of that learning we can share with you.

JOHN NELSON '02

Background
I graduated from Kellogg's one-year program last July. My family business is a color cosmetics firm. Our customers include brands such as Clinique, Maybelline, Estee Lauder and Revlon. Our business designs and manufacturers both the primary package, as well as the formula, so in simple terms, we develop something like a lipstick case as well as the formula that goes inside the lipstick case. We have approximately 150 employees and one facility, which is located in Southern California. My father purchased the business in 1989 from the founder, who started the company in 1955.

I am the chief operating officer, my father is the chief executive officer, and my sister is the director of product marketing. My sister and I are the only siblings, and none of our three spouses are involved in the business. Both my sister and I worked for at least three years before we joined the business. I worked at Andersen Consulting in their supply chain line of business and my sister worked at Nordstrom's in their special events and promotions group.

Entering the Family Business

"My decision to initially enter the business was not an emotional one since there was no emotional attachment on my end prior to joining."

My decision to initially enter the business was not an emotional one since there was no emotional attachment on my end prior to joining. I never grew up around the business and I certainly did not view it as a family business because my father had only purchased the company the year before I went away to the University of Missouri. For me, the business was just the place where my father worked. It would have felt no different for me had he worked at General Motors, for example.

After earning my undergraduate degree in international studies and general business from Missouri, I returned to Southern California where I worked for three years with Fortune 500 companies doing consulting. I always planned to go back to business school, but before I did that I wanted to balance my three years of corporate experience with a more hands on entrepreneurial environment. I distinctly remember wanting to work in an environment where I could see the results of my recommendations and where I could actually implement my ideas. So, at that time I explored various small to mid-sized companies, one of which happened to be my father's. After talking with a few different companies, my father's company seemed like the best fit for me at that time. There was no pressure by my father for me to enter the business. I was the one who approached him and really initiated the discussion about what I felt I could bring to the business. When I entered the business in 1999, it was with the idea that it was strictly a short-term commitment.

Staying in the Business

"I'm sure my decision to remain in the business would have been quite different had I not seen the strategic opportunities of the business and the financial upside."

After spending some time in the business, I came to the decision that I wanted to remain with the company. The factors that drove that decision were quite different from my initial decision to enter the business. When I entered, the company was not really performing as well as it could have been but I saw potential. I saw underlying opportunities that if exploited could provide a form of uniqueness in the marketplace. I'm sure my decision to remain in the business would have been quite different had I not seen the strategic opportunities of the business and the financial upside. I also needed to know that I could take on significant amounts of responsibility. Fortunately for me, my father's management style and his personality really allow me to do that. These factors are unemotional and were at the top of my list for entering any business at that time.

"After spending two years in the business, with my father and then my sister, who entered the company at the tail end of that time, I found it extremely gratifying to really be a part of a family business."

But my third reason to stay in the business was driven by emotion. After spending two years in the business, with my father and then my sister, who entered the company at the tail end of that time, I found it extremely gratifying to really be a part of a family business.

Lessons Learned
Since my return to the family business last July, I have learned some important lessons that I want to share. First, diversity has proven a real advantage for us. My father, my sister and I have very diverse backgrounds. I think on paper people would look at us and ask how such different people could get along, let alone work effectively together. But we have found a way to embrace that uniqueness because all three of us have our skin in the game. We all know that the future success of the business is not a given.

Another important lesson I have learned is that establishing an outside board of directors has been extremely beneficial for us. Our business, like many other businesses, regardless of if they are family run or not, had a tradition of being inwardly focused. To combat this we established an outside board of directors that allowed me to become accountable to somebody else besides my father. I really cannot say enough about what a great experience having an outside board has been for us. Another thing I have learned is just how valuable my M.B.A. experience is. When I came to Kellogg, I already knew I would be returning to my family business, therefore, I was able to tailor my courses and my activities towards the family business area. Both inside and outside the classroom I was able to apply what I was learning in real time fashion, and by the time I left Kellogg I had a much more holistic view of our business.

"The fourth thing I learned is that regardless of how much my father, my sister and I planned for my return to the business, there were surprises."

The fourth thing I learned is that regardless of how much my father, my sister and I planned for my return to the business, there were surprises; specifically, certain managers who we predicted to be on board with the change turned out to be our biggest resistors. These managers consumed a tremendous amount of time with their problems and ultimately they decided to depart the business, which I am now convinced was the best thing for us.

Most important has been my father's progressive attitude and openness towards change. He has set the tone for both my sister and me as owners as well as managers. I feel extremely fortunate that he has given us a tremendous amount of professional freedom—freedom that we have never asked for at any point.

In conclusion, I am here to represent the viewpoint of a person who is committed to joining the family business. In my case, four years ago I was committed to entering my father's business but today, I am committed to making—not my father's business—our family's business as successful as it can possibly be.

ANDREA PAIZ

A Family Heritage
I am a third generation member of a family business with primary focus in food retailing in Central America, as well as other investments and other ventures.

I have decided to join my family's business and I am excited, I am nervous, I am afraid. I have never worked professionally at our family's business, however, I did spend one month during school vacations from the time I was nine to 16 years old, working at supermarkets, demonstrating products and putting products on the shelves. In order to work for the family's business full-time, we must have a college degree and one year's experience in a company not related to our own. So, after graduating from Babson College I worked for New Zealand Milk as a brand manager in Central America. I left New Zealand Milk to come to Kellogg and it has been here where I have pondered the question of whether I should go back to my family's business or continue a path with multinational brand companies.

Over the last four years, our family business has gone through some changes as we partnered in 1999 with Royal Ahold, the Dutch international food retailer and then partnered with CSU in 2001, a Costa Rican family owned food retailer. So, while we hold a part of a larger pie, we only hold a third of this pie. Even though our family continues to run the business in Guatelema, our core family business is no longer family controlled, so we are now faced with the decision of what to do for the future as a family. As the third generation, we have taken this as an opportunity to define what we want our family business to be in the future. At the same time, we are taking over the business as the second generation reaches a point where they want to explore other areas in their lives.

Sell or Stay?

> "My decision to join the family business comes at a point when the third generation is in the process of defining whether it wants to continue in business together or cash out with each of us going our separate ways."

My decision to join the family business comes at a point when the third generation is in the process of defining whether it wants to continue in business together or cash out with each of us going our separate ways. If we choose to continue working together then we must determine how we are going to regulate the ways we do business with each other. To assist with this, we are in the process of creating a 2020 third generation vision, family constitution, family office and family council. We realize that in order for us to have a successful transition into the third generation, we must redefine our ways of doing business. What worked for the second generation will most likely not work for us.

Personal Decisions

What are my plans for the future? I have decided to return to my home country, Guatemala, and join my uncle's distribution company that not only distributes, but also runs marketing activities for international companies without headquarters in the region. I was fortunate enough to have had a job experience at New Zealand Milk, which is in the same industry as the one my uncle was running and I was also thankful that my uncle noticed my progress on the job and my capabilities. He offered me a job after Kellogg and I will be joining the company searching for new product lines and launching them into the market.

> "These experiences definitely brought us together, got us thinking about what we want to do in the future and the unanimous decision was that no matter what, we wanted to continue doing business together."

A big factor in helping me realize that I wanted to work with the family was the fact that this was a very emotional year for our family, as we lost my uncle in a terrible tragedy and then lost my grandmother, all in a two-month period. Even though we had been working with a family business consultant for over 18 years, we were not fully prepared for this double tragedy. Through these sad experiences our family came together like never before. The feeling of love and support from cousins coming from Hong Kong, Spain, France, Boston, Chicago, Miami, to be there for the family was overwhelming. While we have always been a very close family, sometimes it is hard to keep everyone together when you are down to the third generation. These experiences definitely brought us together, got us thinking about what we want to do in the future and the unanimous decision was that no matter what, we wanted to continue doing business together. Ultimately, this helped to further strengthen our family ties and has made it clear that there is no way that any of us can do one percent individually of what we are able to achieve collectively as a family.

Nobody ever thinks tragedy will hit him or her, but when it hit my family, we realized that all of our planning helped us to deal with this in the best possible way. Had we not already done this work together, we most likely would have started drifting apart, particularly because it was my grandmother who held the family together and made sure we continued to share in family rather than business events. My grandmother was our source of strength and leadership in terms of the family while my grandfather led the business.

I believe that at this point in my life, working with my family will provide me with excellent working conditions, as well as an ability to grow professionally. I also foresee long-term opportunities for myself and envision enough flexibility for me to engage in other family related dealings, such as being a part of the formation of a family office or participating on the board of directors.

The Pressures of Success

So you may be asking why am I nervous or afraid? I had a great professional experience working for a non-family business. I enjoyed having my privacy. Being able to achieve my goals at a place where I was just another employee was great. There was great personal satisfaction. It was something that was only mine. Working with the family, a lot of this privacy gets taken away, especially when my cousins, who are the same age I am, are now deciding my salary and my working conditions. Also, being your own individual in a place where you have to earn your job promotions is hard enough. Being a member of the owner family adds several other pressures and sets you apart from the rest of the employees. Everyone is watching you. Everyone is waiting to see if you'll fulfill expectations. Everyone is comparing you to the rest of the family, and to my luck, they all happen to be overachievers.

I've also had a great professional experience in terms of my success as a brand manager for another company. I have been blessed in my family's strong belief in education, providing third generation members with scholarships to pay for M.B.A. tuitions. This has provided us with a family with M.B.A. degrees from top universities around the world. Everyone makes mistakes, and I'm afraid of making a mistake with my family. We've always talked about preparing the family for when the black sheep of the family came along … there hasn't been one, could it possibly be me?

My parents have never pressured me into joining the family business, rather, they have strongly encouraged me to follow my dreams and focus on my true passion. However, a few members in my family have expressed an interest that I join a particular business unit after I graduate from Kellogg. This has made me feel good because not only do they recognize my achievements, but also they are thinking about me and are trying to welcome me into the family business as best they can.

> "I come to you today representing the viewpoint of a family member excited to return to work with a family."

This is my story and these are some of the questions I have been asking myself as I have thought about joining the family business. I come to you today representing the viewpoint of a family member excited to return to work with a family. I come as part of a family who has done extensive work in the family business area and I hope that I can provide answers to questions you may have about how we are creating a stimulating environment in which our family can continue to grow.

CARRIE MEEK

Family History

I am a first year student at Kellogg and I am also the fourth generation member of a family business in retail lumber called Meek's Lumber. My great-grandfather started our family business in 1920. Pappy, as we call him, bought the first yard in southwest Missouri, just outside of Springfield and started expanding by buying other yards in the area, and that is how he grew the business. He had one son, my grandfather, who was the heir apparent and was groomed from a very young age to go into the business. He did, and father and son worked together running the business. In the '40s they were having trouble getting supplies of lumber into Missouri so my grandfather traveled out to California to try and see if he could get lumber in more cheaply than through the Midwest. While he was out there he decided to buy a mill. No one really understands the decision, but that's what the decision was. My grandfather found a partner in California and once he did that he started going there about every six months and buying yards out there. He supplied the capital and his partner supplied the management. That meant the family business was expanding in two geographic locations, the Midwest and California.

Two Brothers, Two Divisions

My grandfather had four sons. His two youngest, my Uncle Terry and my father decided to go into the business. They each began working from about the age of 23. When my dad was 30, my grandfather died. My uncle and my dad immediately took over the family business and it was becoming clear as my dad was traveling out to California, that it was very difficult to manage a California business from Missouri. At the same time, the business in California was growing considerably and our partner out there was reaching the age of retirement, so when I was eight in 1982, my father moved my sister, my mom and me out to Sacramento to take over the West Coast Division. That is how the company is structured today.

> "We have 45 stores and do about $350,000,000 in sales annually that is split pretty evenly between the two regions. This provides for significant competition between the two siblings, healthy competition but competition nonetheless."

My father runs the West Coast, which is now in Nevada and California and my uncle runs the Midwest, which is now in Arkansas and Missouri. We have 45 stores and do about $350,000,000 in sales annually that is split pretty evenly between the two regions. This provides for significant competition between the two siblings, healthy competition but competition nonetheless. We do about 70 percent in contractor sales and 30 percent in cash business. Most of our sales are to homebuilders doing custom, high-end building. The rest is high volume track business, which is low margin.

Personal Background

Growing up, especially when I was in Springfield, we saw our name all over the place – it was on the doors of our stores, it was on our trucks and we talked about it at the dinner table. I saw this as an extension of the family since I really didn't know any better. When I was probably about 12, I started working summers in the main office and then also worked in the lumberyard a couple of summers and just loved it. I developed a sense of pride and responsibility for this part of our family. My father, as a model in my life, has a really strong work ethic and a lot of integrity and provides a great model at work, but he also lives a life where his family is his number one priority. That is important in my life and also in some decisions that I will probably make in the future.

I went to college at Georgetown University in Washington, D.C. where I majored in finance and marketing. I had always had an interest in media so after college I moved to New York and went to work for Reuters where I was in product development. After Reuters, I followed my boss down to The Street.com, where I eventually ran their product development group and after that I went to work for a start-up consulting group to run their media strategy group and was sent out to San Francisco to open their West Coast offices. Once I got out to San Francisco they ran out of money, of course, and I was laid off and had to decide where I was going to go next. Ironically, almost at the same time we lost our controller in Sacramento. We had real exposure because we were in the process of moving all of our yards over to a new point-of-sale system and no one to manage it. I stepped in immediately and spent about a year in the family business as an interim controller and a strategic planner. Then, I got into Kellogg and came to school.

Company at a Crossroads

Our company is at a crossroads now because my father has two daughters who are grown. My sister is four years older than I and has settled in Portland with three children and will not be going into the business. My uncle has four children, one who has already entered, one is not entering but will be the chief counsel for the business in Springfield, one may enter, and one definitely will not enter. My uncle is at the stage where he is ready to start planning his retirement. My father is at the same stage. We have many questions. Do we split geographically and each go our separate ways? We have different needs moving forward. Do we sell the business? Do we keep the business? What do we really want to do?

> "My father always said, 'Just go out and find your passion and whatever your passion is just do it. Stick with it and you will find success in whatever you do.'"

Which brings us to my decision, which is slightly different from Andrea's and John's in that it is always up in the air and always changing. My father always said, "Just go out and find your passion and whatever your passion is just do it. Stick with it and you will find success in whatever you do." He has never put any pressure on us to go into the business, but he has always said that we are welcome to do it if we want to. Having that freedom to choose has really been wonderful.

Decisions, Decisions

Yes, I would love to run the family business and work with my father because it would be a great opportunity. We had a great time when I was there before and I would be able to get a lot of experience very quickly. Most likely, I would be moved into a president position within two years after graduation from Kellogg. So that is a real draw. On the other side, Sacramento is not my favorite town and that certainly plays a part. Lumber is a commodity product that is getting more and more competitive, especially in California, which is becoming more heavily regulated. Also, I am still at a stage where I don't know who my family will be, but I know that once I get married and have children they will be very important to me. The odds of my husband finding his ideal job in Sacramento are not necessarily great, so that leaves a bit of uncertainty for me in terms of where that might take me in the future. At this stage I have decided not to go into the family business. That may change as we continue to talk about it.

> "I have put pressure on myself because there is this piece of my life that is tied to the family business that has been around for 85 years."

In closing, it is true that my father doesn't put any pressure on me to go into the business. In fact, he walks the walk. He has a succession plan in place with executives who can run the business once he retires. We have someone groomed to be CEO. Having said that, I have put pressure on myself because there is this piece of my life that is tied to the family business that has been around for 85 years. My sister is definitely not going into the business so if I decide not to go into the business there is a good chance that we might actually sell it and then we would lose that piece of ourselves. The hardest part for me is feeling like I am letting go of a tradition, which makes me sad. Whether my decision will change or not, I don't know. I am working for a family business consulting group this summer. One thing I am really interested in looking into is family business consulting because I love the elements of mixing family and business, which can provide a lot of fun and drama.

JAMEE FIELD

A Venerable Company Dissolves

My great-great-great-great-great grandfather, Marshall Field I, started a retail store bearing his name in 1865. The family's holdings expanded through the years and eventually became known as Field Enterprises. In 1982, under the stipulation of the will of Marshall Field I, my father and his brother liquidated Field Enterprises. I come to you today to represent the aftermath of a family business.

Family Office

> "A product of the dissolution of our family business was the creation of our family office."

A product of the dissolution of our family business was the creation of our family office. The family office serves to monitor our investments, it brings the family together, and it helps us to manage our lives. We meet every quarter as a family to discuss the management of our various funds and investments. Our trustees, some of the staff from the family office, and our legal council, attend these meetings. The family office was set up by my father and is not large enough to warrant any "activities" as yet to bring us all together. In another generation or two this will change and the quarterly meetings may have to become weekend retreats where everyone will spend some quality time with one another.

As I said, the other purpose of the family office is to help us to manage our lives. The staff does everything from paying bills for us while we are out of town to helping us research different charitable organizations for potential donations. While it is important to be able to manage your own life, a little help never hurts.

Here is a little of my personal background. I went to Middlebury College in Vermont, where I majored in economics and psychology. After I graduated I moved to New York, where I worked in sales and trading for four years. After that I was accepted into Kellogg. All along the way, the family office was there to support me. I feel like the office is part of the family. It is a small office with 25 people in two locations, one in Chicago and one in New York. Basically, it is the mainstay of what we are doing. My father has been very great in saying, "Go out and do what you want. Feel free to follow your dreams and we will be there to support you every step of the way."

Audience Questions

Please comment on the various reasons (want to, ought to, have to and need to) for joining a family company.

Carrie: As I mentioned before, I don't have any sense from my family that I *ought to*, but the struggle comes from within me as to whether I *ought to*. That is probably the hardest part. As much as parents try to manage the pressures that they may or may not be putting on their kids, sometimes it is hard for them to realize how much pressure the children are putting on themselves.

Andrea: I don't *have to*, but there is always a feeling that I *ought to*. It was easy for the previous generation of only five children to each go their separate ways, but with 21 cousins there was some apprehension that if we all entered the business we wouldn't be able to work together. To help, the family provided us with the ability to get M.B.A.s from top schools. The problem is now no one is returning and so from 21 cousins there are only three in the business. I'm going back to a business belonging to my uncle, but it is a small business that is not a core supermarket or hypermarket. I feel that I *ought to* go back to the core family business because if I don't, with the second generation retiring, I would worry about what is going to happen to the business.

What do you think about prenuptial agreements?

Jamee:

> "I think if you run a family business, you want to keep it in the family and you put in place measures that guarantee it stays within the family whether that means it goes into a trust that is controlled by trustees, or you require all of your children to sign prenuptial agreements."

We actually have something in place for that. As it stands, any money I have is in trust which means that even I must go to the trustees to ask for money when I need it, this puts the money under the control of the trustees so I will not need a prenuptial agreement. I think if you run a family business, you want to keep it in the family and you put in place measures that guarantee it stays within the family whether that means it goes into a trust that is controlled by trustees, or you require all of your children to sign prenuptial agreements. I think that keeping the business within the family where it was meant to be is important.

This is for the panelists whose families have sold part or all of your businesses, how closely have you watched the situation? Do you have an attachment, especially the Chicago based businesses?

Jay: My generation did not have any say in the sale of the business, and I, like a couple of my cousins, was working in the business when it was sold and we were sad to see it go. It was very much a part of our family heritage. My great-grandfather's name is on the door and it meant a lot to me, living in the Chicago area to have that family heritage.

Jamee: I think when most family businesses are sold it is out of necessity more so than anything else. Either you have run out of family to run the business or in my case, my father had to sell because it stipulated from when the business was originally created that if at any point one of the male heirs wanted out everything had to be liquidated. My father's brother wanted out in 1982 and so, as stipulated by the will, there was a forced liquidation.

Will someone on the panel touch on the concept of the family business as an inhibitor to outside careers?

Jamee: I think it is definitely true. Especially coming from a family business that has a recognizable name. I took a while to find a job and two of my interviewers actually asked me what my work ethic was. Having grown up with my kind of background they questioned if I even had a work ethic. I think a family business can be inhibiting in the sense that people interview you knowing that if you don't get this job it's not really a problem for you because you have something to fall back on.

Andrea: Someone once said, "Don't put your name on your family business." It is a great source of pride, but when it comes to generations down the line it can be a source of pressure. I went for six months trying to find a job with various multinational companies in Central America and because our supermarket was their main source of selling their products, a lot of them thought it was a conflict of interest for me or that I was not going to work hard.

What is the configuration of your family office?

Jamee: The family office is constructed with all professionals. Aside from my father, we do not have any family members in the office. We have numerous administrative assistants. We have a couple of money managers. For the quarterly meetings we have three trustees who come from backgrounds of either investment banking or money management accounting. Also included in those meetings is the office manager. When my father retires, the office manager will be taking over everything. The office accountant and an outside lawyer that we have for counsel also attend the meetings. We have two offices, one in New York and one in Chicago. The one in Chicago is mainly for personal business; the one in New York is mainly for money management purposes.

What do you see as something family companies can to do entice the next generation back into the business?

John: There was always the opportunity over the dinner table or during the weekends, just to talk about the business in a casual setting. I think it is probably a fine line. If the talks are too structured then people are going to start feeling the pressure and I think one thing that you have heard from everybody here is the fact that none of us felt pressure to enter the family business.

Andrea: One of the things that brings us back is that we grew up at those supermarkets. I was just nine years old and already selling products and asking store managers for summer jobs. That certainly brings us back to the business. But I think part of the reason why many of us haven't joined the family business is because the proper structures have yet to be put into place where we really feel that we are being compensated to the level we deserve, especially after the work outside the family business and M.B.A.s earned.

Carrie:

"I feel as hard as it is, the more freedom you can offer the better the chance that the next generation will actually choose to come back. They want to feel like this is their own choice. They do not want to feel that they are being forced to carry on someone else's legacy."

I feel as hard as it is, the more freedom you can offer the better the chance that the next generation will actually choose to come back. They want to feel like this is their own choice. They do not want to feel that they are being forced to carry on someone else's legacy. A huge draw can be the potential management experience and getting more experience at a younger age because, for instance, if I were to decide to go back in, by the age of 35 I could be running a company with 750 people in it. I think that you can really draw people in by saying that you will have a significant role and that role will be defined. I think that it is also important that you are ready to provide that role and to give up the control necessary to allow someone to grow in his or her role.

Will you comment on the role that philanthropy plays within your family businesses and your families?

Jamee: Philanthropy plays a very big role in my family and in the family office partly because we no longer have the family business, but in a larger part it is simply that this is always what my family has done throughout all the generations. We have a foundation that we all sit on and have fun family debates as to where the money will go. I think it brings us together and it reinforces the values set up by the family. I think it is extremely beneficial to a family to have some sort of philanthropy.

Andrea: We also have always been very involved in philanthropy and it comes from my grandparents. My grandmother founded the Girl Scout Club of Guatemala and both of my grandparents were involved in many philanthropic activities. We do have a foundation that focuses on education and art. It brings in big name people and allows Guatemalans to enjoy artistic and cultural events that would not happen otherwise.

For those of you where the core business has been sold, if you wanted to go and do a start-up business or buy an existing business, how does your family come into play and either support you or not support you?

Jay: The simple answer to your question is that they wouldn't. There really hasn't been a mechanism put in place to support the entrepreneurial ventures of either the third or fourth generations. It is certainly a topic that we've talked a lot about as family members, but up to this point that opportunity has not been created.

Andrea: We (the third generation) actually are working towards that right now and it is exciting because we are defining what will make our business a family business. I think it must be well defined, for example, supporting ventures through an established fund. As long as a certain number of cousins are involved, then it will become a family business.

How did your families go about preparing the professional management and the rank and file employees for your entry into the business?

John: We spent a tremendous amount of time trying to map out key managers' responses to the change before I came back into the business and then we had a series of rollout meetings where we talked about my role. We tried to couple that with the new direction of the business, so it wasn't just John is now coming in as the COO. We were very surprised by the resistance we got from people we initially thought would be supportive and by the support from some we thought would be resistant. I think that you don't know until you actually get in there how people will react.

Carrie:

"I think it is key when you go into the business to immediately acknowledge what everyone is bringing to the table and to show that you are not there to try and pull the rug out from under them or steal their jobs or anything like that."

When I just stepped in on an interim role we didn't really prepare management for my entry mainly because we didn't know where it was going to go. We were kind of playing it by ear. There was definitely a sense of trepidation for what my role was going to be and whose toes I was going to be stepping on. I think it is key when you go into the business to immediately acknowledge what everyone is bringing to the table and to show that you are not there to try and pull the rug out from under them or steal their jobs or anything like that. Make it clear that you recognize the value that they bring to the business.

How do you feel about siblings' spouses who feel that they have certain family rights to a possible position or at least equity in the business?

John: I would shy away from bringing the spouses into the business. There is no way my wife would want to work with the three of us as it is. But I think in general, it would be difficult because of the dynamics. In our particular situation, it is all we can do to just be focused on the day-to-day business with the core family members who are owners and managers.

Andrea: We started out with them being involved. My grandmother took the five spouses of her children as her children, but they also came in at a time when the business was just starting out so among the five children and spouses they really grew the business to what it is today. As a third generation, we keep the spouses out. It is hard enough to retain the family, the culture, and the values among the 21 of us who grew up in the same type of home without bringing in spouses. I think some of them do feel left out, but I think we've always tried to make it very clear for them.

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Barry Merkin

Barry Merkin is Clinical Professor of Management and Strategy at Kellogg School of Management where he has been teaching Entrepreneurship since 1993. He has a B.A. degree in American civilization from Brown University and an M.B.A. from Harvard Business School. He was President and CEO of four companies, most recently Dresher, Inc. (NYSE), three times named as one of the "Best Small Companies in America" by Business Week and Forbes. He has held numerous professional leadership roles, including the Young Presidents' Organization, World Presidents' Organization, American Association of Entrepreneurs, Harvard Business School Club and the National Conference of Christians and Jews. His corporate directorships have included Follett, Transmedia, Charter Communication and All Phase Electric. In 2000, he received one of the Ernst & Young Entrepreneurship of the Year Awards

Jay Owen, Jr.

Jay Owen, Jr. is a fourth generation family member of Dominick's Finer Foods, a Chicago area supermarket chain. The company was started by Dominick DiMatteo when he opened his first Dominick's store in 1918 on Chicago's northwest side. By the early 1990s Dominick's had garnered a 28 percent share of the Chicago grocery market. In January 1995, the company was purchased from the DiMatteo family by the Yucaipa Companies and DODI Management was created to serve as a family office. At the time of the sale, Dominick's had 101 stores in the greater Chicago area and was one of Chicago's largest employers with over 18,000 employees.

John Nelson

John Nelson is COO for Spatz Laboratories, a color cosmetics firm, which designs and manufacturers new products for brands such as Revlon, Estee Lauder, Maybelline, and M.A.C. The business includes the following capabilities: product and package marketing, package engineering, FDA certified formula development laboratory, injection mold fabrication, injection molding, custom assembly, package decoration, formula filling, and pack-out. The business was founded in 1955 by Walter Spatz and purchased by John's father, Joel, in 1989. John's sister, Laura, also works on the management team as Director of Product Marketing. Spatz Laboratories is located in Southern California and employs over 150 people.

Andrea Paiz

Andrea Paiz is a third generation member of La Fragua in Central America, which was founded by her grandfather Carlos B. Paiz in 1928. The company is now a group of retail companies operating primarily in the areas of food, clothing and household goods. Store formats throughout Central America include supermarkets, hypermarkets (with gas stations), discount stores, online shopping and membership clubs. In December 1999, LaFragua entered into a joint venture with Royald Ahold and two years later they were joined by a Costa Rican retailer owned by the Uribe family, Corporación de Supermercados Unidos. The joint company is now called CARCHO (Central American Retail Holding Company) and is run regionally by the Paiz and Uribe families with headquarters in Guatemala and Costa Rica. The joint company has over 15,000 employees and 300 stores.

Carrie Meek
Carrie Meek is a fourth generation family member of Meek's Lumber. Meek's is a building materials supplier with more than 80 years of experience in the industry. Her great-grandfather started the company in 1920 in southwest Missouri. Meek's has earned a reputation for being a provider of expert service as well as quality building and home improvement merchandise. Currently, there are 45 building centers in the Midwest and on the West Coast with headquarters located in Sacramento, California and Springfield, Missouri.

Jamee Field
Jamee Field is a descendant of the original Marshall Field, who started the retail store that bore his name in Chicago in 1865. The company eventually became known as Field Enterprises but was liquidated by Jamee's father and his brother in 1982. Her father established a family office and family foundation, called Old Mountain Company, with the assets. The office employs 25 people and has locations in Chicago and New York.

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Trends In Valuation Of Family Businesses

Valuation issues are more intense in family businesses, ranging from touchy to treacherous. This presentation highlights many important reasons to put a value on a family business and coming trends in the valuation field. Results of a new valuation practice survey are presented. Audience responses to several questions are also included.

Trends In Valuation Of Family Businesses

THE REASON FOR VALUATION AFFECTS OUTCOME

For most business owners, the purpose for valuing your company is going to be one of the most important factors in determining the outcome of the valuation. But why should the purpose of a valuation affect the answer? Isn't the value of your company something that you can objectively measure like your height or your weight? When someone asks me how much I weigh, the answer should not change whether he is asking me because he is going to put it on my driver's license, or whether he is trying to allocate the seating load in a six passenger aircraft.

One of the real problems with determining the value of a company is that it is not necessarily a completely objective measurement. In fact asking, "what is the value of a company" isn't even a very precise question. For example, asking how far is it from Chicago to New York has lots of potentially correct answers. One answer might be 750 miles as the crow flies, which really doesn't have a lot of relevance unless you are a crow with a lot of stamina. Other answers might be, it is 900 miles driving distance or a two and a half hour flight. All of these answers might be correct depending on the purpose of the question. Similarly, the answer to "what is the value of my company" depends on the perspective of why you are asking the question.

"The question of fair market value is really dependent on factors like: is the business publicly traded or privately owned, and what particular ownership positions you are talking about."

The question of fair market value is really dependent on factors like: is the business publicly traded or privately owned, and what particular ownership positions you are talking about. When you ask what is the value of a company, are you really asking what is the value of a small percentage of that company that someone might own? Are you asking what the value would be if this company were to be publicly traded? Are you asking what the value would be if we put the whole company up for auction? In valuation speak, we have names for those different values. The value of 100 percent, is called a *control value* if you are referring to the valuation of a company as if it were publicly traded, in that case, you are talking about a *marketable minority interest value.* If you are talking about the value of a small illiquid interest, then you are talking about a *non-marketable minority interest value.* These values can be very, very different. I think when companies tell us, "I've had people give me 10 different values for my company and they are all over the map," very often what they may be getting are answers to very different valuation questions. There can be well over 100 percent or more difference in value between the highest value (typically a control value) and the lowest value (typically the non-marketable minority interest value).

CHANGING REASONS FOR SEEKING COMPANY VALUATION

When I first started in the business of valuing companies 25 years ago, most family owned businesses wanted a valuation for one purpose and that was usually to satisfy some tax question like estate taxes or gift taxes and that was the only reason they wanted the valuation. The objective was often to get the lowest value possible. At least then everyone was asking the same question—that is, they wanted to know the value of a small minority interest in the company because that was what they were typically using for estate purposes or gift purposes.

> "Today, companies tend to use valuation for lots of different reasons not just for estate or gift tax purposes."

Today, companies tend to use valuation for lots of different reasons not just for estate or gift tax purposes.

Reasons for Valuation
- Shareholder buy/sell transaction
- Estate tax planning or settlement
- Gifting of stock
- Planning for sale of company
- ESOP transaction
- Divorce
- Management compensation
- Other

Buy/sell transactions are increasingly a reason companies seek a valuation. Obviously, if a company is planning or looking at liquidity options including selling the business, or establishing an employee stock ownership plan (ESOP), a valuation is necessary. It can also be needed in connection with financing. One additional purpose that is becoming increasingly important is the use of valuation in connection with management compensation, both for performance measurement as well as incentive purposes. The question of what is the value of your company now becomes more complex because that value is going to be used for lots of different purposes. As a result, you may require more than one answer to that question to address different requirements. Typically, what we see among many companies is that if they go through a valuation process, the value is often used for multiple purposes.

Following are a series of questions posed to the audience and their responses.

INDEPENDENT APPRAISALS

Audience poll

If you have had an independent appraisal of your shares, what was the motivating purpose?

Percent	*Answer*
28%	Shareholder buy/sell transaction
21%	Estate tax planning or settlement
23%	Gifting of stock
3%	Planning for sale of the company
1%	ESOP transaction
1%	Divorce
2%	Other
21%	No independent appraisal done

Interestingly enough, almost 80 percent of you have had an independent appraisal done. The biggest single reason is for a shareholder buy/sell transaction but over 40 percent have had it done principally for estate tax or gifting reasons which are very similar. These three purposes are by far and away the biggest reasons why appraisals are done. This illustrates one of the issues in terms of having reasons for the valuation that do not always ask the same question. Obviously, all things being equal, most people would prefer to have the value for an estate tax or gift be as low as possible. On the other hand, for a buy/sell transaction the answer is not so clear. Clearly, if you are the buyer, you want the value to be low; if you are the seller, you want the value to be high. Even this simplistic view is not always correct because in family businesses there is also the element that you really want a fair transaction. Not every buy/sell transaction in a family business is necessarily an adverse circumstance. Of course we hear more about the conflicts, which can arise from transactions among family members because these stories are the ones that are most interesting. However, in truth, most family transactions are friendly transactions where there is not a desire by one party to get an advantage over the other party. They simply want a fair result and that does not necessarily mean they want an especially low value or an especially high value. What they are really looking for is in fact a fair value.

BUY/SELLS

Audience poll

Do you have a buy/sell agreement?

Percent	*Answer*
53%	Yes
47%	No

A little over half of you have a buy/sell agreement. Let's compare this to the result reported by the recent American Family Business Survey by the Raymond Institute [1] that looked at a broad group of family owned and closely held companies and asked the same question in terms of a buy/sell agreement. In these broader results almost 70 percent of those companies had some form of buy/sell agreement.

Even though the majority of you do have buy/sell agreements it is at a slightly lower percentage than the group surveyed. Interestingly enough, The Raymond Institute did the same survey five years ago and this percentage was a little under 60 percent at that time. Buy/sell agreements went up about 10 percentage points over that period, which is consistent with what we see anecdotally in the marketplace.

> "More and more companies seem to be putting in some sort of formal buy/sell agreements, very often with some specification in the buy/sell agreement about how that buy/sell is going to be actually executed."

More and more companies seem to be putting in some sort of formal buy/sell agreements, very often with some specification in the buy/sell agreement about how that buy/sell is going to be actually executed. There are various processes that people use for coming up with a price at which the buy/sell is executed whether it be based on an independent valuation of the company, or whether it be based on some sort of gaming approach such as a "shotgun" or American or Russian roulette transaction. These agreements often conflict with the other reasons why a company may need to get a valuation. Even if a buy/sell dictates that the company buy/sell at a certain formula, that formula might not be useful for other things. It may or may not be appropriate to use that formula for your estate and gift taxes. Many buy/sell agreements are designed for conflict situations, particularly the ones that have provisions like some of the shotgun and roulette provisions whereby one party names the price and the other party gets to go above or below that price. That might be good for a buy/sell, but it doesn't necessarily provide the right number for use if you really are trying to, for example, provide incentives to management or if you really are selling as opposed to gifting stock to other family members.

DETERMINING A COMPANY'S FAIR MARKET VALUE

Basis for Determining Fair Market Value
- Book value
- Formula value
- ESOP value
- Independent appraisal
- Negotiated value

> "There are lots of ways to determine value in a company."

There are lots of ways to determine value in a company. We see a wide range. There are simple agreements to buy and sell company stock based on book value. Probably even more common right now are formula values that can be a combination of, or adjustment to, book value or it can be a combination of book value weighted with other things. An ESOP is a creature of the U.S. tax code and is a vehicle for employees owning stock. It is a specialized pension plan for employees. Basically, a company contributes stock into this special retirement vehicle for the benefit of employees. While there are many tax advantages to it, there is also a lot of complexity to it, which is why only some companies use it where it is appropriate. Very often if a company has an ESOP then they are going to use that valuation for other purposes as well and there are specific rules about how you value stock for ESOP purposes. Then, there are the various negotiated value mechanisms like the shotguns, the roulettes and so forth.

Audience poll:

What basis does your company use to determine the value of its stock?

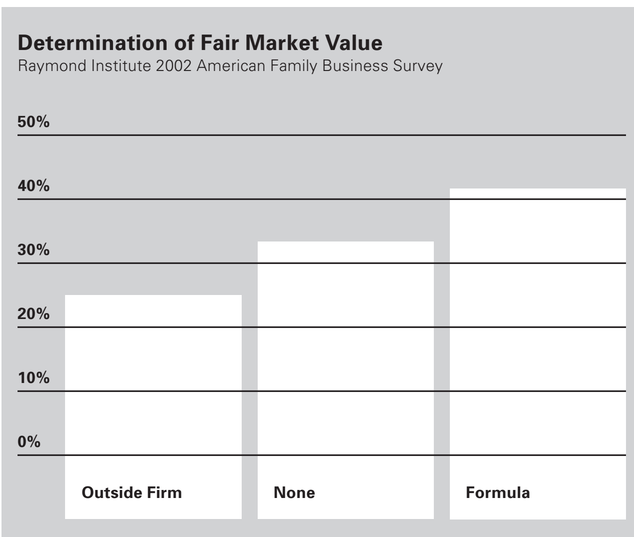
Percent	*Answer*
12%	Book value
26%	Formula value
0%	ESOP value
46%	Independent appraisals
1%	Negotiated value
15%	No valuation conducted

As you can see, we've got quite a large percentage of the group that have independent valuations of their businesses, which shows a very progressive group, while a fair amount also use formula values for their stock.

If we look at the people here who have buy/sell agreements we see that most of those people use either the formula value or independent appraisals. This makes sense since, if you have a buy/sell, you probably want to have something that's going to be a bit more market driven than book value. A typical formula value might be based on numbers like seven times the last three years average earnings, or you might even have a more complicated formula that takes the weighted average of book value. In that case you are really basing the value on the formula. For IRS purposes in particular, you might have to hire an independent appraiser to verify that the formula is representative of fair market value, but you are still basing the value on the formula.

OUTSIDE VALUATION

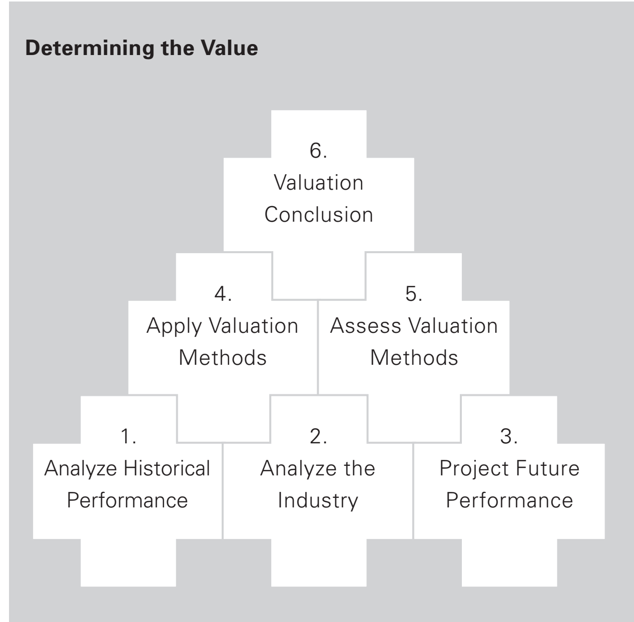
If you are getting a true independent appraisal, the appraiser is not just applying a formula, he is going through a much more complicated process to try to assess the value. This has both pluses and minuses. On the plus side it is probably more flexible and more sensitive to qualitative factors, but it has the minus of being less quantitative and objective than just applying a formula. I think this is consistent with what we expected, which is that if you do have a buy/sell then you are probably going to be using one of the methods that produces more of a market based value. We see a lot of formulas today typically moving towards trying to capture market based variables like multiples of earnings and things like that. Sometimes you can look at book value as being the ultimate simple formula, (i.e. one times book value). Now when we see formulas the tendency is that they are moving more towards market-based and earnings-based measures.



Determination of Fair Market Value
Raymond Institute 2002 American Family Business Survey

Results from the Raymond Survey show that 25 percent of the companies reported using an outside firm, and over 40 percent used a formula. Members of this audience, however, when compared to the survey group seem to rely more on an outside independent appraisal of their businesses.

One of the things that we always look at and try to understand is why companies pick the use of a formula versus book value versus getting an outside third party appraisal. Recently, several Kellogg students did a number of interviews with companies and this was one of the issues they asked about. One of the companies they talked to was still run by the entrepreneur who founded it. This man stated that he did not like having something so important to his company as valuation out of his control. Entrepreneurs like having things in control; they like to understand it. Obviously, if you have a formula you can sit down and calculate what the results of the formula are. If it's book value it's simple; you can probably just look at your balance sheet and immediately tell what the value is on that basis. The outside valuation process is much more complicated as the next chart indicates.



Determining the Value

There are a number of different pieces of the puzzle that have to come together in the outside valuation process. This model is more flexible in taking into account unexpected changes. You are not necessarily locked into a formula.

REVIEWING THE FORMULA

"One of the things I've spent a lot of time on in the last year or so is in helping companies adjust their valuation formulas, because the formulas that were created in the '90s do not necessarily work today."

One of the things I've spent a lot of time on in the last year or so is in helping companies adjust their valuation formulas, because the formulas that were created in the '90s do not necessarily work today. From time to time, companies that never thought they would lose money two years in a row are losing money. Their formulas might be based on earnings, and even though the business may still have underlying strength and possibility going forward, they have to make some really tough adjustments. As a result, their accounting earnings are well below what they had ever been in the past and suddenly the valuation formulas need to be adjusted to reflect the new reality.

In addition, particularly in the last couple of years, some of the accounting standards have been tightened. Many of these standards technically only apply to some of the SEC reporting companies, but many family owned businesses like to adopt those standards as well. Some of the changes in the standards really impact several of the valuation formulas, so again some of the formulas have to be adjusted. For example, you may have to look at acquisitions and adjust them down if they no longer are at the price at which you acquired them. For many companies that's mostly a net positive because they would rather not have to write off the good will and affect the earnings and they do not care as much about book value. On the other hand, if you are a family owned business and some of your valuation formulas and compensation plans etc. are based on book value, this may throw you a curve so you really have to go back and make some of those adjustments. Some of the changes in accounting standards and rules have impacted formula values as well and this has made companies go back and tweak their formulas.

"One thing to keep in mind about formulas is that formula valuations can work well only if they are periodically reviewed and refreshed."

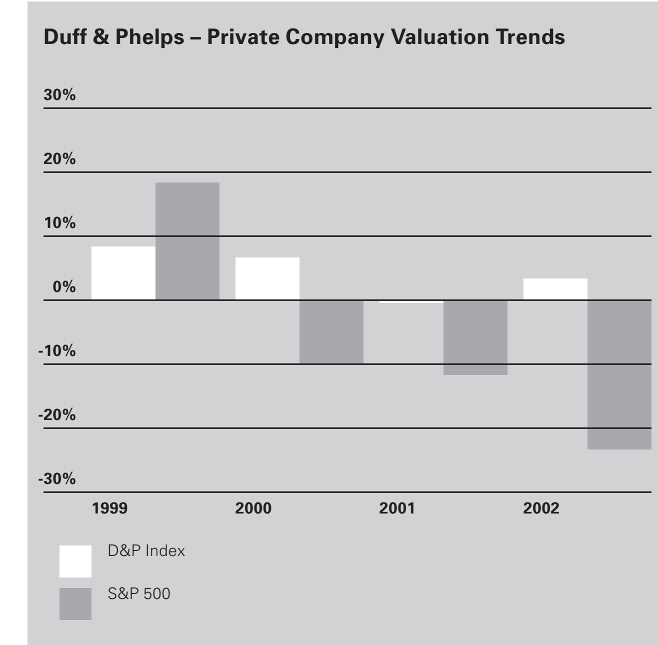
One thing to keep in mind about formulas is that formula valuations can work well only if they are periodically reviewed and refreshed. There needs to be a process in place for doing that from the beginning. You do not want to change the formula and have someone, whether it is another family member or someone else who is going to be affected by that change say, "Wait a minute, you can't change the rules in the middle of the game." There needs to be some mechanism in place that allows someone, whether it is the board of directors or a family council or someone else, to periodically review the formula.

VALUATION OF PRIVATE COMPANIES

Many companies are concerned about the outside valuation process because they think that their company is not as volatile as those in the public markets. They are afraid that if, at the end of the day, a valuation process simply compares their company to the public markets, they are going to have the same ups and downs as the market as a whole. When I get this question I usually respond that based on our own experience, the values of private companies do not necessarily go in lock step with that of the market indices as a whole. Each company is unique and that's really true of a public company as well. The overall trend in the market may be one thing, but valuing an individual company may be very different.

"As part of our research in preparing for this conference we discovered that there is not a lot of good data about the value of privately owned companies."

As part of our research in preparing for this conference we discovered that there is not a lot of good data about the value of privately owned companies. Obviously it is not something that any of you probably report to anyone outside your close group of advisors. However, we do have our own fairly large client base of valuation on companies, which by no means is a random or statistically significant sample. We looked at that because we did obviously have that information and we saw how, on average, the values for the family owned companies have changed over the last few years.

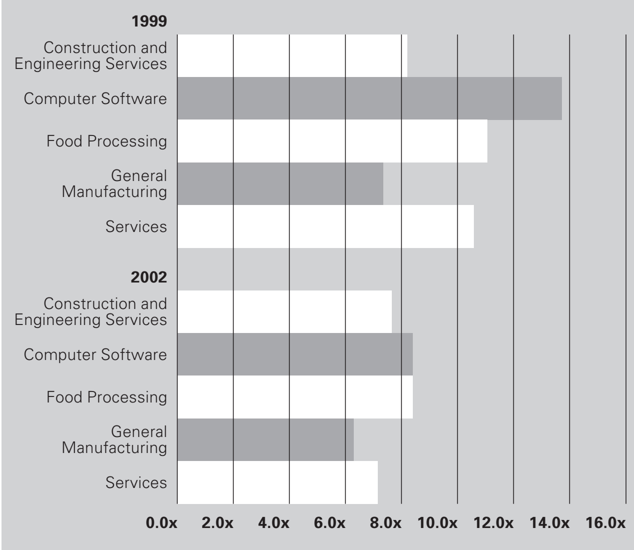


Duff & Phelps – Private Company Valuation Trends

We created an index of privately owned companies. In 1999, which was sort of the peak of the bull market, those values did not go up as much as the market as a whole, but in the subsequent years they did not go down as much as the broad market indices. We were not surprised by the fact that this happened, but I have to admit we were surprised when we looked at the overall magnitude of the difference.

"One of the obvious possible explanations is simply the fact that the valuation process is a human process and certainly if you asked most of our clients what they would prefer in terms of their valuation, they would say that they would prefer it not to be the most volatile."

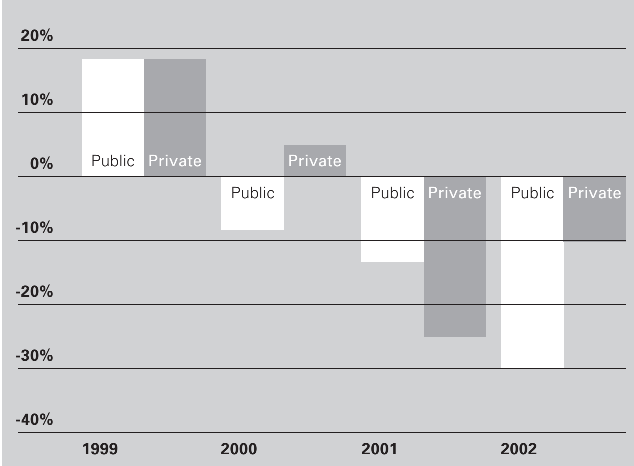
One of the obvious possible explanations is simply the fact that the valuation process is a human process and certainly if you asked most of our clients what they would prefer in terms of their valuation, they would say that they would prefer it not to be the most volatile. To what extent were we simply responding to the clients' desires for a less volatile performance and giving that to them? That's certainly a possibility for some of what is going on here. Probably not the total explanation, though, since one of the key lessons that we have learned in our business is that it is very dangerous to defer change in a volatile market situation just to smooth things out because it usually takes a lot longer than you think for that change to be effected. While there is some smoothing going on, I think a better explanation is the fact that our clients tend to be smaller than the typical company and they also tend to be more in industries like the basic manufacturing industries, which are less apt to have as much of a change as others such as technology companies in terms of multiples.



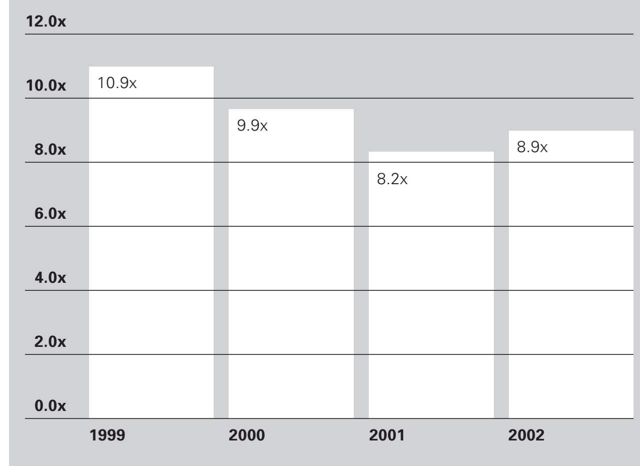
Industry Valuation Trends
Industry EBITDA Multiple Trends

MERGER AND ACQUISITION ACTIVITY

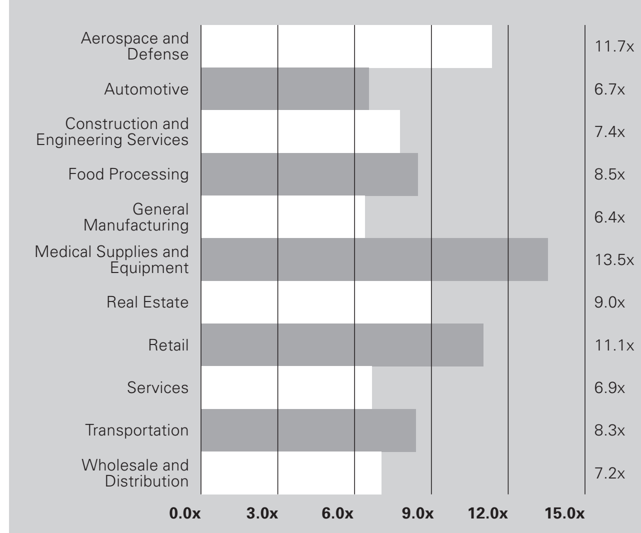
I wanted to touch on the fact that when you are talking about value of a business as a whole for sale purposes, as opposed to the value as a going concern, things beyond the public market valuation multiples can have a big impact. The level of merger and acquisition (M&A) activity, which clearly has changed dramatically, could affect it. The multiples paid in acquisitions have not been as volatile as the stock market, so as a result the values of a company, if you are talking about the value of a business as a whole, probably have not changed as much as the value of a small piece of the business. Obviously, we see that in terms of what people are willing to pay for businesses has changed a lot depending on what industry you are focusing on.



M&A Transaction Activity
Annual Change in M&A Transactions



M&A Transaction Activity
EBITDA Multiples Paid



M&A Transaction Activity
2002 Industry Multiples

FUTURE TRENDS

Future Valuation Trends

Financial performance (adjusted)
Growth opportunities
Industry trends
Market position
Management team
Unique company characteristics
Current state of capital markets

As far as the future, we see that there are a lot of things that are outside of the company's reported financial performance that are increasingly important to the value of the business. The growth opportunities, trends in the industry market position, management teams. As the market has gotten tougher, the market has gotten more selective in terms of pricing of public company stocks, as well as private company stocks. There is a vast difference between the best companies in industry and the worst companies. Based on these sorts of qualitative factors, which really look more towards the long term, we expect that the whole process of valuations is going to get a lot more complicated. Valuation formulas are probably going to have to get a lot more complicated and the job of doing an independent appraisal will be more complex as well.

Audience Questions

Does the IRS have any preferences about what valuation methodology they tend to accept more easily?
I think that if you have a reasonable formula, you can use that, but you have to demonstrate that it is reasonable and has some relation to economic realities.

What is the cost of an independent appraisal?
It varies depending on the complexity of the business and the degree to which it is diversified. There are many other factors like whether you want a very detailed report or whether you just want an opinion. We do annual valuations of companies that range from $20,000 to $200,000.

Is there much of a difference between the valuations of public and private companies?
What we find is that when you are talking about selling the whole business the multiples are pretty comparable. That is a change from 10 years ago when we would look at the prices paid. We saw much more of a discount for private companies relative to public companies. But that seems to have gone away particularly if we adjust for things like size and industry. I think the reason, frankly, is the emergence of the whole private equity community. Previously if people talked about selling a family company or privately owned business, the market was principally strategic buyers, or competitors. Occasionally there was also a loose configuration of people who would invest in private businesses. Now, there is this very sophisticated, well capitalized, aggressive private equity community whose whole business is buying and selling their privately owned businesses. I think they have really made that market more efficient and they have, in essence, arbitraged that difference between public and private companies.

1 *American Family Business Survey.* The George & Robin Raymond Family Business Institute and Massachusetts Mutual Life Insurance Company. 2003.

Chester A. Gougis
Chester A. Gougis, President and Chief Executive Officer, Duff & Phelps, LLC, joined the firm in 1979 from the corporate finance group of Harris Trust and Savings Bank. He graduated magna cum laude from Harvard University in 1974 with a B.S. in economics and received his M.B.A. in finance and accounting in 1976 from the University of Chicago. He is a member of the Economics Club of Chicago, The ESOP Association, National Center for Employee Ownership, Valuation Study Group, Executive Club of Chicago, and the Business Valuation Association. He is a vice chairman of the board of trustees of the Chicago Symphony Orchestra. He serves on the board of trustees of Network Chicago (WTTW), and the Ravinia Festival. He is current chairman of the board of directors of The Night Ministry and is affiliated with the Chicago Urban League.

RECIPIENT: The Puig Family
Corporación Puig
Barcelona, Spain

SPEAKERS: Mariano Puig, Sr.

Marc Puig

Kellogg Award For Special Contributions To Family Business

The Kellogg School of Management named the Puig family of Barcelona, Spain as the recipient of the 2003 Kellogg Award for Special Contributions to Family Business. The annual award recognizes a business family for its leadership and significant contributions to the field of family business study. Former chairman of Corporación Puig, Mariano Puig, Sr. and his wife Maria, along with son Marc, a current Corporación Puig executive, were present to receive the award. Bestowing this award on the Puig family is especially meaningful for the Kellogg community because a key mission of the Center for Family Enterprises is to promote best practices and to stimulate innovative thinking in the realm of family business. In that vein, it is important to be able to recognize firms that serve as global role models for excellence and innovation. The Puigs have served as remarkable role models, going so far as to allow their company to be studied by scholars and practitioners.

Kellogg Award For Special Contributions To Family Business

THE PUIG FAMILY: LEADERS IN PUBLIC POLICY AND EDUCATIONAL INITIATIVES

For more than a decade, the Puig family has been instrumental in developing public policies, educational programs and research to benefit family firms in Spain and throughout the world. In addition to establishing academic and political support in the area of family enterprise, the Puig family has allowed its own governance, succession practices and lessons it has learned to be shared with families attending educational programs at numerous universities.

Mariano Puig, Sr. is co-founder and past president of the Instituto de la Empresa Familiar (IEF) of Spain, an association of 100 leading family businesses that has significantly affected the fiscal policies of their country, as well as education and research on family business in Spain. The IEF has funded 14 professorial chairs at 14 universities in Spain devoted to family business education and research. The Puig family co-founded The European Group of Family Enterprises (GEEF) and Mariano served as its first president. The GEEF influences tax policies toward family businesses and promotes the important role of family enterprise as a fundamental engine to economic growth.

THEIR FAMILY COMPANY

Today's multi-national Corporación Puig has its roots in a small perfume-manufacturing firm founded in Barcelona in 1914 by Mariano's father, Antonio Puig. Antonio had four sons who were all active in the business. Under Antonio's leadership the business grew in several key areas and began to focus on internationalization. In the 1980s and '90s, the business grew through diversification. In the mid '90s, the business was restructured into a holding organization and the second generation passed on their power to an executive structure composed of three of the 14 cousins in the third generation and one non-family member. In 2000, the first non-family CEO was named and the business was restructured from a territory focus to a line of business focus. Current support structures include: a family council, an assembly of shareholders, a holding company, a family/non-family advisory board, a family handbook and a family protocol.

Corporación Puig employs 5,000 people and is a one billion Euro business specializing in fragrance, personal care items and fashion. Name brands include Nina Ricci, Paco Rabanne and Carolina Herrera.

Acceptance Comments by Mariano and Marc Puig

LEADING THE WAY FOR FAMILY BUSINESSES IN EUROPE

Mariano: My family believes that we have received a great deal from society and the best thing we can do in return is to help other family businesses so that they do not commit the same mistakes that we did. That is why we have felt that it is important to be active in leading the way to help in the education and mentoring of other family businesses.

A prime opportunity to be a leader in this area occurred in the 1980s when a small group of family business entrepreneurs met together to share our experiences with succession in our businesses. We were very pleased with the ideas and solutions that we were able to find for our common problems. One of the things we realized was that in our country, family business was much more important than we thought. We discovered that private companies provide more than two-thirds of the jobs and more than two-thirds of the gross national product. It was then that we decided to organize ourselves and create the Instituto de la Empresa Familiar (IEF) with three main objectives. First, we wanted to improve the image of the family business entrepreneur and the family business in the eyes of society. Second, we wanted an academic role through which we could help other family businesses prepare for their own succession issues. Third, we wanted to lobby the government on issues important to family businesses.

In Lausanne, Switzerland, housed at the IMD Business School, exists an independent association called the Family Business Network (FBN), which has contacts with other family business organizations throughout the world. I have the honor of being a member of their board. One day we asked the FBN to lobby the Brussels Authority, which regulates laws in Europe, on our behalf. But the FBN's answer to us was that they were strictly an educational organization and could not lobby. So we had a meeting of all the presidents of different family business associations from different countries in Europe and we decided to create a new organization, The European Group of Family Enterprises (GEEF), which was established to highlight the role of family enterprise in the European Union, promote a positive public image, and favorably influence tax policies for family businesses. I was chosen the first president, which turned out to be a lot of work.

A LONG LINE OF ENTREPRENEURS

I come from a family of entrepreneurs going back several generations. My great-grandfather was an entrepreneur, so was my grandfather, my father, and my brothers. And the next generation is the most dedicated of all to the world of business. My wife, who has been my life companion for almost 50 years, is also a fifth generation member of a family business.

At the beginning of the last century, my father started a small perfume business. My father had four sons. After each of us completed our studies, we started in the business working in various aspects of the company. While we all had our own jobs, we knew that we were a team. In the mid '50s, my father stepped down and there were many changes, especially going from a single leader to a group of four. The most important characteristic of this period for us was communication. We had informal communication, corridor communication, telephone communication, as well as formal communication with an agenda and so on.

The company grew. We went international and we started doing business in the U.S. more than 40 years ago. Three key events helped to spur our company's growth. First, the Cold War ended and the Berlin Wall fell. The world began to globalize. Our company was growing but we thought we should accelerate our process in order to have critical mass to compete in global markets. We made important acquisitions in different countries in the world in order to have this critical mass.

Second, we decided to go to professional management. This was very important because it showed a common purpose with the management, and showed the members of the company that it was not necessary to be a part of the family to be in a top position.

Third, we created a new governance system. We looked at the next generation and we saw 13 shareholders plus four from the second generation, too many to manage the business in the old way. We looked at many ideas and decided to prune the tree, divide the business and create a family council. In the family council we focused on two documents, one was a protocol, and one was a handbook that shows all the values of the family. We created the assembly of shareholders, which is a forum for information and education for all the shareholders because in the third generation there are some shareholders working in the company and there are shareholders that are not. And they have different points of view. We also created a board with both family and non-family members.

THE SUCCESSOR GENERATION

"We asked them where they wanted the company to be 10 years from now and how they would like to organize themselves to obtain that."

This was all to help us prepare for succession because we knew that succession in family businesses is not like succession in non-family multinational businesses. In those cases, the man at the top changes every five to seven years and it is a well-oiled mechanism that has been used very often. In the family business the change of the man at the top goes from one generation to another generation. That's completely different. In 1996, we felt we were prepared to start our succession plan. The board, which was made up of second generation family members and non-family members, called three key members of the third generation plus a non-family member together and we asked them two important questions. We asked them where they wanted the company to be 10 years from now and how they would like to organize themselves to obtain that. We asked them to decide their future. I will now pass the microphone to my son, Marc, a member of the third generation.

THE THIRD GENERATION'S VISION

Marc: I was a member of that group of four people who had the mandate from the board to try to visualize the future and I will explain briefly what we did with that mandate. First of all, we decided to go and take a two-day retreat at a resort in the northeast of the U.S. Before we went there, each one of us was to write a hypothetical article for *The Wall Street Journal* about what we wanted them to write 10 years in the future about our company. What that did was to force each one of us to put down on paper the vision and the dreams that we had for our company. We challenged each other, discussed the different points of view, but basically came out with one vision of what we wanted the company to be and we called that the Horizon 2006 Plan.

We also discussed how we wanted to organize ourselves. In that sense we chose probably a non-standard solution because we had already been working together for 10 years and we felt that we wanted to continue with that kind of relationship rather than have one person at the top. We wanted to have a leadership team composed of the four of us and the team would be the Executive Committee, or Ex Com.

After the retreat we spent about a year working with a consulting firm that looked at our proposal from different angles and challenged our ideas. In the end they concurred with our proposal and we presented it to the board. It was interesting because the board, especially some of the independent non-family members, were not comfortable with our leadership solution. They said, "Look, at the end of the day, as long as you deliver the promises that you have in this plan on an annual basis we will trust in your leadership solution." So we had the approval of the board, we then got the approval of the shareholders and finally, in June 1998, we made our presentation to 150 managers all over the world to send the message that the transition at the executive level and at the day-to-day operation level had been finalized.

We are now six years into our 10-year plan and last year we checked our hypothesis to see if we were on schedule with our earnings and we confirmed that we are so we will continue working with the same plan

ANOTHER CHALLENGE TO THE THIRD GENERATION

"They asked us to examine the future relationship between the family and the business and they asked us to update the governance and government bodies that were created 10 years before."

Four years after that first exercise had been completed at the operating level, the board asked us similar questions at the shareholder level. They asked us to examine the future relationship between the family and the business and they asked us to update the governance and governance bodies that were created 10 years before. This was a very different situation than before because there are 13 members of this group with different experiences. Five work in the business, three don't work at all and the rest work for other companies. Asking that question of us was really like opening up Pandora's box. Nobody knew what was going to happen. We created a sub-committee, and that had more sub-committees and we worked for about a year, a thousand hours, in different meetings and some proposals were then periodically shared with everybody.

"What the second generation did was basically give us the opportunity to work together and to learn how to solve issues that were sure to be important to our generation."

What the second generation did was basically give us the opportunity to work together and to learn how to solve issues that were sure to be important to our generation. We presented a proposal to the board, or the second generation, that was approved and that is what we are working now to implement.

When we were asked the question about how we wanted to organize the next generation and when we tried to solve that we found that we first had to answer the question of why we wanted to work together, otherwise we would not be able to answer how we wanted to be organized. We realized that we felt that owning shares of this company was different from owning other properties and that there was a sense of responsibility to pass on those shares to the next generation just like our parents had passed them on to us. We decided to keep the business together and then said that our mission was basically to take the lead from the prior generation, build the company and devote our energy and our efforts to making it bigger and keeping control with the objective of passing it on to the following generation. It is also important to maintain certain values and beliefs that are very strong in our family.

AN EXAMPLE OF PUIG FAMILY GOVERNANCE

We had to decide who works in the business and to what extent and how many members can work in the future in the business and work well. Often, family members are motivated to work in the company because we feel that we are not just working for ourselves but we are leaving something to the following generation. This is something that transcends our own existence. At the same time, we were still faced with how to decide who works there.

We now have a protocol established that says you have to work five years outside the company and you have to have a certain university degree and once you have it that doesn't mean that you already have a job in the company. You have to go to the board of directors and then the family council has to approve that position. This provides enough filters so that if somebody is really not ready he or she will not go into the business.

We have business governing bodies. There is a holding company that has a board where there are more family members than non-family members, but within that board there is what we call the compensation and nomination committee and on that committee there are more non-family members than family members. At the lower level we have the different operating companies and the boards of those operating companies have more non-family members than family members. We feel that with these structures in place there are sufficient mechanisms for objective assessment on the placement of people into certain positions.

LOOKING TO THE FUTURE

Mariano: As of five months ago, upon reaching the prescribed age limit, I relinquished my position as the chairman to my younger brother. I will remain a member of the board and president of the assembly of shareholders, but just until the end of next year when I will again reach the age limit for that job.

Looking into the future, I see an excellent next generation of shareholders some of whom are doing excellent work inside the company. They will be making serious decisions, not easy decisions. For instance, how will the group generate sufficient cash flow to keep the business growing while giving satisfaction to all the shareholders? I believe with our network of governance bodies all of our shareholders will be able to channel their ideas, aspirations, and dreams to help find solutions to these challenges in the future. I am very optimistic.

Audience Questions

What products do you have?
Mariano: We are in the perfume, cosmetics and fashion business. You may know some of our brands coming from Paris, Nina Ricci, Paco Rabanne and Carolina Herrera of New York and some others that are not sold in this country. We manufacture more than 350 million units of perfume, soaps and cosmetics and we are selling around the world.

Mariano, how did you prepare to step away from running the company and how long did it take you to prepare to step back and let go of the reins?
Mariano: Well you know, I have been preparing a long time and now the worst question that I can get when I see a fellow in the street is, "Oh, Mariano, are you still working?" I have had a hard time preparing my mind for retirement, especially since I am not a golfer. But I am still an entrepreneur, so I now dedicate time to others in family businesses because we believe in family business. They create jobs, which is what every country needs and they create wealth for our countries. I am still very busy. One day my long time secretary came to me and said, "Look Mr. Puig, you told me that we were retired."

It sounds like you changed careers. What advice do you have for those of us who are nearing your age in terms of what we should do to prepare for that new career?
Mariano: I think I retired two times. First, I passed the executive power to other people and I felt extraordinary relief at not being responsible for all of the final statements every single month and looking at budgets and so on. Second, I left as the chairman of the board, which was a lot of responsibility. But you always feel involved in the business that you have been dedicated to all your life. Business is like a child. One day your child leaves home, but you follow him or her. I see some colleagues of mine – they do not want to leave. Sometimes they do ridiculous things and I don't want to look ridiculous in this world. I prefer to be where I think I should be. I am enjoying life. I am doing a lot of things and I don't have a problem in how to fill up my agenda. I should cut some things out.

Marc, what can someone from your generation learn from this process?
Marc: Well, there are several things, but here are two key lessons. We would not have been so successful without the willingness and generosity of the second generation to want to let go of the business much earlier than what was necessary. Another key was the willingness of the next generation to want to take over and to want to play a role in that project. And it helps to know that there is enough talent in the pool to make it happen.

Marc, you achieved double-digit growth over a few years, were there any fundamental changes that you had to make in your business to get on that path or stay on that path?
Marc: Remember that Spain became part of the European community in 1986 or 1987 so the process of growth started with the second generation. The whole game really changed for us. We had to gain a certain critical mass, otherwise we couldn't even play – our competitor's companies are much bigger than us. Most of the family businesses that used to be around have either been bought or disappeared. Now we are having to compete with the Procter and Gambles, the L'Oreals, and the Unilevers of the world, so we have to grow faster than the industry to be able to compete with them. In 1995, we were basically a cash rich company and at that point we started to buy other companies elsewhere and we became loaded with some debt. That was something that changed the perception of the family and the level of risk that we were willing to take. Updating our company was a big process, as was growing internationally at the rate that we were growing. At the beginning of the '90s we had less than 10 subsidiaries, I think it was five or six outside Spain, now we have 40 subsidiaries in 35 different countries, so that also created a big transitional change in terms of how we organize the company. We still face many challenges but we are prepared to meet them.

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Issues and Answers

This section looks at issues of importance to family businesses. In order to gain insight into the practices and concerns of audience members, participants answered questions about their family business experiences via confidential voting machines that instantly tabulated and displayed their responses to a series of personal and business related questions. This sampling was gathered in an effort to look into the business habits of those present to see if patterns and insights could be discerned with the entire group. In addition, this interactive technology allowed participants to pose their own questions to the group in attendance.

The responses are solely reflective of those present at the Conference and voting on a particular question.

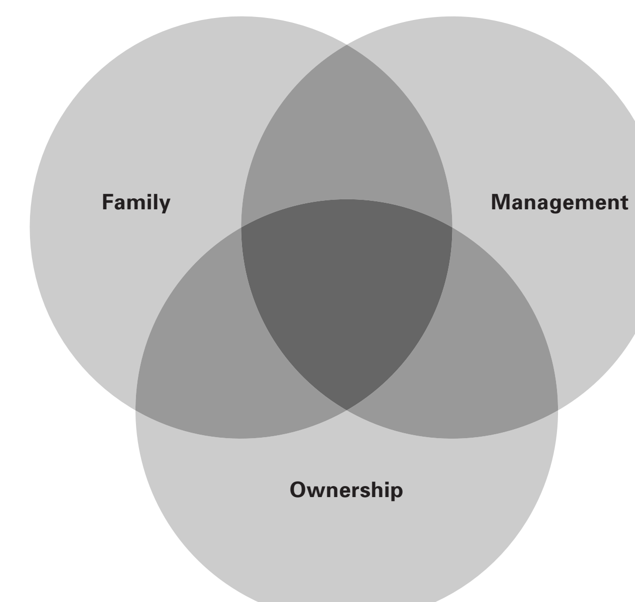
Issues and Answers

TWO MODELS OF FAMILY BUSINESS

There are two conceptual models that aid in understanding family businesses, the Three Circles Model and the Stages of Ownership Evolution Model. Each is helpful in providing insights into the various perspectives that sometimes compete and sometimes complement one another in the family business system.

The audience members were asked questions to help categorize and clarify their own roles within the family business in relation to these two models. Results of this polling are also presented.

THREE CIRCLES MODEL OF FAMILY BUSINESS

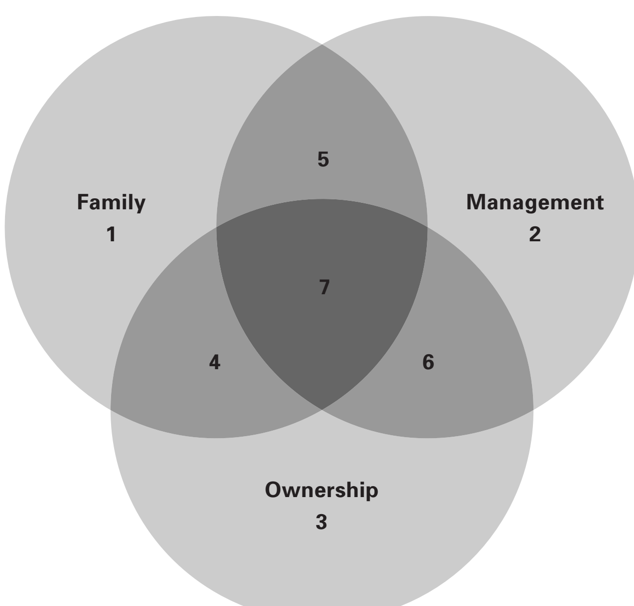


The Three Circles Model, which is one of the first conceptual models in the world of family business, reveals a business system made up of three interconnected systems: management, family and ownership. Mixing these three systems together builds in certain role conflicts as well as certain differences of perspective, which can give rise to a number of challenges for family companies.

"The Three Circles Model says different people in the same business will see issues predictably differently because of the perspective they bring, whether it is the family perspective, the managerial perspective, or the ownership perspective."

The Three Circles Model says different people in the same business will see issues predictably differently because of the perspective they bring, whether it is the family perspective, the managerial perspective, or the ownership perspective. Sometimes just knowing and anticipating that can be helpful, because people often attribute issues within a family business as being personality driven when they are really perspective driven. A family member not involved in management will often react very differently to a situation from a non-family manager or even another family member who is in management.

ROLE IN FAMILY BUSINESS SYSTEM



The Three Circles Model can be refined further to more closely reflect the role of a particular person. For example, in this model, a number one is a person who is a family member, but not an owner and not working in the business. A number two is a person working in the business who is not part of the family and not an owner. A number four is a family owner; a number seven is family, works in the business, and is an owner, etc. One of the most complex and stressful roles in this model is that of a seven because a seven has role conflict and is often torn among thinking like an owner, a manager, and a family member.

Audience Poll

Consider the following distinct perspectives.
What role best describes your personal situation?

Percent	*Answer*
8%	1. Family member only
5%	2. Management member only
1%	3. Ownership only
15%	4. Family + Owner
4%	5. Family + Manager
5%	6. Owner + Manager
62%	7. Family + Owner + Manager

Almost two thirds of the attendees are in category number 7 – family members and owners and managers.

STAGES OF OWNERSHIP EVOLUTION MODEL

"The second model highlights the various stages of ownership evolution looking at whether the business is going from a controlling owner to a small team of owners, called a sibling partnership, or whether it is going from a small group of owners to a larger group of owners."

The second model highlights the various stages of ownership evolution looking at whether the business is going from a controlling owner to a small team of owners, called a sibling partnership, or whether it is going from a small group of owners to a larger group of owners. The three stages of ownership evolution that are common over time are the following:

1. Controlling owner
2. Sibling partnership
3. Cousin collaboration

The dynamics and the issues are obviously very different in each of these ownership succession scenarios; the succession issues are different, as are the governance issues. Moving from one stage of ownership succession evolution to another requires a major shift in perspective and in how one thinks about the organization.

OWNERSHIP STAGES

Audience Poll

Which of the following OWNERSHIP STAGES best describes your family's enterprise?

Percent	*Answer*
6%	Single Controlling Owner
16%	Transition from Single Controlling Owner to Single Controlling Owner
37%	Transition from Single Controlling Owner to Sibling Partnership
6%	Continuation as a Sibling Partnership
35%	Transition from Sibling Partnership to Cousin Collaboration

BUSINESS LONGEVITY

Some interesting data about business longevity was reported in a book called, *"Creative Destruction: Why Companies that Are Built to Last Underperform the Market—And How to Successfully Transform Them."*[1] According to the authors, who looked at business survival rates for companies in the McKinsey 1000, the original Forbes 100, and the S&P 500, those businesses had between a 15 and 39 percent rate of survival long term, which in this study meant between 36-70 years. The numbers of businesses surviving are as follows:

- McKinsey 1000: 160 survived from 1962-1998
- Original Forbes 100: 39 survived from 1917-1987
  Only two outperformed 7.5% CAGR
- S&P 500: 74 survived from 1957-1997
  Only 12 outperformed the index

Many people use the S&P 500 or similar indicators as their financial benchmarks, but the problem with using this benchmark is that it has survivor's bias. The only businesses being looked at are those that are still around. Even so, some of this information, like only 15 percent of the S&P 500 companies lasted 40 years, and only 12 of those actually outperformed the index itself, is important in the larger context of understanding just how difficult it is to carry on a company from generation to generation. Our own information shows that family businesses are actually doing quite well by comparison, even though family businesses have more complex challenges than other kinds of businesses. What this indicates is that family businesses have some very powerful and distinct strengths that cause them to overcome their extra challenges and outlast the market in general.

Family businesses by their nature face challenges that are nonexistent in non-family companies. For example:

- Resolving generational transition issues
- Establishing and maintaining congruent family values and goals
- Assuring qualifications for family members wishing to work in the business
- Providing family shareholder liquidity

All of these issues are complicated by the fact that a person's role within the family business system influences the way he or she perceives these issues and their relative importance to the family business system.

Audience Poll

When was your family's business FOUNDED or acquired by your family?

Percent	*Answer*
21%	Before 1900
30%	1900-1940
34%	1941-1980
15%	After 1980

AUDIENCE DEMOGRAPHICS

The following series of questions were asked to establish the group's demographics and gain insights into issues of importance to the audience.

OWNERSHIP

How many adult family SHAREHOLDERS (or adult family beneficial shareholders) does the family enterprise you represent have?

Percent	*Answer*
6%	One
38%	2-5
33%	6-19
23%	20+

STRUCTURE OF FAMILY ENTERPRISE

Which of the following best describes the MAKEUP of your family's enterprise interests?

Percent	*Answer*
47%	Core operating business
28%	(Mini) conglomerate of several operating businesses
3%	Family office/investment company
0%	Family foundation
8%	All of the above
4%	Core business or conglomerate plus foundation
2%	Family office/investment company plus foundation
8%	Core business or conglomerate plus family office and foundation

CHALLENGES TO CONTINUITY IN GENERAL

Which of the following classic family business CHALLENGES do you feel is the most serious threat to long-term success and continuity for family firms in general?

Percent	*Answer*
31%	Generational transition
14%	Strategic change
8%	Sibling rivalry
5%	Death/estate taxes
39%	Different values, needs and goals of family owners
3%	Attracting and retaining excellent non-family management

LEAST THREAT TO CONTINUITY IN GENERAL

Which is the LEAST threatening, in general?

Percent	*Answer*
2%	Generational transition
15%	Strategic change
6%	Sibling rivalry
36%	Death/estate taxes
1%	Different values, needs and goals of family owners
40%	Attracting and retaining excellent non-family management

THREATS TO YOUR BUSINESS

Which of the following classic family business challenges do you feel is the most serious concern of your family?

Percent	*Answer*
20%	Generational transition*
18%	Strategic change
11%	Sibling rivalry*
6%	Death/estate taxes
38%	Different values, needs and goals of family owners*
7%	Attracting and retaining excellent non-family management

*Notice that the vast majority of these challenges are concerned with family matters.

INDEPENDENT DIRECTORS

Do you have 3 or more independent (non-management/non-family) members on your board of directors?

Percent	*Answer*
46%	Yes
54%	No

FAMILY MEETINGS

How many formal family meetings does your family have per year?

Percent	*Answer*
48%	0
16%	1
9%	2
11%	3-4
16%	5 or more

QUALIFICATIONS TO JOIN THE BUSINESS

Does your family have a policy regarding qualifications family members must meet to be employed in the family business?

Percent	*Answer*
44%	Yes
56%	No

WORK EXPERIENCE

Did you have significant work experience outside the family business before joining your family's business permanently?

Percent	*Answer*
58%	Yes
42%	No

If your answer was "Yes," would you recommend doing so to others?

Percent	*Answer*
100%	Yes
0%	No

If your answer was "No," would you recommend doing so to others?

Percent	*Answer*
89%	Yes
11%	No

FREEDOM TO CHOOSE

How psychologically "free" did you feel in your decision to join the family's business?

Percent	*Answer*
55%	Totally!
7%	I felt it would really please my parents
27%	I felt some sense of duty to do so
11%	I was expected to

BUSINESS LEADERSHIP

How many non-family CEOs has your company had?

Percent	*Answer*
63%	None
23%	One
6%	Two
8%	Three or more

FAMILY POLICIES

Does your family expect there to be prenuptial agreements?

Percent	*Answer*
45%	Yes
45%	No
10%	Don't know

AFFINITY GROUP DISCUSSIONS

Participants broke into small groups of 7-10 people, based on distinct commonalities related to their roles in their family businesses. Each affinity group brainstormed for an hour to identify key questions and topics of interest to pose to all participants later in the Conference.

CATEGORIES

Participants assigned themselves to one of 10 affinity sections based on whether they were aligned as:

- Family/Owner/Managers, ages 33 and under
- Family/Owner/Managers, ages 34-45
- Family/Owner/Managers, ages 46-57
- Family/Owner/Managers, ages 58-69
- Family/Owner/Managers, ages 70 and older
- Family/Managers/Not Owners, all ages
- Non-Family Managers, all ages
- Family or Family/Owner Male
- Family or Family/Owner Female
- Non-Family Advisor/Director

The groups came up with 67 questions that spanned seven general topics including:

- Family compensation
- Next generation preparation/evaluation
- Letting go/retirement
- Family role in ownership
- Succession process and decision-making
- Board roles/functioning
- Non-family equity

Based on the questions that came from the affinity group brainstorming sessions, 14 questions were composed, asked of the entire group and tabulated immediately using the audience response technology.

Fundamentally, how do you pay family members?

Percent	*Answer*
10%	More or less equally
19%	Less than market
61%	At market
10%	More than market

Who is the greatest influence in establishing family compensation?

Percent	*Answer*
55%	CEO
17%	Family board
15%	Compensation consultant
9%	Independent directors
4%	Family tradition

Generally speaking, for their positions in the company, family members are:

Percent	*Answer*
24%	All extremely well qualified
41%	All appropriately qualified
27%	Some not fully qualified
8%	Employed regardless of qualifications

How does the senior generation retire?

Percent	*Answer*
10%	Mandatory age
0%	Per board decision
3%	Semi-retirement
64%	Personal choice
23%	Probably never

How does the family participate in ownership?

Percent	*Answer*
63%	Per capita equivalently
17%	Only those working in the business
20%	Non-voting shares for those not working in the business

What do you do to assure commitment and loyalty of non-family executives?

Percent	*Answer*
18%	Intangible reasons/relationships
10%	Actual shares
24%	Phantom shares
9%	Actual or phantom options
39%	Generous cash compensation

Who has the greatest influence on choice of successor CEO leadership?

Percent	*Answer*
69%	Incumbent family CEO
11%	Independent directors
18%	Family board members
1%	Consultant/human resources
1%	Non-family CEO

How does your board make important decisions?

Percent	*Answer*
34%	Advice to CEO
29%	Informal consensus
5%	Ownership vote
32%	Full board vote

How long is the maximum term for your non-management directors on your board?

Percent	*Answer*
7%	0-3 years
11%	4-6 years
7%	7-10 years
0%	11-15 years
75%	No official limit

What most motivates independent board members to engage and contribute?

Percent	Answer
4%	Equity
15%	Passion
7%	Fees
54%	Relationship
11%	Give back
9%	Learning

What best describes the role of in-laws in your business family?

Percent	Answer
27%	Welcome in management
2%	Welcome as owners
16%	Welcome in family meetings only
55%	No active involvement

How does the family address significant conflicts?

Percent	Answer
13%	Outside consultant/facilitator/arbitrator
27%	CEO dictum
27%	Board
3%	Family ownership majority
24%	Family ownership consensus
6%	Separate from each other

When it gets right down to it, how do you make decisions?

Percent	Answer
17%	Family first
32%	Business first
51%	Attempt to balance

What most motivates your commitment to enterprise ownership and leadership?

Percent	Answer
10%	Financial benefits
29%	Family pride/identity
0%	Perpetuate values
37%	Enjoy management/leadership position
19%	Stewardship
5%	Can't lose it on "my watch"

ANALYSIS AND INSIGHTS

FOCUS OF GROUPS VARY BY GROUP'S IDENTIFICATION

Looking at the questions by affinity groups, especially in the Family/Owner/Managers groups, reveals distinct patterns based on where participants are in their life cycles as it relates to the business. For example, the youngest segment's questions related more to interpersonal conflict resolution, the middle two age groups had more questions specific to running the business and the systems in place for family involvement, and the oldest two age groups focused more on transition to the next generation.

The 45 and under age group had questions of succession, wondering when and how the older generation would leave. The oldest age groups had questions of succession, wondering if they had prepared the next generation for their increased responsibilities. The two middle age groups of Family/Owner/Managers, spanning ages 46-69, did not ask any questions about succession but asked more questions about running the business. The family managers, who were not owners, had questions about the family/business intersection points. The owner managers, who were not family, had questions about the roles of outsiders.

1 Foster, Richard and Sarah Kaplan. *"Creative Destruction: Why Companies that Are Built to Last Underperform the Market—And How to Successfully Transform Them."* Doubleday. 2001.

APPENDIX A

SHARED THEMES BY AFFINITY GROUPINGS

When participants with certain commonalities were grouped together shared themes and concerns emerged particular to that group. The focus of the questions asked by affinity group sections were:

Family/Manager/Owners
Ages: Under 33
Themes: Solving family conflicts, Succession

Ages: 34-45
Themes: Family compensation, Succession, Role of former leaders, Requirements to be in the business/on the board, Relationship of business to family, Nitty-gritty financial business decisions
Ages: 46-57
Themes: Compensation, Outside directors, Why stay a family business? Nitty-gritty financial business decisions

Ages: 58-69
Themes: Training/evaluating potential of next generation, Compensation for family/non-family

Ages: 70 and over
Themes: Succession, Developing next generation

Family/Manager/Not Owners
All ages:
Themes: Extended family, Equity allocation, Succession, Ownership criteria, Why stay in a family business? Motivating next generation, Relating as a family

Non-Family Managers
All ages:
Themes: Roles/involvement/advancement of non-family in management and board

APPENDIX B

QUESTIONS ASKED BY AFFINITY GROUPINGS

Family/Owner/Managers ages 33 and under asked:

How do you deal with nepotism?

How are inter-family disputes resolved in relation to the company?

How are decisions made when family company disputes arise?

Who makes the decision of who will succeed the current CEO?

Family/Owner/Managers ages 34-45 asked:

How many years did you work in your family business before you thought you were being compensated fairly (i.e. at market value)?

What percentage of shareholders are working in the business?

What is the primary role of the board in family business?

Do you have strategic planning for succession?

Do you hold real estate in LLCs?

What type of requirements should you have to join the family firm?

What is the role of the previous owner(s) after they are bought out?

Should leadership in the subsequent generation be chosen by prior generation, independently or combination of both?

What is your after-tax dividend payout as a percentage of net income?

How is a successor/CEO chosen?

Is the preceding generation's compensation fair market value too low or too high?

Is the next generation's compensation fair market value too low or too high?

Who decides family members' compensation?

What policies do you have on retirement?

Does the family govern over the business, or does the business govern over the family?

How do you keep non-working shareholders interested in the business, not just the dividends?

Family/Owner/Managers ages 46-57 asked:

Why do you want to remain family owned? (not a question of private/public)

What should be the limit of years served for outside directors?

How is family member compensation decided?

How does family governance work?

What should be the age limit for an outside board member?

Do you pay family members in the same generation the same?

Do you feel your company plus your individual tax bill is too high, too low, just right?

What are your sources of capital?

Family/Owner/Managers ages 58-69 asked:

Where do you find good information on training regimen models for the next generation for their business enterprise leadership, their family asset management leadership and their fast track possibilities (under 5 years)?

How do you structure phantom stock or stock options for outside key employees?

How do you value phantom stock?

How is compensation set for family members when they join the company?

How do you evaluate the potential of the next generation and non-family managers?

Do family businesses evaluate their future generations, managers and key employees by use of psychological profiling?

Family/Owner/Managers ages 70 and over asked:

How do we develop our children as stewards?

Do you have an established succession strategy?

How do we "retire to" something as opposed to "retire from" something?

Family/Managers, Not Owners, all ages asked:

How do you deal with in-laws and extended family at family meetings?

What methodology is best for allocation of equity inside and outside the business (those who work in the company and those who don't)?

How do you bring inactive family members up to speed in the business?

How do you distribute equity to those who want to buy in and reduce strife at the time of death of senior family members while protecting the equity of those already in the company?

How do you deal with the split between equity and operational control?

What are the criteria to transfer responsibility and power to the next generation?

What size is your company in sales?

What different kinds of equity does your family business have?

What are your family's criteria for ownership?

What is the single best reason for you to remain a family business (by age of firm)?

How do you start the process of succession planning and when should it begin?

How do you get subsequent generations to have the same "fire" and "love" for the business as the founder?

How do you enable/push the original founder to let go of the family business?

How does a founding owner decide stock allocation among children, some in the family business, and some not?

How do families maintain quality relationships while demanding high standards of performance from family employees and directors?

Non-Family Managers, all ages asked:

Would you promote a more qualified and loyal non-family member to CEO over a family member?

How do you align non-family executives with family interests short-term and long-term?

Would you consider allowing non-family executives to purchase stock in your family business?

What is the decision-making process at the board level?

Do you include key non-family executives in regular family board meetings?

What percent of the board is made up of non-family members?

What motivates independent board members to fully engage and contribute?

Lloyd Shefsky

Lloyd Shefsky is Clinical Professor of Entrepreneurship, founder of the Kellogg Center for Executive Women and founder and Co-Director of the Center for Family Enterprises at Kellogg School of Management. He has a B.S. degree from DePaul University, a J.D. degree from University of Chicago Law School and is also a certified public accountant. Thirty-three years ago, he founded the law firm where he is now Of Counsel, Shefsky & Froelich, Ltd., which specializes in advising entrepreneurs and their companies at every stage of development. He is the author of *"Entrepreneurs Are Made Not Born,"* a book that has been translated into five languages and is on reading lists at major business schools. He is director and president emeritus of the Sports Lawyers Association, an organization he founded in 1975, which currently has 1,200 members who represent professional athletes and sports entities. In 1995, he received the Entrepreneur of the Year Award for his support of entrepreneurship from *Inc. Magazine*, Ernst & Young, LLP, and Merrill Lynch.

John Ward

John Ward is Clinical Professor of Family Enterprise and Co-Director of the Center for Family Enterprises at Kellogg School of Management. He has a B.A. degree from Northwestern University, an M.B.A. degree and a Ph.D. degree from Stanford Graduate School of Business. He teaches family enterprise continuity and is an active researcher and writer on governance. He serves on the boards of four companies in the U.S. and Europe and is the author of four books that are leaders in the field: *"Keeping the Family Business Healthy," "Effective Boards for Private Enterprises," "Strategic Planning for the Family Business"* (with co-author R. Carlock) and *"Perpetuating the Family Business."* He is the program director of Kellogg's unique "Governing the Family Business" program and of Kellogg's family business programs at Hong Kong University of Science and Technology and Indian School of Business.

PRESENTER: John Ward
Clinical Professor and Co-Director
Center for Family Enterprises
Kellogg School of Management

Best New Research Ideas For Families In Business

This is a summary of the year's most outstanding new research on family business performance and successful practice. The presentation includes relevant audience feedback.

Best New Research Ideas For Families In Business

NEW RESEARCH

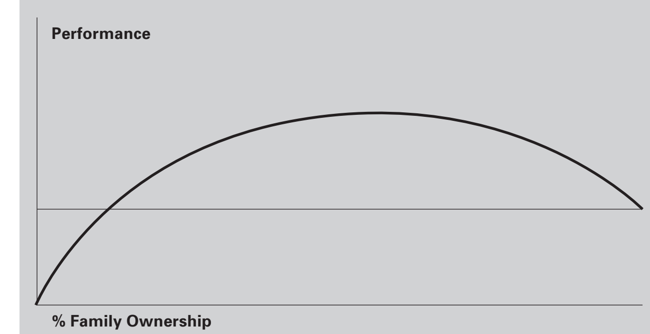
This presentation is a distillation of six academic research papers from the last 12 months that represent much of the current thinking in the field of family business research. The topics covered are:

Family business performance
Defining a family business
Family business philanthropy
Family business internationalization
"Letting go"
Family business succession

FAMILY BUSINESS PERFORMANCE

Family Businesses are More Profitable

S&P 500	35% Family Firms
EBITA / ROE	54% vs. 43%



David Reeb from the University of Alabama and Ronald Anderson from American University in Washington D.C., did an extensive study of the S&P 500 companies last year looking specifically at family businesses and their level of profitability as compared to non-family companies.[1] One of their most powerful and important findings was that on average family businesses are substantially more profitable than non-family businesses. Other research, including some of my own from a few years ago, supports this conclusion. However, the database I used included private companies while Reeb and Anderson's research is based solely upon publicly traded, family controlled companies.

Since these are all publicly traded companies and they have a substantial number of public shareholders at large, the researchers defined a business as a family business if the founding family still held more shares than anyone else, not necessarily a majority of shares, just more than any other party. By their definition, they found that 35 percent of the S&P 500 companies are family controlled. This corresponds to similar findings of the Fortune 1000 companies that 35 percent of them are family controlled and presents a fairly consistent pattern that about a third of the publicly traded companies in North America are family companies.

"On an EBITDA/ROE basis family companies are more than 20 percent more profitable than non-family companies."

The research also showed that on an EBITDA/ROE basis family companies are more than 20 percent more profitable than non-family companies. Out of the 160 family businesses in the S&P 500, the average EBITDA/ROE of those that are family businesses is 54 percent, while the average EBITDA/ROE of those that are not family businesses is 43 percent, making family businesses about 20 percent more profitable on average. Some of the measures used are even stronger than this while some are not quite as robust, however, all of them are substantially profound in terms of supporting findings that family businesses are more profitable than non-family businesses.

Percent of Family Ownership Affects Profitability

The authors also discovered that the percent of shares that the family controls affects the company's profitability level. There is a point at which, with a small number of family owned shares, the company starts to become more profitable and stays more profitable reaching a peak profitability level when the family controls 30-60 percent of the shares. If the family's ownership is much below 30 percent, there is a kind of diluting effect because they are not as significant an influence within the company. On the other end, if ownership is more than 60 percent, some theorize that the company may not be behaving fully professionally and is therefore not providing full value to investors. In addition, with such a high concentration of stocks in the same hands there may also be some questions about liquidity since there is less stock available for public trading, which could impact prices. Still, even at less than 30 percent ownership or more than 60 percent ownership, profit is at a premium.

Public or Private, Family Businesses Excel

The data seem to suggest that there are some positive benefits to being a publicly traded family company because of the accountability of the marketplace. Market disciplines can sharpen up a publicly traded family controlled company and make it more effective. While that is a very likely implication, many in family businesses believe that there are also considerable disadvantages in going public, such as being caught up in volatile market fluctuations. Looking at my own research, I can show that 100 percent of private family companies perform equally as well as the public family companies. What the profitability curve illustrates is that, in the public sector, it is much more profitable to be a family owned business rather than a non-family owned business. However, whether in the public or private sector one thing is clear, family businesses exceed other business.

Leadership Affects Profitability

The data also show that among the family owned S&P companies, leadership makes a difference in the level of profitability, with founder CEOs being the most profitable leaders, non-family successor CEOs ranking second, and family successor CEOs coming in third. Looking at the information also reveals that of those companies, 15 percent are run by their founding CEO, 55 percent are run by a non-family successor CEO, and 30 percent are run by a family successor CEO.

Family Companies and Debt

While it violates conventional thinking in economics and finance, it is a false assumption that family firms pay more for debt. The theory in economics and finance, known as the agency principle, is that owner controlled companies will abuse other claimants and they will serve their self-interest to the disadvantage of other constituents. It is the theory that economics and finance is built on and it is false. In reality there is a greater alignment between the interests of the debtor and the owner in a family controlled company, which is a very interesting piece of information that financial institutions seem to understand.

DIVERSIFICATION AND INTEGRATION PAYS

Audience Poll

The audience was asked to rate their own business' level of diversification for reasons of comparison with the current data. Audience members registered their answers via instant voting technology used during the Conference.

How diversified is your firm?

Percent	*Answer*
48%	One core business
32%	2-4 SBUs
20%	5+ SBUs

"Family controlled companies that are diversified are more profitable than non-family controlled companies that are diversified."

Diversification, especially for family companies, pays. Even so, family companies in the S&P 500 have the same low level of diversification as the non-family companies. At last year's Kellogg Family Business Conference, Harvard Business School's Professor Tarun Khanna presented breakthrough research showing that family controlled companies that are diversified are more profitable than non-family controlled companies that are diversified.[2] Yet observation of the S&P 500 companies shows that they do not diversify, perhaps as a result of trying to meet market expectations. Privately controlled family companies, on the other hand, do what they know to be right and are willing to consider diversification. Increasingly, research is giving new insight into this situation and what we are finding is that the more a family business is a public company the more it has to behave according to public market expectations and the more it gives up in certain areas like pursuing diversification.

A final point that came through from this research is that family controlled companies tend to be more vertically integrated than non-family controlled companies and more profitable because of it. Whether a family business counts its business units as horizontal or diversifying business units, or thinks about them as vertical integration business units, the result is the same. Both provide superior returns for family controlled companies.

DEFINING A FAMILY BUSINESS

What Makes a Business a Family Business?

What is a family company? My personal rule has been that if the family controls 30 percent of the voting equity it is a family business, however, a new study has been published that is more sophisticated and much more complex than that. An international group of researchers from Australia, the United States, and Germany worked together as a team to try to define just what constitutes a family business.[3]

"Some family businesses are more "family" than other family businesses."

They contend that a family business is a function of three variables:
- How much power the family has over the business
- How much experience the family has with the business, people and generations
- How much the family influences the culture of the business.

By adding up all these variables, they came up with what they term a "familiness score" and they found that some family businesses are more "family" than other family businesses. The power of their research lies in the fact that we can now view family businesses along a continuum and can begin to study family businesses or family enterprises as to the degree to which they behave like a family business. Their research is ongoing and they have not as yet developed an index for ranking the numerous variables that go into determining degrees of "familiness."

Creating an Index on the Spot

The audience helped to create an on the spot "familiness" index by answering a series of questions. The audience was asked six questions with multiple-choice answers, how they voted determined their total "familiness" rating or score.

Questions asked were:

1. What percent of voting shares does your family control?

2. What percent of board members are family members?

3. What is the current generation of ownership of your youngest generation of adult owners?

4. How many total family members have been employed in the family business during the past three years?

5. How many of the following exist in your company to provide family influence on the values of the business?

- Family values statement
- Family values writings in company employee letters or annual reports
- Business ceremonies celebrating founding, history, etc.
- Non-employed family visible to employees

6. How many "all family" meetings does the family have per year?

Each question had several possible answers with each answer assigned a specific number of points. After audience members chose their particular answer, they were then instructed to record the points assigned to that answer separately. After answering all the questions, they added up their six recorded point totals, which gave them their score. Scores ranged from a possible low of six points to a high of 24 points.

Results of the Familiness Poll

Fourteen percent of the audience scored very high on the familiness rankings with between 20-24 points; 47 percent scored high with between 15-19 points; 37 percent were fairly low with 10-14 points; two percent scored very low, between 6-9 points.

"This research is exciting because this is the first time that family business has been looked at as a continuum and not just defined by clear-cut guidelines."

These scores are non-judgmental and merely reflect the degree to which a family business acts as such. Sometimes, being too family-like can have drawbacks for a company as in the case where there are large numbers of family members on the board of directors and working in the business. In that instance, positive outside influences can be diluted due to minimal participation of qualified outside professionals in the company. This research is exciting because this is the first time that family business has been looked at as a continuum and not just defined by clear-cut guidelines like my 30 percent ownership rule. By looking at just how family-like a business is researchers can begin to examine them in more sophisticated ways and begin asking questions such as, do the more family-like businesses pay less in dividends?

FAMILY BUSINESS PHILANTHROPY

Family Businesses Are More Philanthropic—And In Interesting Ways

"Family controlled companies are substantially, by about 25 percent, more philanthropic."

While most people have a sense that family businesses are more philanthropic than non-family businesses, no one has ever proved it before until two researchers, Reginald Litz from the University of Manitoba, and Alice Stewart from Ohio State University, documented it.[4] They studied a large industry with numerous family and non-family companies and they measured the degree to which these businesses were involved both with money and with time in philanthropic and community-based activities. They found that family controlled companies are substantially, by about 25 percent, more philanthropic both with time and money, than non-family controlled companies of equal size in the same industry. This confirms for the first time what many who walk into various institutions and look at the donors' plaques have suspected for years.

Giving Priorities

Family Firms are more Philanthropic
= 25% more emphasis

Priority	Purpose
Youth	Commercial
Religious	Political
Charitable	Stakeholder
Business	Altruistic
Service	Family Commitment Culture

The researchers went a step further and determined the order of priority for family business giving, which they determined to be: youth, religious, charitable, business, service. In contrast, non-family businesses donated more heavily to business and service causes. This study proves that family businesses are more philanthropic or charitable, and that *the nature* of the charity or philanthropy is different for family controlled companies.

Why Family Businesses Donate

"This study found that there is a fifth and very powerful reason that family businesses are philanthropic and that is to make the business feel more like a family business."

The researchers found that there are four basic motivations for philanthropy:
- It makes good business sense
- It helps control the political environment
- Concern for stakeholders, employees, customers, the community
- Truly altruistic reasons

Most of the philanthropic literature focuses on these four motivations for philanthropy. This study found that there is a fifth and very powerful reason that family businesses are philanthropic and that is to make the business feel more like a family business. It is actually internal to the company's culture to be charitable from the inside out.

What this study shows is that family businesses: are more philanthropic, have different priorities for giving, and are charitable because it is part of their internal company cultures.

FAMILY BUSINESS INTERNATIONALIZATION

Go Early

"Family businesses that go international sooner rather than later, younger in their business lives rather than later in their lives, are more successful."

New research from Spain looked carefully at family businesses that are successful in their internationalization strategies.[5] They found that family businesses that go international sooner rather than later, younger in their business lives rather than later in their lives, are more successful, which runs counter to normal behaviors. Prevailing wisdom holds that in the early generations of the business, when it is still fairly small, the family will be more conservative in its behaviors. Early on it is more likely to be concerned with domestic issues, and in later generations it will become more international as the next generations come along and as the business grows bigger and the world changes, etc. While that is a logical path, it is not the path to success. What the study found is that the later in the life of the family business that it goes international, the less likely it is to be successful internationally. The best business strategy is to strike early and strike hard.

Go with Alliances

They also discovered that thriving international family businesses succeeded through forming alliances, not through exporting or even significantly through acquisitions. In addition, it was more successful for the companies if their alliances were with other family controlled companies, family-to-family. They also found that the people who are most likely to act in this manner are the independent directors, as opposed to family members. The degree to which family controlled companies go international successfully is dependent upon:
- Going early
- Going with the strength and encouragement of an independent board
- Doing it through alliances–particularly family-to-family alliances.

"LETTING GO"

Why the Succession Process Struggles

Researcher, Anika Hall, studied one family business in Finland for many years as it navigated through the succession process and tried to see if she could understand how and why the process works and sometimes struggles along the leadership path.[6]

"The owner said that for an entrepreneur to let go of his business was the same as letting go of his baby or of his identity."

She witnessed the struggle of the owner as it grew time for him to begin passing on leadership of the company to others. The owner said that for an entrepreneur to let go of his business was the same as letting go of his baby or of his identity, which for him was a very difficult, if not an impossible, thing to do. Ms. Hall looked long and hard at this reasoning and concluded that part of the problem was that the entrepreneur had role confusion because he defined himself as three things in one. He saw himself as entrepreneur, as CEO and as owner. All of which was true, but the one that most defined him to himself was the entrepreneur. He looked upon himself foremost as an entrepreneur and only then as a CEO and owner. And it was this future lack of entrepreneurial involvement that was his major source of anxiety.

Separate Out the Roles

She concluded that in order to have a successful "letting go" experience the family, as a system, must separate these three notions of CEO, owner and entrepreneur, and develop all three pieces individually. Once the roles are clarified, the family can bring in a second person as a successor CEO whose role will be defined as distinct and separate from the ownership and entrepreneur roles. She advised bringing in a successor CEO and allowing that person, whether from within or outside of the family, to define the role as CEO for him or herself. She also advised the family to define what ownership means for them and to envision ownership as an active role. Finally, she said, disconnect the concept or the role of entrepreneur from the other two and get the retiring owner into a new venture. Take this person who is fundamentally an entrepreneur in heart and motivation and acknowledge that you can create a role for a CEO and you can create the concept of a role for ownership, but you will never satisfy the entrepreneur in that person until you get that person into a new entrepreneurial venture.

FAMILY BUSINESS SUCCESSION

Four Reasons for Entering

Why do successors enter the family business and does their reason for entering affect their level of success? Two professors from a Canadian university looked at these questions and came up with four basic motivations why people join the family company.[7] They concluded that there are people who truly *want to* join because they see it as the most fulfilling and the most satisfying, logical step in their lives. There are people who feel that they *ought to* join to fulfill the expectations of their parents, or because they feel a sense of duty unfulfilled if they do not. There are those who *have to* join because they think it is the only way they can protect their investment or their heritage. And there are people who *need to* join the family business because they have no choice since the family company is the only place they can get a job. Once they identified these factors, the authors tried to predict the success of the successor by his/her motivation for joining the business.

Why Do Successors Join the Family Business?

Want to
Ought to
Have to
Need to
Another Question:
Is *stewardship* a burden or an opportunity?

Ranking the Motivating Factors

According to the researchers, a successor who *wants to* join will be the most successful. In general, the succession process will be smoother and the business will thrive with this kind of leader. The second most successful scenario is a successor who feels he/she *ought to* do it out of a sense of expectation, duty or responsibility. Those who *have to*, to protect their interests or investments represent the third most successful scenario, and the least successful is the one who feels he/she *needs to* join the family company because of lack of alternatives.

"What is the difference between stewardship and duty? Is duty in one's head and stewardship in one's heart?"

A real dilemma that many successors face concerns the difference between stewardship and duty, which is defined here as ought to. I ought to because I am a steward or I ought to because it is a duty. What is the difference between stewardship and duty? It is a notion that troubles many successors who are not quite able to separate the concept of duty and the concept of stewardship. Is there a difference and if there is a difference, how is it defined? Can they be separated? Is duty, in one's head and stewardship in one's heart? Is duty looking back and stewardship looking forward? These questions are powerfully rooted in successors and in their thinking and add complexity to their decision-making struggles.

NOTES:

1 Anderson, Ronald and David Reeb. "Founding Family Ownership and Firm Performance: Evidence from the S&P 500." Unpublished.

2 Tarun, Khanna, "Family Business in Emerging Markets." Presented at the Family Business Invitational Conference, Evanston, U.S.A. 2002.

3 Astrachan, Joseph, Sabine Klein and Kosmas Smyrnios. "The F-PEC Scale of Family Influence: A Proposal for Solving the Family Business Definition Problem." *Family Business Review*. March 2002.

4 Litz, Reginald and Alice Stewart. "Charity Begins at Home: Family Firms and Patterns of Community Involvement." *Nonprofit and Voluntary Sector Quarterly*. Vol. 29, No. 1.

5 Gallo, Miguel A. etal. "Internationalization Via Strategic Alliances in Family Business." Paper presented at the Family Business Network Conference. Helsinki, Finland. 2002.

6 Hall, Anika. "External Management of Family Businesses: Succession as a Role Transition Process." Paper presented at Family Business Network Conference. Helsinki, Finland. 2002. Unpublished.

7 Sharma, Prodita and Greg Irving. "Four Shades of Family Business Successor Commitment: Motivating Factors and Expected Outcomes." Paper presented at Family Firm Institute Conference. Boston, USA. 2002. Unpublished.

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Case Discussion:

The Murugappa Group: Centuries-Old Business Heritage and Tradition

The Murugappa Group: Centuries-Old Business Heritage and Tradition was written specifically for this Conference. We are grateful to the Murugappa family for their support of this project. This case addresses the classic dilemmas faced by family businesses the world over:

- **Tradition and change**
- **Individuality and collectivity**
- **Operating ownership and governing ownership**
- **Succession and leadership**

It was an honor to have M.M. Murugappan and M.V. Subbiah attend the Conference and participate in the case discussion.

Case Discussion: **The Murugappa Group: Centuries-Old Business Heritage and Tradition**

**MURUGAPPA CASE DISCUSSION:
QUESTIONS AND ANSWERS**

Conference attendees considered the following questions prior to the presentation. Summaries of their answers follow.

Why has the Murugappa family been so successful for so long?

Strong cultural and traditional structure and value system

Clear family rules

Communication

Entrepreneurial education and values

Diversification

How do they manage change?

Family values and beliefs periodically revisited

Management separated from ownership

Each generation sent out into the wider world for education

Educational standards set for family

Change and risk taking incorporated as part of the family tradition

Through the generations, what has changed and what has not changed?

Changed from operating owners to governing owners

Changed power concentration–more dispersed as family grows

Maintained family values and traditions

Maintained dedication to family

Maintained Hindu religion and beliefs

Would you consider the business more adaptive or more proactive with change? What is the difference?

Proactive—always looking for new opportunities by sending sons to other countries

What are the issues in the future with the "governing ownership" model? What would you recommend?

Competing over the long term

Winning each day more than you lose

Aligning goals of shareholders with the goals of management

Finding the best talent for all positions

A Conversation with M.V. Subbiah and M.M. Murugappan

Audience Questions

Why are you so diversified?
Subbiah: We had to be. As entrepreneurs we had no choice, because the environment dictated it. I remember when I first joined the business many years ago, we were making 250,000 bicycles and that was all the capacity we were ALLOWED by the government. We wanted to increase it to 500,000 bicycles but the government wouldn't give us permission. So we kept on growing by diversifying or by backward integration because that is all that the government would allow us to do. Today, in at least five or six of our businesses we are number one in the country. Actually, between 1985 and 1997 we grew at the rate of twice the level of national growth and our profits grew three times in the same period. Subsequently, with the competition increasing we were forced to slow down a bit. Yes, we suffered a little bit, but compared to the other companies in business we have done far better.

What changes are happening in your family?
Subbiah: The family has been going through tremendous change within the political and economic system and within the tradition of India and I think a lot of issues have been brought up for discussion, particularly the gender issue and the marriage issue.

Has it been helpful for you to get input from this group?
Murugu: It has been a fascinating experience for us to talk about our family more than we talk about our business. It is very interesting to get different perspectives. It is very reassuring to hear that all families are very similar. But having said that, it is interesting because all of you are in an open market and in a developed economy and issues that you are facing relative to the business and its performance and its continuity are probably issues that we will face in the future. Relative to the family, it seems to me that my work is cut out for the next several years because as we redo our family constitution, there seem to be so many more issues to address and that is going to keep me more than busy.

Can you share a little bit of your personal philosophy versus the family philosophy about the role of family leadership and the concept of kartha?

Subbiah: The role of the kartha, who is both the family and business patriarch, is to decide on which person has the right skill for a particular situation and allow that person to take the leadership role in that situation. It is not one-man leadership, one man who takes on everything. For example, my nephew Murugu here is excellent when it comes to patience and negotiations, as well as dealing with people in any situation. Naturally, if I had to negotiate with people I would bring him in or at least ask Murugu's advice before I went to the negotiating table. I started life in the abrasives business and therefore I'm known to be the abrasive member of the family, so whenever there were tough negotiations with unions, I was called in whichever company was required to be doing negotiations.

Kartha is situation bound leadership. Traditionally, the kartha was not necessarily the oldest in the family but the one best suited for the job. This is what we are trying to see if we can bring back into the system. Unfortunately, some of this has been lost. You must understand that many of our Hindu traditions were suppressed by 250 years of Anglo-Saxon law, which we continue with even after independence. So the law that we have is somewhat in contradiction with the traditions that we have. Our value doesn't allow us to overstep the law or go around the law so how do we manage within the law? We have had to learn to manage with the law of the country, which is completely Anglo-Saxon and at odds with many of the traditions from which we come. I think this is where the role of kartha becomes an extremely important role. Fortunately for us, Anglo-Saxon law allows the kartha to be the eldest male member since this complies with Anglo-Saxon law and tradition. However, we do know of old families where the eldest son does not get the leadership situation of the family because he is not seen as the best one for the role.

The role of the kartha is a very special part of your culture and a very powerful one. Do you see the selection process changing in the future?

Subbiah: Much earlier in history the selection process of the kartha was to choose the most acceptable person. Everyone was rotated around all the different jobs and the one who was the most acceptable person overall became the kartha. It was not by nomination, it was the most acceptable person. I can see signs of it already beginning to happen in our own family. The kartha is not going to be necessarily the family elder or the head of the family or one of the business heads; it will be the most acceptable person.

What did you hope to gain by handing over the business to professional management?

Murugu: Well the hope is to do it better. We have a governing ownership model which is helping us to evolve. We were all very close to the business and our abilities, interests and talents were available only to a specific part of the business and as we have stepped back from the business we now find that we have the possibility of looking across businesses. Though they are very diverse, at least there is time to think through ideas and share best practices, get involved with a variety of issues of governance, which we had not done very much of before. So going forward, I think primarily the leveraging of family talent is going to be a cornerstone for success.

Subbiah: I want to close with this quote from Shanti Parva as translated by Professor Pulin Garg. "The nature of beauty is in order. The nature of systems is in this certainty; the nature of structure is security. Order, certainty and security define the *oughts* of a man. It is a sad day when they break down and are replaced by *shoulds* and this I think is one of the problems in lots of families, when *oughts* break down and become *shoulds* then there is chaos and oppression. In such times, the only way to regenerate the *oughts* is not to defy, not to deny, but define. Not to resist, not to desist, but persist." I think this is what our family is trying to do.

Case Discussion: **The Murugappa Group: Centuries-Old Business Heritage and Tradition**

"All embraced the Murugappa family culture, an amalgam of respect for the elders, traditional values, and modern professionalism."[2]

AMM (1918-1999), 2nd generation, family elder and kartha from 1965-1999, family business leader from 1965-1983

"The important thing is to be flexible, just like a tree. There are heavy winds; there are storms blowing. The trees that are flexible survive. The trees that are rigid do not."

Murugappan (b:1935), 3rd generation, family elder and kartha since 1999

"My goal was to introduce change without disrupting performance and to create an open culture. I started to bring in this idea of professionalization. I thought, 'Let's try to change business thought around here so that there is no more emotional attachment to individual businesses and there is more logic and strategy attachment.' "

Subbiah (b:1939), 3rd generation, family business leader since 1996

"With the economy opening up, we needed the kind of input that independent board members offered. A lot of us in the family didn't have wide exposure because we were just running our businesses."

Venky (b:1958), 4th generation, active in the family business since 1980

For at least five generations, members of the extended Murugappa family were successful in developing and leading important businesses in India. One of these enterprises, started in the 1910s by Dewan Bahadur[3], continued as of mid-2000 as the family-governed Murugappa Group. It was India's sixteenth largest business group, with $850 million in sales and 23,500 employees. Headquartered in Chennai (Madras), India's fourth largest urban center, the Murugappa Group was a loose confederation of seven companies.

It was composed of 25 business units in 38 manufacturing locations spread over 11 Indian states in the fields of abrasives, bioproducts, confectionery, bicycles, steel tubes, chains, roll formed door frames, sugar, fertilizers, pesticides, mutual funds, vehicle financing, stock brokerage, nutraceuticals, sanitaryware, rubber, tea and coffee plantations. Family ownership of the companies ranges from 34% to 100%. **(See Exhibit B: Businesses of the Murugappa Group as of 2000)**.

Up until 1990, each of the seven companies was headed by a family member as CEO. There was no formal interaction among the companies as a Group and only informal consultations among family members. In 1990, with the opening up of the Indian economy and the start of a liberalization process, the family felt it advantageous to be a Group in a more formal way and officially constituted a Murugappa Corporate Board (MCB), composed of family members. MV, one of Dewan Bahadur's six grandsons active in the enterprise, became Group CEO. His brother, Subbiah, became Group COO **(See Exhibits C1 and C2: Murugappa Family Tree Charts)**. Family members continued as CEOs of the seven companies and non-family members served as presidents of the companies and as the Group CFO.

With India's signing of the World Trade Organization agreement in 1995, the family recognized new opportunities for the Group, such as increased export-oriented activities, and also threats, such as liberal imports. These situations required speedier and more flexible Group business portfolio decisions than could be made when individual family members were emotionally involved in separate business units and focused on their individual company's day-to-day management. It was hard for the Group to make a business decision to restructure, downsize or sell a division or unit, if that entity was a favorite of a brother or cousin running it. Even when all family members wanted to make positive business decisions for the Group as a whole, they could not make decisions as nimbly as required in the new faster-paced global economy.

In September 1999, ownership and operational management of the companies were separated for the very first time. CEO leadership of the seven individual companies switched from family members to professional non-family managers, all promoted from within. The five family members who had headed the seven different companies moved into a shared office suite at headquarters and became full-time directors of the newly reorganized nine-member Murugappa Corporate Board (MCB). They were joined on the MCB by three appointed independent outside board members and the Group's non-family CFO. Each full-time MCB family board member was assigned three broad strategic tasks for the Group: a functional responsibility across all business units (for example marketing, human resources, technology or strategy), a mentoring role to the CEO and board of one or more companies he had not led before, and a role as adviser/guide to younger family members working for the Murugappa Group. **(See Exhibit D: The Murugappa Group Governance Structure as of 2000)**

The Chairman of the restructured MCB was Subbiah. By mid-2000, the Group and family were moving forward with, and adjusting to, the changes in the governing structure. However, Subbiah believed there was still more professionalizing to do to secure the continued success of the enterprise for the family, employees and community. Subbiah had no time to waste to complete a smooth transition. He was 61-years-old, and, if he followed the precedent started by his uncle, AMM, and continued by his brother, MV, he was scheduled to retire at age 65.

As Subbiah felt more decisions about business and family leadership needed to be addressed soon, he decided to head 300km further south in the state of Tamil Nadu for a weekend trip to his family's finely crafted, meticulously maintained ancestral home in the village of Pallathur, pop. 10,000. **(See Exhibit E: Map of the Murugappa Family Homeland)** He hoped to spend time at his family home, as well as at the 10th century temple supported by his family's clan and the hospital funded by his family over the past seventy-five years. As he traveled southward, he reflected on the lessons learned from the family and business in the past in order to plan with other family members for the future…

FAMILY HISTORY

Dewan Bahadur and his Murugappa ancestors were members of the Chettiar clan within India's Vaisya caste. Members of this clan were businessmen, historically active in trading, money lending and banking. **(See Exhibit F: Brief Description of Chettiar Culture)**. Nine generations earlier, in the mid-1700s, ancestor Vellayan Chettiar successfully pursued business in these fields. He had five sons who went on separately to build flourishing businesses that became industry leaders in India for generations. His second son, Arunachalam, was Dewan Bahadur's great-great-grandfather. Arunachalam had one son who, in turn, had two sons. One of these sons had three sons, all of whom worked in the family enterprise.[4] The youngest of these sons, born in 1884, was the energetic and entrepreneurial, Dewan Bahadur.

The current family enterprise had its beginning in 1898 when Dewan Bahadur, at age 14, was sent to neighboring Burma (now Myanmar) where he worked a few years as a banking clerk for another Chettiar family business. Two decades later, through tireless hard work, scrupulous honesty and savvy business sense, Dewan Bahadur had built a financial institution that was the largest private bank in lower Burma. During the same time period, he married and had a family that included five daughters and three sons–Murugappa, Vellayan and Arunachalam (AMM)–reared back in India by his frugal wife, Valli.

When Dewan Bahadur's father died, his will followed the Indian tradition of partitioning the joint family business property and sharing the wealth equally. In 1929, when his own three sons were old enough to work in the family enterprise, Dewan Bahadur started a new tradition and divided up his family business estate equally, while he was still alive and active in the enterprise, in order to give them all the opportunity to be a family energetically pursuing business together.[5] Doing so, Dewan Bahadur said, "gave each the confidence that he had a place as an individual in the whole." This action multiplied the family's entrepreneurial manpower to maximize opportunities for the enterprise, wealth creation and family unity. Dewan Bahadur died in 1949, but the groundwork he laid for his family enterprise continued. Prior to his death, Dewan Bahadur also served as his family's elder and kartha.

The kartha system is a unique and flexible Hindu leadership tradition. In it, the kartha is the male family leader in charge of guiding and choreographing the course of the family. Among other things, he is responsible for directing the education and work paths of individual family members. Major family business decisions must also be blessed by him. On behalf of the family, he encourages and utilizes members' individual strengths and supports weaknesses, even subordinating himself when others are best suited for the leadership of particular tasks and roles. However, when the family is under stress, the kartha serves as a general, around whom family members rally and submit. Until the early 1800s, a family's kartha would name his own successor based upon whom he felt was the most acceptable family leader, regardless of birth order. However, under British Rule in the mid-1800s, a colonial tax collection law called the "Hindu Undivided Family" required that the kartha be the oldest male family member. Although these laws are no longer in place, the tradition still exists in most Indian families that the eldest male family member serves as both family elder and kartha until death.

As Dewan Bahadur's sons in the second generation grew in the business, they shared their father's entrepreneurial spirit, but were different from one another and complemented each other in their managerial styles. Murugappa, (1902-1965) was an excellent communicator who was diplomatic and good at external relations. He was one of the first Chettiars to visit the U.S and he pioneered the family's launch into industrial manufacturing in the 1930s. He was also the first Chettiar to occupy several esteemed commercial and social leadership positions in India. He established a consultative decision-making system amongst male members of the family that helped keep the family together very well. Murugappa became leader of the family business, the family elder and kartha after the death of his father in 1949.

Vellayan, (1905-1945), was business-oriented, ambitious and interested in deal making. While returning to Burma to continue in business after WWII, he was tragically assassinated by Burmese communists who resented Indian commercial interests in their country. Prior to his death, Vellayan was very close to the leaders of the newly independent Burma. He also bought new properties for the family enterprise, including a parachute manufacturing business.

AMM, (1918-1999), was operations-oriented with a focus on details. He started the family's stockbrokerage business and increased professionalism in the firm. He and his eldest brother, Murugappa, established independent boards of directors for individual companies and attracted excellent non-family managers. AMM became family elder, kartha and head of the business after the death of Murugappa in 1965. Because AMM was neither a natural communicator nor externally-focused, he called on these skills in other family members, like his nephew MV, who had great leadership and communications skills that benefited the family and enterprise. In 1983, AMM set the trend of retiring as the family's business leader at age 65 and handed over that role to his nephew, MV (1929-1997). AMM remained as family elder and kartha until his death in 1999, when his nephew, Murugappan, filled that role.

The sons of Dewan Bahadur developed expectations for their six sons in the third generation, born between 1929 and 1943, to be active in the enterprise. When Murugappa held the positions of family elder, kartha and business leader from 1949 to 1965, he was instrumental in preparing males of the next generation for their future in the enterprise by guiding their education, training and work assignments. He arranged for the young men to spend time in England studying and/or working with joint-venture partners. He did this so that third generation males got business experience away from the family and were prevented from being pampered or taken advantage of early in their careers. The third generation sons included: Muthiah (son of Murugappa[7]), MV, Murugappan and Subbiah (sons of Vellayan) and Muru and Algy (sons of AMM.) **(Exhibit H: Photos of the Murugappa Family Group Members)**

There were seven sons in the fourth generation, born between 1953 and 1976. They included: Murugu and Venky (sons of Muthiah), A. Vellayan and A. Venky (sons of MV), S. Vellayan (son of Subbiah), Arun M. (son of Muru) and Arun A. (son of Algy). AMM held the position of family elder, kartha and business leader during their formative years and guided their training. Most achieved graduate degrees in business, science or technology from universities in India, Britain or the U.S. With the exception of S. Vellayan, who joined a U.S. consultancy firm after his MBA, and Arun A., who worked for two years with GE Capital in India, the others gained work experience in the family business and held positions of increased responsibility in the family enterprise. Male family members are compensated in an equitable manner dependent on the range of seniority and experience.

As of mid-2000, S. Vellayan was the only son in the fourth generation not working in the family enterprise. After graduating from business school in the US, he married outside the arranged marriage norms of the family and did not return to the family business because it would be socially uncomfortable for his wife. Instead, he continued to work as a management consultant in the U.S. By custom, the wives and daughters of the family did not work in the business. They were, however, very active supporting the family's foundation and charities that included hospitals, schools and a technical research center that focused on sustainable development of the rural areas near their home and business communities. **(See Exhibit I: Family Norms and Customs)**

BUSINESS HISTORY

Over the decades, the family enterprise grew through a variety of forms: start-ups, acquisitions, joint ventures, diversification, vertical integration, public offerings, and divestitures. These different growth strategies evolved as the political and economic situation of India and the surrounding area changed. The family took advantage of opportunities that presented themselves, sought out others and regrouped after disappointment, all the while working deftly and ethically within the realities of India's governmental, economic and political parameters.

For example, in the 1920s through 1930s, when 70% of Chettiar wealth was in Burma, Dewan Bahadur and his sons made a decision that diverged from others in their clan and repatriated much of their monies from Burma to India. Concurrently, they had the insight that India was on the verge of industrialization and decided to use the funds to finance the family's first steps into major manufacturing in India. In making these two strategic decisions, they escaped the financial ruin suffered by most other Chettiars due to the Great Depression, World War II and the Burmese nationalization movement. Instead, the family was poised to prosper.

The family's view of business opportunities continued to broaden in the late 1920s and early 1930s. First, Dewan Bahadur developed a close friendship with a most distinguished Indian statesman named Sir A. Ramaswami Mudaliar[8] who influenced him to look for opportunities to bring to India from outside its borders. In 1931, Dewan Bahadur sent his middle son, Vellayan, on a trip to explore business opportunities in China and Japan. He sent his eldest son, Murugappa, on an eight-month business trip that included attending the International Chambers of Commerce Convention in the United States. In the years after their return, the sons kept an eye out for business opportunities the family could set up and lead in India. In the late 1930s, Murugappa determined there was market demand in India for the manufacture of quality security furniture[9] and was instrumental in setting up a plant.

A much larger foray into industrial manufacturing, conceived by Murugappa during the same time period, was to enter the business of making abrasives, a product used by manufacturers to sand, sharpen and smooth equipment, materials, components and end-products. The family's insight was that if world war broke out, the volume and variety of imported goods would decrease and local manufacturing (with the need for abrasives) would expand with the new opportunity. To this end, the family used its recently established contacts abroad to identify, negotiate to buy, dismantle, ship and install in India used equipment from an abrasives plant in the U.S. that was being updated. The thinking was,

"Let's take a risk, buy the old equipment and facilities and bring them here."[10]

The plant was operational in 1942. As of 2000, the abrasives business, now called CUMI, generated $67 million in sales and was headed by third generation Murugappan, before the MCB reorganization took place.

After India's independence from Britain in 1948, the government announced a five-year plan to expand industry and raise living standards, in part through foreign support. Murugappa guided the Group to take advantage of this opportunity and be among the first to enter a joint venture with a British concern. The Group developed a plant to make bicycles, followed by steel tubes. The joint venture partner held a 43% interest in the company. Over time, the business grew, integrated into most bicycle components, and diversified into steel tubes for furniture and other industrial applications. The British partner eventually departed the industry and divested its ownership position. In 2000, this business, called Tube Investments of India (TII), was 29.4% family-owned and generated $251 million in sales. Prior to reorganization, it was headed by third generation MV until his retirement in 1996, after which it was headed by fourth generation A. Vellayan.

In the 1960s and 1970s, the Indian government required difficult-to-get licenses to start new businesses, assuring those awarded licenses near monopolies. When the Murugappa Group was awarded only one of several licenses applied for, it chose three other methods for growth. One method was to vertically integrate backwards in their current industries. As an example, CUMI became the only abrasives company in the world to be totally integrated from power generation for its plants, to producing raw materials, to manufacturing, marketing and selling its finished products.

Another method for growth was to purchase existing businesses. One acquisition in 1980 was the poorly run English and Scottish tea estate company, Cooperative Wholesale Society (CWS) India (renamed Parry Agro Industries in 1992). As of 2000, its sales were $22 million. The boldest acquisition occurred in 1981 with the purchase of Madras-based EID-Parry, a huge, 193-year-old business that the Group had been interested in since 1958. EID-Parry was the second oldest commercial name in India and included fertilizers, pesticides, sanitaryware, confectionery and sugar mills. According to Algy,

"At the time the deal was made, EID-Parry was one-and-a-half times larger than our entire group!"

For years, financial institutions asked the Murugappa Group to take over EID-Parry's management, given the Group's trustworthiness and decision-making acumen. The family repeatedly turned down the overtures, responding that without control it wasn't in the family's interest. Eventually, the financial institutions relented and the family gained control of the publicly traded company, largely due to the relationship-building skill of MV who was instrumental in negotiating the deal. The agreement made headlines because it showed the Group's entrepreneurial side and its commitment to invest in what many in India felt was an uncertain venture. AMM wrote of the take-over in his memoir:

"Our values remain traditional and conservative, but when an opportunity to grow [like EID-Parry] comes along, we don't ignore it even if it means plowing a lot of money into what might be a risky business."[11]

Although Subbiah had argued that the huge, ailing company was too sick to become profitable, once the sale was completed, MV and AMM tapped Subbiah to lead its turn around. As of 2000, EID-Parry was generating $263 million in revenue. Prior to the Group's reorganization, the business continued to be run by Subbiah.

A third method of growth for the Murugappa Group was to enter businesses that did not require licenses. In 1978, they started a financial services business called CIFCO that grew to $37 million in 2000 and was headed by Algy until reorganization.

Since the 2000 reorganization, the thinking was to shift reliance away from its slow-but-steady growth manufacturing sector to opportunities in its high growth financial services sector, where it also had capability. According to Murugu,

"Now we've been looking at our portfolio of businesses in different perspectives. We've been saying that we have far too much manufacturing or are far too integrated within manufacturing. Ninety percent of our revenues come from manufacturing related businesses. Perhaps we need to go more into services, so there's an overall balance in the portfolio."

The Group also wanted to increase exports from its chains, tubes, grinding wheels and sanitaryware divisions. Additionally, the Group started exploring entirely new opportunities in global industries that employed the highly talented, more cost-effective Indian workforce, such as information technology-enabled services. Because the Murugappa Group was not yet a legally constituted holding company, it could only start a business within an existing business–and most of their existing businesses were publicly traded and headed by non-family CEOs. So questions arose as to how to maintain a governing structure on top of a governing structure.

INFLUENTIAL OUTSIDERS

Dewan Bahadur initiated a tradition of making use of trusted advisors, starting with Sir A. Ramaswami Mudaliar in the 1930s. In the late 1950s, Dewan Bahadur's descendents showed a willingness to include non-family members in business management and made Sir Mudaliar the first non-executive, non-family chairman of their two most important businesses, TII and CUMI.

In 1994, the Murugappa Group engaged its first management consultant, A. D. Little, to look at issues of governance and leadership succession. This resulted in a succession plan, based on merit as well as seniority, in which senior family members were to fill the positions of Managing Director, Chief Operating Officer and Chief Executive Officer of the Group's companies until each retired at 65. This plan was put into practice and worked well for a while. A.D. Little also taught the Group "process management" to help shift thinking from a transaction orientation to an innovation and creativity focus. A draft of a Family Business Constitution was also composed at this time, but never finalized.

During 1996-1997, the Murugappa Group hired McKinsey & Co to do a portfolio analysis of the companies. The result of that effort was a recommendation for the Murugappa Group to develop a more concentrated portfolio of business units. Acting on that recommendation, the Group exited a few of the non-core businesses. McKinsey & Co did not address issues of family business governance or succession.

After taking over business leadership from MV in 1996, Subbiah, in consultation with AMM, engaged a prominent business colleague and respected family friend, Dr. A. S. Ganguly, to facilitate communication on family business leadership among the family leaders active in the enterprise. The group met one or two days a month for almost two years to chart the course of change. They discussed topics such as: How best could family members make the transition from operating to governing the businesses? What roles should family members play as governors? Could current non-family COOs of the business units step up into the Managing Director/CEO roles? What should be the composition of the Group board and the family role in the subsidiary boards? During the meetings, the Murugappa Group surfaced five re-organization goals: To be more of a Group rather than a collection of separate entities; To be more flexible in the make-up of the portfolio of businesses; To have less emotional attachment by individuals to their businesses; To shift away from family-led units to non-family-led units; And, to mentor non-family Managing Directors/CEOs for the long-term view.

Supporting a CEO rather than *being* a CEO was a shift for the family members. According to Murugu,

"We needed to increasingly believe that we direct companies, but we own nothing. This is hard because in India people say, 'How come you have your chief executives run the company? What if they make mistakes and run the companies aground?' Our ability to transcend all this is very, very important. We need to stay committed to the cause of growing the business professionally and within our values."

The role of the non-family CEO in each of the seven businesses was vital to the success of the changes that the Group wanted to make. The non-family CFO, Mr. Partho S. Datta (Partho), hired in 1998, explained it this way:

"The (business unit) CEO is the most critical function and we need to do whatever it takes to strengthen him and put him on a very high pedestal. The CEO asks, 'Am I able to get the right sort of people for my business? Am I able to get the right sort of financial resources? Can I make sure that my people are not disadvantaged by members of the board?' This will be his minimal agenda."

Concurrent with reaching outward for advice, the Group also looked inward for input. After the family members in business leadership revisited the set of values and beliefs developed under the leadership of MV in 1987 (**Exhibit J: Values and Beliefs of the Murugappa Group.**), they picked a group of about 80 people across the organization for a meeting. According to Venky, this is what occurred,

"First we examined if there was a sense of personal congruence with the values. Then, we looked at which of the values we thought we were actually violating in terms of business process and how we do business. We talked about the customer, the employees, the stockholders, and business ethics. These were difficult questions to ask and difficult ones to answer. Then, we looked at how we could alter business processes to meet or exceed the value system and to ensure that values aren't violated."

Prior to implementing the reorganized MCB in 1999 with the guidance of Dr. Ganguly, the Murugappa Group actively recruited three outside board members who represented broad business experience in India, the West, academia, consumer manufacturing and information technology. One outside MCB member was N. S. Raghavan (Raghavan), co-founder and recently retired joint managing director of Infosys, one of India's three largest IT software companies. His reasons for accepting the MCB board position included the family's open, entrepreneurial approach. He said,

"I appreciated that the family was entrepreneurial. They saw the independent board member role as helping them look for solutions outside their zones of comfort. I also admired the humility of the Murugappa family and their willingness to listen to us. I don't know too many companies or too many people with their level of experience who are as open to constructive criticism and feedback as they are. One of the things I keep pushing is the velocity of the decision-making. The market is not going to wait, so I'm trying to push. The Group needs to get into more growth areas, growth industries. It is saddled with old economy companies and that means market capitalization is very low. Let's take some risk and go ahead."

A second outside MCB member was Dr. Marti Subrahmanyam (Marti), an Indian native and Professor of International Business Finance at NYU's Stern School of Business. He chose to be on the MCB to show Indian family businesses that a family business model, such as the one envisioned by the Murugappa Group, can be done. He commented,

"The central issue confronting the Group is really that we do things very slowly and assume we can continue doing that. If you ask the man in the street what he thinks of the Murugappa Group, he will say they are impeccable in terms of their values, but very conservative, very slow. I think what we're striving for on the board is an external perspective. A lot of the Murugappa Group businesses have been going in one direction for thirty or forty years. The world around them has changed. Most of the experience of the internal pieces, family or non-family, is confined to one little set of rules, but the rules have changed."

A third outside MCB member was Mr. Natalino Duo (Natalino), an Italian who worked as India's Regional Managing Director for Benneton, a successful family-owned global clothing manufacturer. When he was asked to serve on the board, he felt the enterprise was sending a message to the international business community,

"It is clear the Murugappa Group has a commitment to globalization from their decision to choose a foreign independent board member with my background."

FAMILY MANAGEMENT

From the 1920s up to 1987, each business unit was run by a hands-on family owner/manager and most decisions were made at the individual company level. If one of the businesses had money and desire to expand, it did so. The Group level had the potential to lead capital and human resource allocation, but leveraging of resources and transfer of knowledge across businesses was infrequent or absent. Earlier in the enterprise's development, family interaction happened frequently and casually because the families had lived in the same compound or near one another. A Group Corporate Committee was started in 1987, and later became the MCB in 1990. This occurred to increase the exchange of ideas, advice and knowledge that had decreased over the years as the businesses grew larger and more diverse and the families lived farther from one another than in the past.

In 1993, MV, then aged 64, had presented a proposal for family business leadership succession to AMM, who had veto power in his role as family kartha. The proposal had been developed through evaluation of options, discussion and consensus by the eight males in leadership positions of the family enterprise at the time. These included MV, Murugappan, Subbiah, Muru and Algy in the third generation and A. Vellayan, Murugu and Venky in the fourth generation. The proposal called for MV's youngest brother, Subbiah, to take over the business leadership when MV retired in 1994 at age 65. AMM agreed to the selection of Subbiah as business leader, but directed MV to remain in the position through 1995 during India's transition to membership in the WTO.

During this time of change and soon thereafter, the unexpected deaths of Muru (in 1995) and MV (in 1996) occurred. This situation stretched the surviving family members in business leadership roles and revealed the shortcoming of the succession plan put in place in 1994. Even family elder and kartha, AMM, who was 77-years-old and retired, pitched in by making himself more available to help fill the Group's leadership void temporarily. His will to keep the family and business running served as a morale boost for younger family members until they regained their bearings. It was during this time that AMM said,

"The Group needed professional leadership of its companies; The Family, as members of a governing board, should only offer policy guidelines and monitor results. Their numbers in the business would then not matter."[13]

AMM continued in his role of family elder and kartha, but prepared the family for the time when his oldest nephew, Murugappan, would take over those roles after he died. At the same time, Subbiah, as the recently named CEO of the Murugappa Group, felt disadvantaged in the transition because his predecessor MV, who had strong family leadership skills and business experience, had died and could not be the support to Subbiah as he had hoped.

By mid-2000, things had stabilized. Murugappan, age 65, was the family elder and kartha, but had chosen not to play a role on the MCB. Instead, he was very active in the family's foundations that supported schools, hospitals, technology research and the temple. Family members on the MCB were embracing their new role, creating a path for family members in the future. According to A. Vellayan,

"To make the transition and succession work, trust across the generations is paramount. Meritocracy is the way to the top. Upcoming family members understand that a place on the board is not automatic. We have a clear-cut set of criteria for upcoming family members to work towards to become board members."

Both the family and non-family members of the MCB, and Murugappan in his role as kartha, agreed that a Family Constitution was needed that would articulate the family's roles, responsibilities and relationships.[14] However, there was disagreement as to the form it should take. Murugappan favored a constitution acknowledged by custom and practice, but not written down. Subbiah, as business leader, favored a more formal written document that had few precedents in India. Subbiah's point of view was,

"Developing a formal constitution is absolutely essential if we want to sustain and grow our business. We need to bring the family together, develop a constitution and revisit it regularly starting with the aspirations of every individual. There are a lot of Western examples available for this, but the only Indian family that has something similar is the Chandaria family of Africa, who have now spread all over the world."[15]

The independent board member Marti, explained his view as an outsider,

"The reality is, we have seven executive directors and ten CEO/MDs in the Murugappa Group and we need formal processes. And, those formal processes–even the standard thirteen accounting boards–have to be much more formal, which means written things, formal things. We need to mesh all the rest of it. The tradition of the family has been very conservative in terms of everybody knowing everything. I've been saying, 'That's great as a concept, but in practice, we can't continue to do that.' This business is way too complicated for that. It takes too much time."

LEADERSHIP FOR THE FUTURE

For generations, both family and business decisions were made by the oldest male family member until death. Then, AMM set a new tradition of separating the family and business leadership roles when he retained his position as elder and kartha, but retired from business at 65 turning over business leadership to his nephew, MV. When Murugappan was next in line for all three roles, he became family kartha and elder, but declined a leadership role in the Group level business, deferring that responsibility to his younger brother Subbiah. As of mid-2000, Subbiah, as MCB Chairman, had steered the family enterprise through a reorganization that separated ownership from operations. Now he questioned if the position he held on the MCB was best served with him in it.

He saw at least three options. One was for Subbiah to follow family custom, stay as Chairman until age 65, then offer the post to his next-in-line cousin. Subbiah wondered if this was the most flexible and sustainable framework for success in the future. A second option was for Subbiah to retire early from the MCB and opt out of the business altogether. But, this might mean the MCB would lose the benefit of Subbiah's guidance and counsel, just as he had lost the guidance of his predecessor, MV. A third option was for Subbiah to step down as Chairman before he turned 65, but to remain on the MCB as a whole-time director. This would open the possibility of setting a new precedent in professionalization by appointing a non-family member as Chairman and CEO, if a person right for the position could be found. Then, the question would be, what would the MCB Chairmanship position offer the select few elite candidates qualified to run such a large and important enterprise? And, did options exist to hire an interim Chairman until a permanent one could be found?

On the family side, Subbiah pondered whether he was up to the task of being family kartha, if he eventually became the oldest surviving family member. He thought about the history of the kartha role, and recalled that before British Rule, the kartha did not have to be the oldest male family member, but the most acceptable family leader regardless of birth order. Was there someone in the family who was better suited to this role than he?

TRADITION AND TRANSITION

….Subbiah was stirred from his thoughts as he arrived at the family's ancestral home in Pallathur. He considered how the last years had been a time of great structural changes, shifts in thinking and adaptation for the family and the Group. At the same time, the enterprise had held its own, managing a major spectrum of successful businesses in an increasingly fast-paced, global marketplace. Subbiah was confident that the valuable lessons of the family's strong business heritage, including adapting to and instituting change, would continue to guide the enterprise towards on-going success. He recalled something his nephew, Murugu, had told him recently,

"We consider ourselves custodians to a heritage and trustees to a tradition, both built on togetherness, trust, mutual respect, ethical values and above all dignity, independence and discipline. As the scope and magnitude of the family and business leadership changes, we are preparing ourselves for the great challenges ahead."[16]

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MURUGAPPA CASE EXHIBITS

Exhibit A: Symbolism of the Murugappa Group Company Logo

Exhibit B: Businesses of the Murugappa Group as of 2000

Exhibit C1 and C2: Murugappa Family Tree Charts

Exhibit D: The Murugappa Group Governance Structure as of 2000

Exhibit E: Map of the Murugappa Family Homeland

Exhibit F: Brief Description of Chettiar Culture

Exhibit G: Shares of the Murugappa Group Businesses by Generation, by Male

Exhibit H: Photos of the Murugappa Family Group Members

Exhibit I: Family Norms and Customs

Exhibit J: Values and Beliefs of the Murugappa Group

NOTES

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1 The company's logo is a peacock symbolizing the chariot of the family's god and idol, Lord Muruga, second son of Lord Shiva. The feathers also represent the Group's many companies **(See Exhibit A: Symbolism of the Murugappa Group Company Logo).**

2 From p. 138 of AMM's biography by Muthiah, S., *"Looking Back From 'Moulmein' A Biography of A.M..M. Arunachalam"*, pub. 1999 (AMM)

3 His entire name was Dewan Bahadur A.M. Murugappa Chettiar (1884-1949). "Dewan Bahadur" was the official title bestowed upon the founder later in life by the Viceroy of British India. It means "A Great Man or Distinguished Personage who is a Steward in Charge of a House of Business."

4 The business was arranged in a traditional Indian way, with only male family members involved. This is a practice that continues today.

5 This policy continues today into the fourth generation. Members of each of the original three branches put up capital equally in new ventures so that each of the branches still maintains 33% of the family control stock. **(See Exhibit G: Shares of the Murugappa Group Businesses by Generation, by Male)**

6 AMM p. 39

7 Since inheritance in India passes from father to son, it is customary for a family with no sons to adopt a male relative or an unrelated male from the same clan. Muthiah was born to Vellayan, but adopted by Murugappa when he was 15-years-old because Murugappa had two daughters, but no sons.

8 A native of the Murugappa's home region of Tamil Nadu, Sir A. Ramaswami Mudaliar lived from 1887 to 1976. He was very active in India's Justice Party in the 1920s-1930s, was a member of the War Council in St. James in London, was India's first ambassador to the United Nations after independence, was active in the United Nation's World Health Organization and served as President of the First General Assembly of the UN's Economic and Social Council (ECOSOC) in 1946.

9 Security furniture includes steel almirahs, safes, cashboxes and filing cabinets.

10 Paraphrase of Murugappa, by his grandson, 4th generation Murugu.

11 AMM, p. 183

12 Dr. Ganguly, aged 67, was Board Chair of ICI India, one of India's largest companies. He was the former Chairman and Managing Director of Unilever in India and served on Unilever's Global Holding Company Board. Dr. Ganguly believed so strongly in the family and its enterprise that he volunteered his time.

13 AMM p. 204

14 Topics would include: qualifications for family members' employment; how to make decisions; salary, perquisite, benefit and dividend allocations; what to do for family members in need; the process to pick a family leader and make family decisions; schedule of family meetings; how to prepare for the corporate board, and how to qualify to be on the board.

15 Management Review Journal June 2001 p. 38 paraphrased

16 *Families in Business Magazine* 2/2002 pg 31

EXHIBIT A: SYMBOLISM OF THE MURUGAPPA GROUP COMPANY LOGO

MURUGAPPA
GROUP

The company's logo is a peacock symbolizing the chariot of the family's god and idol, Lord Muruga, second son of Lord Shiva. The feathers also represent the Group's many companies.

The family regularly worships a glass picture of Lord Muruga at the family's private offices on Monday and Friday evenings and before a family member takes leave for a long travel. The head of the family usually arranges the time of worship and has male family members called. Female family members may also attend.

The specific glass painting that they worship has a significant history. It was in Burma with the family for security and comfort when the family's business was there. When the Communists took over Burma after WWII and the family was back in India, an agent rescued the painting and walked three days without food to assure its safe return to the family.

EXHIBIT B: BUSINESSES OF THE MURUGAPPA GROUP AS OF 2000

Company Names	CUMI incl. subsidiaries	TII incl. subsidiaries	EID PARRY incl. subsidiaries	COROMANDEL FERTILISERS	CIFCO	PARRY'S CONFECTIONERY	PARRY AGRO	MURUGAPPA GROUP
Gross Revenues US $ million [1]	$ 67 m	$ 251 m	$ 263 m	$ 141 m	$ 37 m	$ 24 m	$ 22 m	$ 848 m[2]
%Family Owned	33.10%	29.42%	37.25%	78.31%	46.65%	60.39%	76.87%	
Market Cap US $ million [3]	$ 24 m	$ 43 m	$ 43 m	$ 24 m	$ 15 m	$ 5 m	$ 6 m	$ 161 m 4
Products	Coated abrasives, Grinding wheels, Diamond dressing tools, etc.	Bicycles, Steel tubes, Chains	Sugar, Fertilisers, Pesticides, Bio-products, Sanitaryware	Fertilisers	Leasing, Vehicle finance, Brokerage, Mutual funds	Sugar boiled confectionery, Toffees	Tea, Coffee,	Algae
Year Founded (F) or Acquired (A)	1954 F	1949 F	1981 A	1981 A	1978 F	1981 A	1980 A	

NOTES:

1 The exchange rate considered as of March 2000 was US $1 = INR 43.65
2 The Murugappa Group Revenues include the revenues from the privately held (Unlisted) companies. The Gross Revenues of the Murugappa Group is the total of US $ 776 m of Listed companies on the Stock Exchange plus US $ 72 m of Unlisted companies.
3 The exchange rate considered as of March 2000 was US $1 = INR 43.65
4 The market cap of the Murugappa Group in 2000 is the sum of all the listed companies on the stock exchange. This does not include privately held companies.

EXHIBIT C1: MURUGAPPA GROUP FAMILY TREE OF SONS OVER 5 GENERATIONS AS OF 2000

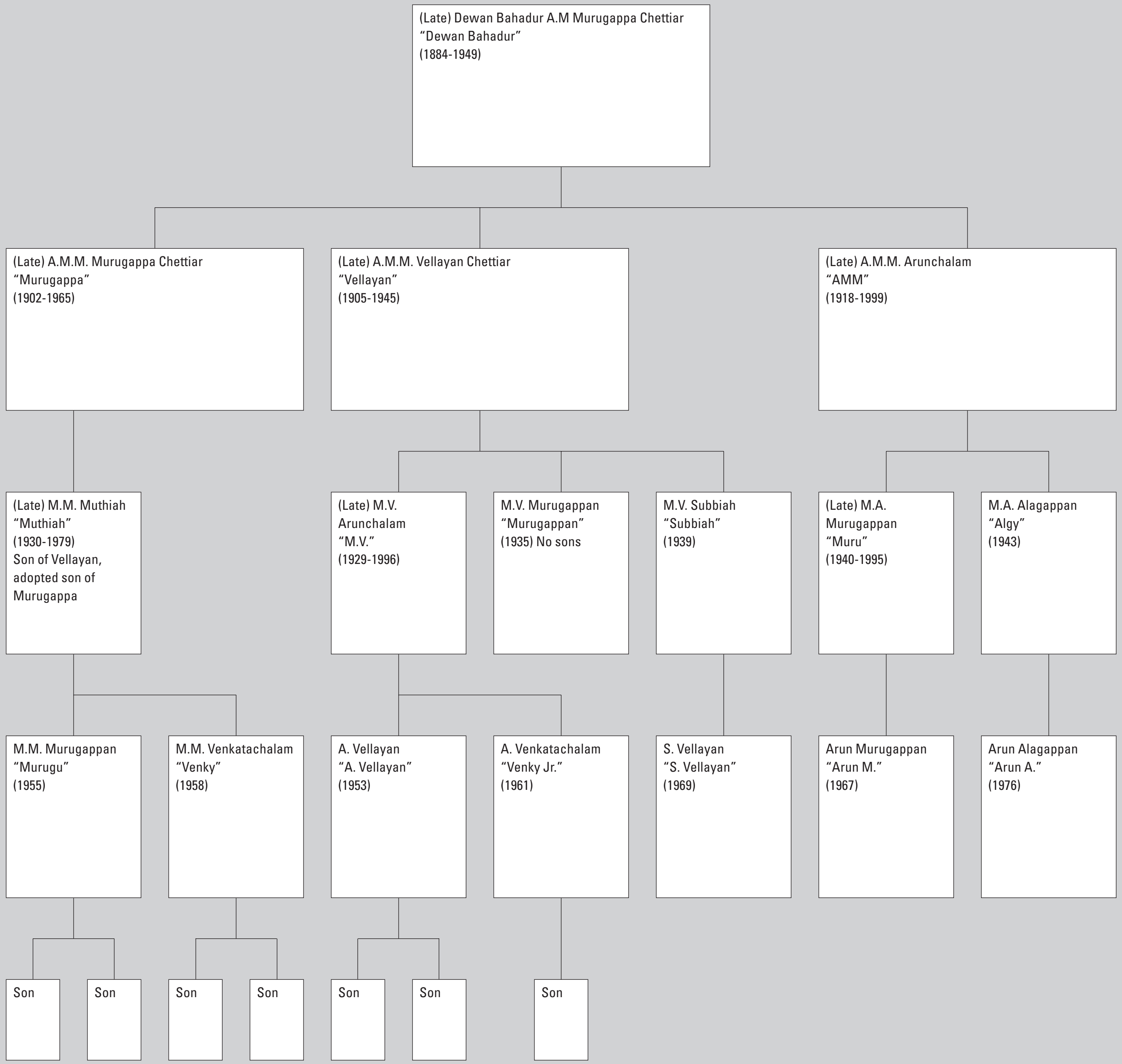
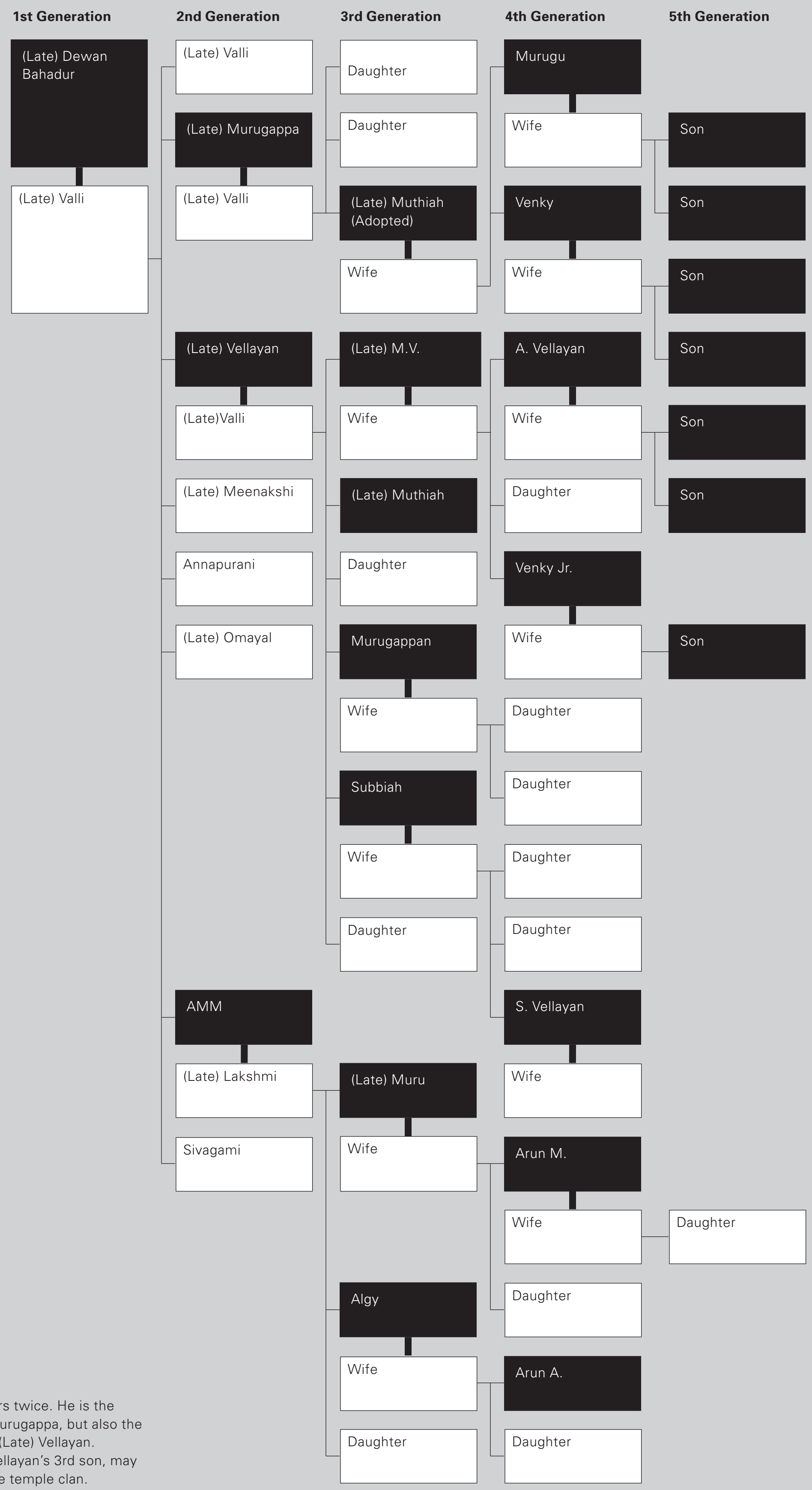


EXHIBIT C2: FAMILY TREE OF DESCENDANTS OF DEWAN BAHADUR, FOUNDER OF THE MURUGAPPA GROUP AS OF 2000



NOTES:

1. (Late) Muthiah appears twice. He is the adopted son of (Late) Murugappa, but also the natural born 2nd son of (Late) Vellayan.
2. Murugappan,(Late) Vellayan's 3rd son, may still adopt a son from the temple clan.

EXHIBIT D: THE MURUGAPPA GROUP GOVERNANCE STRUCTURE AS OF 2000

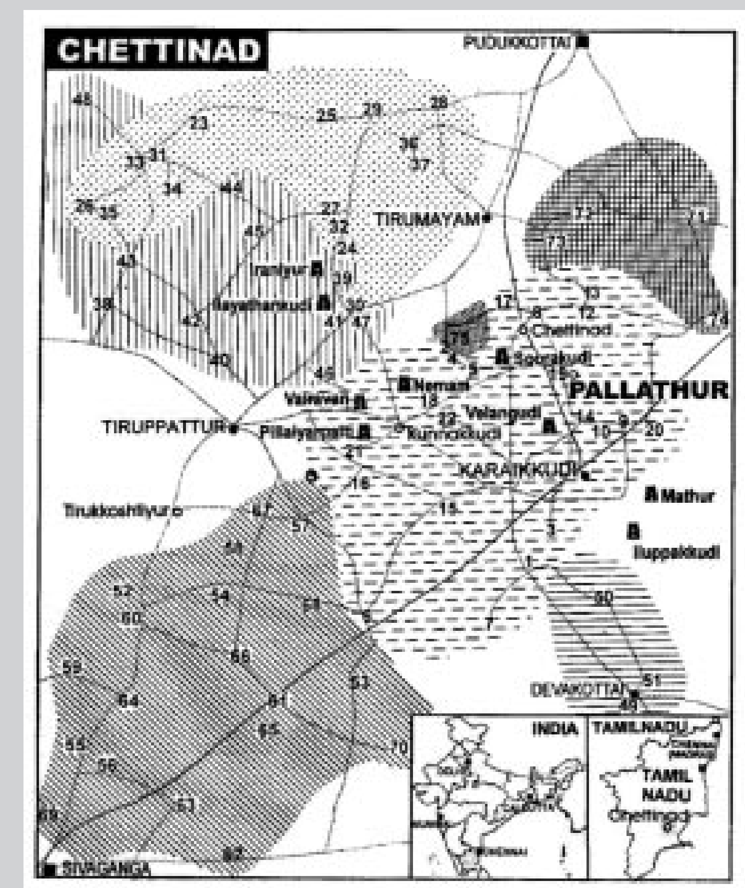
Chairman of the Murugappa Corporate Board (MCB)
Subbiah

plus Five Wholetime Directors (Four Family Members, One CFO)

Name:	Algy	Venky	Murugu	A. Vellayan	Partho
Position:	Vice-Chairman	Director	Director	Director	Director
Functional Area:	Strategy	HR	Technology	Marketing	Finance
Business Mentor:	TII/TIDC Marketing Services	Parrys Confectionery Ltd. Cholamandalam	CUMI Plantations	EID-Parry Coromandel Fertilizers Ltd.	Legal Secy. A/D
Family Mentor of:		Arun M.	Venky Jr.	Arun A.	

plus Three External Non-Wholetime Directors

EXHIBIT E: MAP OF THE MURUGAPPA FAMILY HOMELAND



VILLAGE OF PALLATHUR, CHETTINAD REGION, STATE OF TAMIL NADU, INDIA
Source: *"Looking Back from 'Moulmein': A Biography of A.M.M. Arunachalam,"* S. Muthiah, EastWest Books, 2000

EXHIBIT F: BRIEF DESCRIPTION OF CHETTIAR CULTURE

India's system of hereditary social classes is called the caste system. Although the system has weakened over the last 50 years and people often mingle freely between castes, it is still a strong influence on Indian life. The system originated about 1500 BC when Aryans from central Asia invaded, controlled most of India and developed the system to limit contact between themselves and the local populations. Later, the system became integrated into the teachings of Hinduism, the polytheistic religion most influential in Indian culture since prehistoric times. The four Hindu castes are *Brahmans*–the priests and scholars; *Kshatriyas*–the rulers and warriors; *Vaisyas*–the merchants and professionals; and the *Sudras*–the laborers and servants. Within the castes, there are thousands of subcastes, each with its own rules of behavior.

The Murugappa family is a member of the Vaisya caste, in the subcaste of Nattukottai Chettiar, also known as Nagarathar. The family is related to the original seven families that settled in the Chettinad area, about 300 km south of Madras, now Chennai. This occurred in the 10th century when they were offered land by a king as an inducement to settle in his kingdom and provide the money lending and trading functions. Today, the Chettinad area comprises about 75 villages and a population of about 150,000.

Historically, several business practices marked the Chettiar. These included trustworthiness, orientation to creating wealth, willingness to travel, sophisticated accounting methods and a strong sense of social responsibility. Starting in the late 18th century, Chettiars were asked to lead British commercial expansion in Ceylon (1796), Burma (1824) and Malaya. The French and Dutch also used the Chettiar when they expanded throughout Southeast Asia. The Chettiars only commercial competitors throughout this region were the Chinese. During this time,

"…the Nagarathar (Chettiars) enjoyed not only a privileged position, but also a highly trusted one in those lands across the seas. Money was lent to local farmers and cultivators and petty businessmen at a rate the Chettiars, in conclave, decided on every month…Chettiar unity and integrity in this age were legendary…Less visible than the business of money lending, however, was the signal contribution made to the countries in which the Chettiars established themselves. The expansion of paddy cultivation in Burma, making it the rice bowl of Asia, the development of coconut and rubber acreage in Ceylon…providing support to tin mining and rubber growing in Malaya…(etc.) all contributed to the economic development of whatever countries the Nagarathar went to." [1]

1 The Chettiar Heritage, p. viii

EXHIBIT G: SHARES OF THE MURUGAPPA GROUP BUSINESS BY GENERATION, BY MALE AS OF 2000

2nd Generation	3rd Generation	4th Generation	5th Generation
Murugappa (33%)	Muthiah (33%)	Murugu (16 1/2%)	2 sons (each at 8 1/4%)
		Venky (16 1/2%)	2 sons (each at 8 1/4%)
Vellayan (33%)	M.V. (11%)	A. Vellayan (5 1/2%)	2 sons (each at 2 1/4%)
		Venky Jr. (5 1/2%)	1 son (5 1/2%)
	Murugappan (11%)	No Male Heirs (11%) (These shares could be left to all 4th generation males, or in a trust for Murugappan's two daughters, or, potentially still to an adopted son.)	
	Subbiah (11%)	S. Vellayan (11%)	
AMM (33%)	Muru (16 1/2%)	Arun M. (16 1/2%)	
	Algy (16 1/2%)	Arun A. (16 1/2%)	

NOTE:
There will likely be more sons born in the 5th generation

NOTE:
These shares represent the expected allocation of control shares in the Group holding company once it is legally finalized. Currently, this distribution represents the family male ownership in each business. Those businesses also have public shareholders. Females in the family own some of those public shares.

EXHIBIT H: PHOTOS OF THE MURUGAPPA FAMILY GROUP MEMBERS

Left: Seated: Dewan Bahadur, wife Valli; Standing (L to R): AMM, Murugappa, Vellayan (Photo taken in 1944)
Middle: Murugappa Family in 1978 at AMM's 60th Birthday.
Bottom: Murugappa Family in 1989 at MV's 60th Birthday.

To understand how the Murugappa family practices business, it is instructive to look at several areas within the context of their family culture and the native Indian culture.

Clan and Caste:

Many of the Murugappa family cultural norms and traditions derive from Indian society and the family's place in it as members of the Chettiar clan of businessmen and traders in the Vaisya caste. Through the ages, the Chettiar clan system has held firm. Each Chettiar clan was established around a Hindu temple and supports the temple and surrounding village with contributions from its members' earnings. There were nine Chettiar clans, two of the large ones have seven sub-clans each and one has three sub-clans. The Murugappa family, from the Chettiar village of Pallathur, belongs to the sub-clan Pattinaswami of the Ilayathankudi Temple, a structure that dates from 707 A.D.

Marriage:

Marriage is arranged within the larger Chettiar community with a current population of about 150,000. However tradition forbids marriage within clans or sub-clans and marriage between different castes is strictly forbidden because it is considered a threat to family unity. Upon marriage, a young man is accepted as a member of his clan temple. After marriage, a girl becomes a member of her husbands' clan. In this clan system, a united family is the ideal and the goal. For the most part, the Murugappa family has fit this ideal exceptionally well.

Dowry:

A dowry in Indian tradition is an amount of money or property given to a groom's family from a bride's family at the time of marriage. The way the dowry is administered in the Murugappa family differs from the norm of the country. Starting in the generation of Dewan Bahadur's children, the family has asked for no dowry from the families of the brides of their sons. Whatever money or property the bride brings with her is for the bride to manage and keep as she determines.

When the Murugappa daughters marry, the family pays a dowry to the mother of the groom, as specified by tradition. But, the family differs from the norm in that it has never negotiated what will be given to one of its daughters. This is because the family opens investment accounts for the girls at birth and adds to them regularly. The investment accounts, which include substantial shares in the family's publicly traded subsidiaries, are turned over to the daughters as a "stree danam (daughter gift)" when they marry. Because the family knows that the daughters will be financially secure upon marriage, they arrange marriages for their daughters that focus on the personal characteristics of the potential husband rather than on the wealth of his family.

Adoption:

Inheritance in India passes from father to son. Therefore, it is an ancient Chettiar custom that a family without a son adopts a boy from the same temple clan or sub-clan to ensure succession. However, adopting a son from within one's own family is preferred over adopting from the clan because it is considered easier to instill the family's unique culture and values that way.

Murugappa, the eldest son of Dewan Bahadur, had two daughters and no sons. In order to maintain family unity and continuity, Dewan Bahadur insisted that Murugappa adopt a son from the family. He did this by adopting his brother Vellayan's second son, Muthiah, then 15 years old. Later, when Vellayan was murdered in Burma in 1945, leaving a widow, three remaining sons and two daughters, they all came to live with Murugappa's family and were cared for by him.

All Sons In the Business:

Following Chettiar and Hindu custom, family business employment opportunities are passed to the males. To date, sixteen of seventeen men in the four generations have found a place in the Murugappa Group business, although their interests, abilities, focus and energies have differed. As of 2000, there were nine men from the 3rd and 4th generations in the business. In the fifth generation, so far there are a total of seven sons who will have the opportunity to join.

Egalitarian Compensation:

Male family members are compensated in an equitable manner dependent on the range of seniority and experience. To enhance individual and Group success, informal mentoring between the family members takes place with older, more experienced and/or accomplished members guiding, assisting and supporting younger, less experienced and/or less able members.

As for inheritance, it is family custom that equal thirds of the family's collective business shares–following the three branches of the family emanating from the three sons of Dewan Bahadur–are divided and entrusted to the males in each generation, whether they work in the business or not. Typically, a father's shares are divided equally and passed to the sons at the time of the father's death.

Role of Women in the Family and Business:

The Murugappa daughters and wives have all received good educations, most at the university level. They are the major sources of leadership and guidance in the family's A.M.M. Foundation and its charitable institutions, especially the schools and hospitals. Yet, the family still follows a custom in which the ladies of the family are not a part of the operation of the family business, nor are they participants in the family's shareholder meetings. This is because of the cultural tradition that when a girl marries, she becomes part of her husband's family. Recently, the role of the family's women in the business has been flagged for discussion by the current board leadership and will be addressed in the future.

Position of Elders:

In India, there is a tradition of "gurusishya" which means one must learn from one's elders. This has been upheld both in the Murugappa family and in the business over the generations. A twist on this tradition started under AMM's leadership when he promoted the policy that family members of all ages can give input. Then the elder, who should strive for neutrality to weigh the pros and cons, makes the final decision. The current family elder is Murugappan who sees a shift occurring:

"Respect for elders is still there. But, it is kind of getting to a different level. There is respect, but at the same time, there is now an opportunity to stand up and express one's view. A generation earlier, younger people might express their views, but once the elder came to a decision, it was accepted without attempts to persuade further. Now there is a shift to decisions for the good of the family and the business based on more of a consensus, what I call the "Golden Mean." The elder's role is shifting to that of consensus builder. What we are learning is how to build consensus among different points of view, which are expressed more explicitly than in the past. This model requires more patience–not just by the elder, but by the whole family group."

Thrift:

The tradition of selecting marriage partners for one's children has been used to maintain the Murugappa norm of thrift. According to AMM's biography, when selecting wives for the their sons, the parents looked for girls who were educated, non-extravagant, team-work-oriented and thrifty. Valli, the wife of Dewan Bahadur, exemplified thrift by raising their big family on a tight budget. Her son, AMM, reminisced at age 80,

"She was a role model to us on clever management of moderate resources and inculcated in all of us the virtue of thrift. It is a habit that has still not left us, even in business…We were brought up to be thrifty and to monitor all expenditures carefully–and those habits we took to the workplace."[1]

Creative Adaptation and Flexibility:

A teaching in Hinduism is to "live in harmony with the cosmic order." Starting from Dewan Bahadur onward, Murugappa family members are examples of successful adaptability and flexibility striving for harmony in their environment. Throughout the generations, family members in the business have used situations presented to them as springboards from which to creatively adapt, flex and move forward for the good of family and community. They have anticipated change, shown a willingness to adapt and to take risks.

Dewan Bahadur adapted the norm of inheritance that he experienced to one more conducive to family unity and creation of wealth for his sons. The family also adapted their businesses to political situations, such as divesting their lending, trading and plantation holdings in Burma before WWII and the fall of that country to communism. They adapted, and continue to adapt, to Indian government restrictions on businesses.

Stewardship, Welfare and Trusteeship:

Stewardship is an attitude of leadership that is rooted in Indian religion. It is the responsible use of resources such as money, time and talent for the common good. The Murugappa Group and family have had a long tradition of helping, guiding and supporting others in this manner since the founder developed and supported institutions in his home village. The practice has continued in the form of creating opportunities and institutions of health and learning in the communities where the Murugappa Group does business. According to third generation member, Subbiah,

"(Trusteeship) is actually part of Hinduism and a fundamental of India. Gandhi talks of trusteeship. That's the way of life. When you arrive in this world, you don't come with anything. When you go back from this world, you go back with nothing. So, while you're here, you're holding something in trust for somebody that was held and handed over to you. You enjoyed it and you handed it over safe and better. That is my role."

Good stewardship extends to the family's view towards shareholders. Fourth generation Murugu explained:

"I don't like to let any shareholder down–public or family…The smallest is as important, or more important, to me than the family shareholder because, in a country like ours, he has entrusted his earnings or savings with the Murugappa family. I have to ensure that he is taken care of. Members of the family are trustees, not shareholders. The shareholder has invested in us. He has imposed his confidence in us at a time when we perhaps needed the money. I may not need the money now, but I cannot forget that he did invest in me so that today I am in this position."

Integrity, Trust and Transparency:

Integrity is one of the values most prized as a value by people of Chettiar clans. This byword stands out as a very important success factor with the family members running the business today. According to fourth generation, Murugu,

"I think business, at least part of business, is all about relationships–good, honest, long-lasting relationships…The spoken word is far more important than the written, really."

The Group has put resources behind its desire to make business dealings transparent in order to build trust. In the 1990s, farmers who supplied sugar cane mistrusted the company's weight and payment procedures. Instead of confrontation, the company invested in a computerized weigh-bridge to weigh trucks before and after being loaded with the cane and gave farmers a printout so they were satisfied that the company was being fair in their payments. When the family decided to computerize the whole payment system to transfer money directly into the farmers' accounts, they discovered that the farmers mistrusted banks. To counter this, the company educated the farmers on the benefits of bank accounts. The result was farmers that were totally supportive of the new procedures and trusting of the company's dealings with them.

Charity:

There is an ancient Nagarathar (Chettiar) tradition, *Mahemai*, whereby every family sets aside a portion of its profits annually for the upkeep of its village and clan temples. Philanthropy in the Murugappa family began at least as early as 1924 when Dewan Bahadur built a hospital in his home village of Pallathur. To this day the family makes annual gifts to the hospital to support it and to help assure free access for the poor.

The family also filled needs in the communities in which they operate by starting hospitals or schools with family seed capital. The financial support is from contributions by the Murugappa businesses and the early endowment capital from Dewan Bahadur. All this became formalized with the AMM Foundation in 1953.

The family continues to support these establishments financially, in partnership with the government, and also provide oversight for the institution. In the third generation, the family began to encourage the wives in the family to become active in the oversight function. So far, the wives of the third generation are more actively involved than those in the fourth generation.

The second generation greatly expanded the family's charitable activities. Murugappa Polytechnic was started to assure college educated engineers in the region near the TI business. At first the family provided 25% of the operating budget, the government 75%. Now it is 10% family, 90% government. Currently the Polytechnic has 1000 students and a faculty of 125. The family encourages close ties with the institutions for mutual benefit. As Murugu explained,

"Many times we involve these institutions with the business. The Polytechnic has students who are being trained in industry. If there are industry-wide programs on quality, we invite them. We conduct programs for the teachers and the schools. Members of the companies are on the academic boards and awards committees of the institutions. There is a lot of cross fertilization of thoughts and ideas."

The family has also established and continues to support four high schools, with a total annual enrollment of 8000 students and three reduced-fee hospitals. One hospital is near the family's New Ambadi Estates plantations and the other two are near manufacturing facilities. A nursing school was started in honor of Omayal Achi, a second-generation sister, who died with her whole family in an airplane crash. One of the hospitals is named in honor of the English gentleman who made several of the family's early business introductions. At one time they sponsored cooperative housing for employees, but that idea didn't pan out.

While schools and hospitals are the main focus of family support, the family has other charitable ventures, too. They founded the scientific Sri AMM Murugappa Chettiar Research Center (MCRC) that conducts research on protein-efficient algae, natural dyes, organic farming, and biodegradable plastics. The applications of these to the businesses have the potential to create a lot of income for farmers in the Chettinad region.

As of 2000, the Murugappa companies contributed about $325,000 per year to these institutions and the family foundation added more, for a total support of about $2 million per year.

1 AMM p. 305

EXHIBIT J: VALUES AND BELIEFS OF THE MURUGAPPA GROUP

After detailed discussion with family members and consultants on the best way to operate high performance businesses and grow more rapidly than in the past, these documents were finalized through consensus of family members who are members of the MCB. They can be amended by family consensus, but not by vote.

Values and Beliefs

- Adhere to ethical norms in all dealings with shareholders, employees, customers, financial institutions and government.
- Provide value for money to customers through quality products and services.
- Treat our people with respect and concern; provide opportunities to learn, contribute and advance; recognize and reward initiative, innovativeness and creativity.
- Maintain an organizational climate conducive to trust, open communication and team spirit.
- Maintain a style of operations befitting our size, but reflecting moderation and humility.
- Manage environment effectively for harnessing opportunities.
- Discharge responsibilities to various sections of society and preserve environment.
- Grow in an accelerated manner, consistent with values and beliefs, by continuous organization renewal.

Bill of Rights: Each Family Member

- Has the right to be given an opportunity to work in any of the Group companies provided he has an aptitude for the job.
- Has the right to get a salary commensurate with the level of responsibility held and performance in the business.
- Has the right to question (or seek clarification) with regard to any decision that, in his opinion, will/may affect the Group–with clear understanding that he will abide by the majority decision of the family members.
- Has the right to have information on any major happening (event) that takes place in the Group e.g acquisition, closure, collaboration, etc.
- Has the right to a certain reasonable standard of living and to be provided with the necessities to maintain such standard.
- Has the right to pursue a career of his choice and not be bound to work in the Murugappa Group. In such event he has the right to maintain his share of business and other assets without being involved in the management.

Bill of Responsibilities: Individuals to the Family

- To uphold the traditions, reputation and values the family stands for.
- To ensure proper trusteeship of the businesses and other family assets.
- To promote first the interests of the family and not individual self-interest.
- To share any relevant information affecting the business with the family.
- To provide guidance and direction to other family members, particularly those of succeeding generations, to uphold values as well as to handle senior management positions at a future date.
- To ensure that, in the event of disposal of the individual share of the businesses and partnerships, such disposal is carried out in a manner that will not jeopardize the interest of the family in any manner.
- To make a will.
- To create a Trust or any other mechanism, which is acceptable to the Family Board if there is no male successor.
- To ensure family members are guaranteed a reasonable living standard.