Review of Business & Finance Studies
Vol. 10, No. 1, 2019, pp. 25-32
ISSN: 2150-3338 (print)
ISSN: 2156-8081 (online)

www.theIBFR.com

THE IMPORTANCE OF PLANNING FOR SUCCESSION IN THE FAMILY BUSINESS BEFORE IT IS TOO LATE: A CASE STUDY OF A SMALL MANUFACTURING FIRM

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CASE DESCRIPTION

The family business discussed in this paper was founded in 1932 and had sustained growth during the first two decades of operation. It had transformed itself from a local to a national business and started to venture into international markets. The founder of the company had one daughter, an only child, who never worked in the company. When the founder died in 1955, the spouse of the only child took control of the business but never owned stock in the company. At the end of the 80's the company was run by the third generation. The oldest and only of several siblings to work in the business. The oldest son was responsible for managing the business for more than 40 years. His main concern was always the efficiency of day-to-day operations. He never planned the succession process for the fourth generation. The CEO is ready to retire and at present there are no candidates among the family willing and able to succeed the leader of the company. This case requires two hours out of class preparation by students in small groups and one hour in class discussion among individual groups with teacher assistance. The case is intended for undergrad students in business, marketing or finance.

JEL: M1, M10

KEYWORDS: Family Business, Succession, Family Protocol

CASE INFORMATION

A common problem among small family businesses arises when the founder of the company, or the CEO in later generations, needs to retire. In family business the administrator´s main concern is with the day-to-day operation and with having the necessary liquidity to cope with the company's economic responsibilities to its employees, suppliers, authorities and its customers. During the first generations of the business, the manager of the company, and/or the owners if they are different persons, do not have the inclination to think about what will happen when the CEO retires. They therefore seldom elaborate a plan for the selection and training of a successor. However, in every family business the time for succession comes sooner or later. In the worst case circumstance an illness or unexpected death forces the decision to select a successor in an improvised and hastened fashion. The possibilities range from a situation where not a single member of the family is willing or able to assume the responsibility, to the other extreme where there are several members of the family desiring to be the successor and no clear set of rules and conditions exist to guide in the choice of a suitable candidate. The problem can be compounded if property in the company is not well defined or if there is a lack of planning for the transfer of this property to future generations. The author proposes the case study methodology to illustrate this situation in a small manufacturing family firm that has been in existence for more than 80 years and is currently managed and owned by the third generation of the same family.

LITERATURE REVIEW

Case Study

Case studies are a form of qualitative research. In a quantitative research numbers, usually in the manner of statistics, explain a situation. In qualitative research words are used to describe trends or patterns in a particular situation, which in some cases can lead to theory or at least to applications in similar situations (R., Hancock Dawson, 2017). "Doing case study research remains one of the most challenging of all social science endeavors" (Yin, 2014). Case study can be defined as the intensive study of a single situation where the purpose of the study, in part, is to explain a greater number of cases (population). Among qualitative methods, case studies play a key role. Case studies represent one of the most utilized of the qualitative methods in organizational studies (Eisenhardt, 1989). Moreover, the case study is the most prevalent methodology in research of family business. "We see the case studies as a powerful methodology that can be used with rigor, creativity and in a wide variety of ways to advance the research of family business" (Kotlar, Fang, De Massis, & Frattini, 2014)

Family Protocol

Family Protocol establishes a framework for common coexistence, which leads to achieving family unity and to maintaining commitment to the company, thus promoting the continuity of the joint family project. A good family protocol should be based on three pillars: persons, family and company. If you look at these three pillars, the family protocol may become a genuine road map, with concrete proposals, that allows the family to achieve a double objective. The objectives are to achieve happiness and well-being for family members, and ensure continuity of the family enterprise (IESE & ATRVIA, 2016). The Protocol must embrace as many issues as the family deems appropriate and which have been considered in the family assemblies and forums. Its content will depend on each family, their beliefs, their values, their culture, and the time at which it is carried out. It should consider specific wishes for the company and for the family. It should not be so short that it leaves aside important aspects of the family-business system or is so long and detailed that the members of the family have to adhere to it permanently, even for trivial matters.

Succession Planning

All owners and/or CEOs will, sooner or later, willingly or unwillingly, transfer company property and/or the direction of the company to other people. This may happen suddenly, or it may be planned. The challenge for family businesses is to survive more than one generation. To achieve this, family members must plan the succession of the 3 systems that make up the family enterprise: the family, the company and the property (Belausteguigoitia, 2012). To have continuity in family business requires that the succession process be successful. During this process there are four critical entities. These entities are the company, the family, the predecessor and successor. As soon as the predecessor decides that the company will continue in the family, it is necessary that he or she initiates the preparation of the successor. This preparation usually begins during the potential successors' childhood. In this way the person who takes the reins of the business in the future experiences entrepreneurship and can imagine that one day he or she will become an entrepreneur.

The preparation of the company for succession involves considering the predecessor's and the successor's leadership styles. However, in order to avoid personalized leadership styles, it is important to have a solid organizational structure and well-established management processes. In the family sphere, to ensure success implies the necessity of establishing structures and processes that ensure family cohesion and collaboration of all members with the project of the family business. These structures must also be able to resolve issues related to the struggles for power, decision rules as to who can work in the company, their responsibilities, and possibilities for taking in-laws into the company operations (Balsmeier, Buchwald, & Zimmermann, 2013).

The beginning of the succession process does not imply the predecessor should definitely leave the company. Some CEO's may elect to remain with the firm. However, he or she can and must develop different activities to the ones he or she is responsible for as head of the company. The new activities should be focused on training and motivation of potential successors, while fully exercising his or her previous responsibilities. The succession should be a gradual process in which knowledge and responsibilities are constantly transferred until the successor is able to gain control and confidence in the management of the company (M. Martin Boyer Hernán Ortiz ‐ Molina, 2008).

The succession plan seeks permanence, growth and the continuity of the company over time, without disrupting the balance and the usual course of business. In the case of family enterprises, the succession plan should additionally safeguard the safety and harmony of its members and maintain leadership in the organization. Exclusive focus on daily operations, concern for the short term or the ignorance of the process of succession, may weaken the company fate in the medium and long term, so it is essential to consider it a strategic priority (Ansari, Goergen, & Mira, 2014). For family-owned enterprises, the succession process acquires greater relevance since they must consider other interests of the company related to such topics as family ties, emotional situations interwoven between members, their values, the company's culture, and the family and organization history.

THE COMPANY

The family business considered in this case was established in a small town in Mexico in the year 1932. At that time there was a great scarcity of manufactured products in the country due to a meager industrial infrastructure and the limitations of imports from North America and Europe. The founder of the company was an engineer with a production focus influenced by the old European style of management, where integration of the manufacturing method favored incorporating all the processes within the company with very little outsourcing of parts, except those which were standard; such as raw materials, packaging and fasteners. Another characteristic of this European style was the importance of final product quality at a reasonable price.

The founder chose to produce a measuring instrument which had a great demand and required a certain degree of difficulty in its manufacturing process. Due to the limited supply of these types of products by other local manufacturers, as well as recognition by consumers of the product´s quality, the instruments manufactured by the company were very successful in the market place. Sales were gradually increasing throughout the country. However due to the type of assembly employed by the company, it was not possible to increase production to sufficient volumes to meet the demand. This situation favored the emergence of new manufacturers who competed with a similar product at a lower price, although with lesser quality. The founder of the company had no male offspring only a daughter, who could not or did not want to get involved in the business. In 1949 when his first grandson was born, he saw the need to ask his son-in-law to help him in the management of the family business. The husband of his only daughter was an American, accustomed to systems of production in series where it is customary to outsource the manufacturing of parts that are not economically feasible to produce in house.

This characteristic allowed the company to increase its output at a low-cost while maintaining high quality. Since the business was now able to supply all the demand for its products at low cost and good quality, the competitors were partially displaced from the market and the company's market share grew considerably. The founder and his son-in-law made a good team and little by little the son-in-law took more responsibility. At the beginning he managed the production process, and when the founder died in 1955, he also took control of sales and finance. He continued the tradition of the founder of running the company in an empirical manner, to manage with very little professional staff and with little investment in machinery. He felt it was not necessary to transform production systems that were working well. In 1960 the company acquired a small factory situated in the Capital of the country which manufactured other products than those produced at the original plant, but with similar production processes; casting, grinding, machining, painting. Due to continually increasing demand for the original measuring instrument products, and because the profit margin was higher for these items, similar products were introduced in the production of the new plant. By the end of the 70s this plant manufactured only products akin to the ones the original plant produced. The company continued to prosper and in 1968 the first export to Ecuador was made. During rest of the 70s the company continued exporting to Ecuador and later begin exporting to Cuba.

During the 60s and 70s the company´s share of the domestic market was around 75%. Only one other factory with the same type of products had a national presence. However, there was more competition from small family workshops with very little production capacity and low-quality products. The daughter and son-in-law of the founder had four sons and a daughter, they were the only grandchildren of the founder. The eldest son was pressured by his father to study mechanical engineering in the US. On completion of his studies in 1973 he had the intention of continuing to graduate school in the US. However, in the same year his mother died, and his father offered him work in the company. He felt pressured to return to Mexico and joined the family business in September 1973 at the new plant in the Capital. His early responsibility was engineering and product development.

In 1977 he decided to go back to the US to obtain a master's degree in mechanical engineering. Upon graduation in early 1979 he returned to the family business and took responsibility for production at the plant in the Capital. The founder of the company inherited all the shares in equal parts to his wife and only daughter. When his daughter died in 1973 his wife became the sole owner of the business. His wife died in December 1984. Upon the death of the sole owner, all the shares were divided equally among the five grandchildren. The son-in-law never owned shares of the original company, he only had shares in the new company. When his mother in law died he gave the totality of his shares to his five children, also in equal parts.

Upon receipt of the shares of the two companies the siblings decided to form a holding company to be the titleholder of all the family businesses. These businesses included a sales company, a materials supplier and a firm dedicated to fiscal, financial and technical counsel. All these firms were dedicated to service the group's manufacturing plants. Also, in 1984 the first export to the US was made which included a product specifically designed for this market at the new plant in the Capital. In the same plant two projects of import substitution were initiated, one with a US company and the other with a German company. The projects were based on an economic policy the Mexican Government implemented to encourage the manufacture of products that substituted those previously imported. The policy-restricted imports of a product when, through a project of import substitution, this product was manufactured in Mexico. Through this mechanism the family company manufactured and sold, in the domestic market, several products that were previously only accessible through importation.

In 1987 the eldest son was appointed CEO of the Group and established headquarters in the Capital plant, centralizing consulting operations, purchasing and sales of the two plants. Due to health problems of his oldest daughter, caused by pollution in the Capital City, the CEO made the decision to move with his family to the city where the original plant was and to transfer the Group's headquarters to this city in August 1989. At this time the original plant was in a process of stagnation, due to the limited investment in machinery and equipment and to the lack of product development. This situation also contributed to the decision of the CEO to move his family and headquarters to this City. At the time he took direct responsibility for the original plant. The CEO proposed measures to modernize the production processes, and to foster the development of new products to make the operation more productive. Because the local trade union had obtained privileges for more than fifty years, the CEO faced fierce opposition by the trade union. After several attempts to convince the workers and the union leaders of the necessary changes, the situation came to a critical point of confrontation. Finally, the CEO took the decision to close the plant temporarily and carry out a complete restructuring of the company. A month later operations resumed with staff selected from among the old workers and newly hired personnel.

During the 90s export to other companies in the US increased and later in that decade exports were made to a German company with sales around the world. All export projects were carried out from the plant in the Capital. To increase production at this plant and to limit pollution in the Capital City, the decision was made to transfer all smelting operations to the original plant, leaving the plant in the Capital with machining, stamping, painting and final assembly operations.

In the first years of the new millennium the plant at the Capital specialize in export, mainly in its star product for the German company. Production of this article came to constitute more than 50% of the total production of that plant. By the end of the 90's the German company was experiencing increasing competition from China, so it began to pressure the Mexican company to lower their prices and improve the quality of the article of high consumption. This prompted the family company to make improvements in the production processes at the same time it increased quality controls. Each time it became more difficult to compete with Chinese manufacturers until the German company took the decision to manufacture most of their products in China.

The German company gave notice of contract termination to the Mexican company with six months of grace, as it was stipulated in the contract between the two companies. After losing more than half of its sales in a sudden and unexpected manner, the Capital plant was forced to drastically reduce the staff and union workers, this situation caused a violent reaction by the trade union representing workers of that plant and they decided to go on strike that lasted a month. The CEO of the holding company took the decision to gradually close the Capital plant and move all operations to the original plant. At the beginning former workers from the Capital plant were hired at the original plant to manufacture the products they used to make in the Capital but gradually these workers went back to the Capital City, by then new workers hired in the old plant were learning to make the products for export and domestic sale that were manufactured in the extinct Capital plant.

The CEO reported to the members of the Board of Directors which included all siblings, the situation that the company was facing during all the periods of crisis and presented possible courses of actions to follow. The board delegated the decision to the CEO in all cases without a thorough analysis in each case. Once all the production operations were concentrated at the original plant, only a warehouse for distribution at the national level and for all exports remained in the Capital. At present the company faces sales stagnation because most of its products have exceeded their useful commercial life, mainly due to obsolescence caused by imported product substitutes with new technology that offers lower cost and higher benefits to the end user. The acting CEO, the only family member working in the business, has been in the company for more than forty years, more than twenty years as CEO, and has passed the official age of retirement. In addition, the CEO is tired and feels the company needs a new leader, a young person with new ideas and a renewed team of managers. At this time no family member is interested and able to take responsibility for management of the company. Like his grandfather the founder of the company, and his father who was responsible for the company for 40 years, the current CEO never formulated a written plan for the succession process of the CEO or the property of the company. The company does not have a Family Council or a Family Protocol. The CEO during the second generation always assumed that all his male offspring would come to work in the family business and that they would elect a leader among them.

QUESTIONS

Question 1: Could a family assembly and the appropriate organizational design, including a family protocol stipulating the procedures for succession, had prevented the crisis in which the company finds itself?

Question 2: What options does the family have in the selection and appointment of a new CEO?

Question 3: Are the only options appointing a CEO external to the family or selling the business?

Question 4: What measures should the company take to avoid a similar crisis when the fourth generational succession takes place?

Question 5: Did the family values and the company culture play an important part in the permanence of the organization? Could these have been used to develop a succession plan?

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TEACHING NOTES

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The family business discussed in this paper was founded in 1932 and had sustained growth during the first two decades of operation. It had transformed itself from a local to a national business and started to venture into international markets. The founder of the company had one daughter, an only child, who never worked in the company. When the founder died in 1955, the spouse of the only child took control of the business but never owned stock in the company. At the end of the 80's the company was run by the third generation. The oldest and only of several siblings to work in the business. The oldest son was responsible for managing the business for more than 40 years. His main concern was always the efficiency of day-to-day operations. He never planned the succession process for the fourth generation. The CEO is ready to retire and at present there are no candidates among the family willing and able to succeed the leader of the company. This case requires two hours out of class preparation by students in small groups and one hour in class discussion among individual groups with teacher assistance. The case is intended for undergrad students in business, marketing or finance.

QUESTIONS

Question 1: Could a family assembly and the appropriate organizational design, including a family protocol stipulating the procedures for succession, had prevented the crisis in which the company finds itself?

Solution 1: The Company faces two distinct complications. The first is its market position. Most products the company manufactures, and sells are obsolete. The second problem relates succession of the CEO and the transfer of property to the next generation. Both problems are intimately related. The lack of product development can be traced to the very long, more than 40 years, tenure of the CEO and his background as a mechanical engineer. He has guided the technological development along the lines of mechanical principles. The most up to date technology in the products it manufactures, as with most products today, is directed along electronic principles. The CEO could have hired engineers and technicians to develop new products and the current position of the company would probably be better. But the question remains, should one person remain as the CEO of an organization for such a long time? The problem of succession, both in the administrative arena, and in the transfer of property, is related to a mismatch between the organizational structure and the family structure. Although all three systems interacting in a family enterprise, family, property and business, must remain separate, there is always an area of intersection between two, or even the three systems (Tagiuri & Davis, 1996).

Question 2: What options does the family have in the selection and appointment of a new CEO?

Solution 2: The selection and eventual appointment of a CEO in a family business, especially if it is decided that he or she must be a member of the family, is a long process involving the current leader and possible successors. There must be a period of indoctrination, which should start when the members of the family are very young. This proselytization has the purpose of involving possible candidates in the operation of the business. It must make them feel part of the organization by fostering a love affair with the company.

Question 3: Are the only options appointing a CEO external to the family or selling the business?

Solution 3: At this time, it appears the only option is to appoint an external non-family member as a CEO. In the short run there are no family members that have the desire and the qualifications to take the leadership of the company.

Question 4: What measures should the company take to avoid a similar crisis when the fourth generational succession takes place?

Solution 4: The members of the fourth generation are teenagers or children; the current CEO together with the board members must assume the responsibility for indoctrinating and fostering them, both in their professional development and in their acquaintance with the family business, even if an outsider replaces him in his position as CEO. This will take time and a lot of effort, but it is the only way that some members of future generation will want to come into the business and be prepared to take the leadership.

Question 5: Did the family values and the company culture play an important part in the permanence of the organization? Could these have been used to develop a succession plan?

Solution 5: Family values and company culture in this organization are very solid in the forms of integrity, quality of workmanship, love of family etc. These values have been transmitted from generation to generation and are the must important reason why the business has survived to this day. Whether they could have played a part in the development of a succession plan is irrelevant at this time. It is however, important that they become part of the Family Protocol, which should include a succession plan so that the current crisis can be avoided in the future.

ACKNOWLEDGMENTS

The authors of this article wish to thank the Mexican National Council of Science and Technology (CONACYT) for its support and encouragement on the preparation of this research.

BIOGRAPHY

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