The Center for Family Enterprises grew out of a request by a group of Kellogg M.B.A. students seven years ago to start a club and attend a class focused on the unique aspects of owning, governing and/or managing family businesses. The Center deliberately concentrates on family enterprises, with a focus that includes family businesses, family foundations, family offices, family investment companies and family wealth management.

The Center’s mission is to:

• Provide thought leadership to the field of family enterprise
• Contribute to the body of knowledge through cases, research and publications
• Serve student needs through courses, informal workshops, personal counsel and a resource library
• Build a family business community among Kellogg students, faculty and alumni
• Develop a global network of successful business families who can learn from each other and connect with each other through Kellogg, Kellogg partner executive programs and conferences
• Stimulate awareness and research by other Kellogg faculty on the special issues and opportunities for family firms

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Center Website: www.kellogg.northwestern.edu/familyenterprises

Phone: 847 467-7855  
Fax: 847 491-5747  
2001 Sheridan Road  
Evanston, IL 60208

KELLOGG CENTER FOR FAMILY ENTERPRISES
Nepotism, practiced badly, is largely a self-punishing offense.

ADAM BELLOW, AUTHOR

I think keeping the family’s values relevant to the organization is a fundamental challenge for those of you with your name on the door, or, in our case, on the yard sign.

JENNIFER ALTER WARDEN, BAIRD & WARNER REAL ESTATE

After the Second World War the company was really in ashes, and my uncles had to come together and start anew...Over many generations we learned to survive and to use these challenges to find our opportunities, even in the most difficult times.

JAN VON HAEFTEN, FRANZ HANIEL & CIE
<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
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<tr>
<td>Greetings from Northern Trust Corporation</td>
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<tr>
<td>Greetings from Duff and Phelps, LLC</td>
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<td>Photo Array</td>
<td>10</td>
</tr>
<tr>
<td>Participating Family Companies</td>
<td>14</td>
</tr>
<tr>
<td>Kellogg Student Conference Volunteers</td>
<td>15</td>
</tr>
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<td>Issues and Answers</td>
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<tr>
<td>Perspectives on Nepotism</td>
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<td>Panel: Perspectives on Family Business Success</td>
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<td>Decision-Making and Succession Planning</td>
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<td>107</td>
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<td>Fel-Pro Case B</td>
<td>119</td>
</tr>
<tr>
<td>Appreciation</td>
<td>126</td>
</tr>
</tbody>
</table>
Welcome

Dear Friends,
We are delighted to present the proceedings from Kellogg’s 2005 Family Business Invitational Conference of May 17 and 18. This book documents the many significant and varied Conference presentations and shares it with a wider family business audience.

Our Conference gathers members of the family business community together for two days of lecture, discussion, interaction, experience and celebration. Conference attendees are introduced to new studies and best practices from exemplary family businesses as well as leading university researchers.

This year’s Conference was both national and global in scope with 230 participants representing 90 companies from 18 U.S. states and 10 countries.
We added a new feature with a field trip to the headquarters of SC Johnson in Racine, Wisconsin, one of the companies owned by the Johnson family, our 2005 recipient of the Kellogg Award for Special Contributions to Family Business. We also increased the amount of time participants had to meet one another and strengthen networks with other family business attendees from around the globe.

We are proud that many have told us that this year’s Conference was our best ever. We are already planning our 2006 Conference and welcome your input and suggestions.

In this fourth annual Conference proceedings report you will find information on some of the most pressing, timely and sensitive challenges facing families in business today. Additionally, you will find dialogue on topics presented exclusively at Kellogg.

Included in this year’s book:

Discussions on core family/business values and what makes them a strategic advantage in the marketplace

An examination of the decisions that are made to ensure the perpetuation of a family business

A historical and social look at nepotism and how it fits into American culture

The 2005 Kellogg Award for extraordinary contributions to the field of family business

A new case study written specifically for the Conference documenting the difficult decisions that surround the sale of a family business, the subsequent hard work to carry those core values into new business endeavors, and the establishment of a family office

We are extremely appreciative of our corporate co-sponsor partners, Northern Trust Corporation and Duff & Phelps, LLC, whose consistent commitment to this Conference and to our Center greatly benefits our research, case writing, and publishing. We look forward to a continuing, mutually-successful collaboration.

We celebrate and salute the enterprising families who continue to be preeminent players in the field of business. Their unrivaled contributions to a healthy free market are finally being recognized by the wider business community—to which we can only exclaim, “It’s about time!”

Best Wishes,

Lloyd E. Shefsky

John L. Ward
July 19, 2005

Dear Valued Business Owners and Friends:

Thank you for helping to make this year’s Family Business Conference a practical and rewarding experience. Northern Trust is pleased to continue its sponsorship of this forum and its important focus on sharing insights and best practices to help enterprising families prosper in today’s challenging business environment.

At Northern Trust, we understand the needs of family business clients, as our roots go back to the Smith family, who sought to establish a banking organization that catered to the complex wealth needs of individuals and families. Now 118 years later, we understand the importance of staying focused on our original vision, while also anticipating the future and generating innovative solutions today.

We hope this book will serve as a useful resource to you and your family over the next year, so you can focus on what’s important in building your enterprise. We look forward to partnering with the Kellogg Center for Family Enterprises and Duff & Phelps next year to bring you more fresh perspectives and valuable tools to solve your unique issues.

Best regards,

[Signature]
July 14, 2005

Dear Business Owner and Colleagues:

Family-owned businesses are a key engine of growth for the U.S. economy. Duff & Phelps is very proud to continue its sponsorship of this excellent conference, which focuses on best practices and new ideas for this important business sector.

Duff & Phelps has been a trusted financial advisor and investment banker to family business for more than 70 years. Part of our role in helping our family business clients achieve their goals is helping them maintain awareness 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 businesses. We hope this conference gave you a better understanding of the unique and critical family issues facing your company.

Sincerely,

[Signature]

CAG/Ip
During this opening session, Conference participants used confidential voting technology to answer a series of questions about themselves and their family business experiences. The responses were instantly tabulated and projected on screen for the audience to see. The results helped to determine audience demographics, and reveal any preconceived notions surrounding Conference topics.

As a new feature for the book this year, we are able to compare our results to those of attendees of a similar family business conference held June 1 and 2, 2005 in Barcelona, Spain. That conference was sponsored by IESE Business School of the University of Navarra, Barcelona. IESE and Kellogg have collaborative relationships in family business education and research.

**PRESENTER:**
John L. Ward  
Clinical Professor and Co-Director  
Center for Family Enterprises  
Kellogg School of Management
Who Are You?

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-family Manager / Advisor / Director</td>
<td>16%</td>
</tr>
<tr>
<td>Senior Generation Family Member</td>
<td>29%</td>
</tr>
<tr>
<td>Next Generation IN the Business</td>
<td>40%</td>
</tr>
<tr>
<td>Next Generation NOT in the Business</td>
<td>15%</td>
</tr>
</tbody>
</table>

Why We Are Here

We are pleased to present our fourth annual Invitational Family Business Conference which brings together leading business families from all over the world. We have 220 invitees from more than 90 family companies represented from 10 countries. I especially welcome a new collaborator in this Conference, IESE, the outstanding business school of the University of Navarra in Barcelona, Spain. They have brought several family business friends with them who are a part of the IESE Family Business Initiative.

We hope to accomplish three things through this Conference. First, we want to create an opportunity and an environment for attendees to meet one another and exchange ideas. You all come from family businesses that are very similar to each other in size, structure, age and character. It is our hope that this will encourage you to share experiences and build contacts with other family businesses from around the country and the world.

We want to create an opportunity and an environment for attendees to meet one another and exchange ideas.

Second, we hope to stimulate you with some ideas. As you may know, our Conference does not have a single theme. We are not trying to promote a particular topic but offer a variety of topics for you to consider.

Some of the ideas we will explore:

- Nepotism
- Enduring family business values
- Selling the family business
- Establishing a family office
- Leadership transition
- Decision-making

We will look at Wang Industries as an exercise in how not to transition your company’s leadership. We will examine a new case specifically written for this Conference, examining in the Fel-Pro case the complexities of selling a family business and then establishing a family office. We will look at several exemplary family businesses that embody the values of their founders including: Johnson Family Business Enterprises, Baird & Warner Real Estate, Pella Corporation, Franz Haniel & Cie and The Murugappa Group.

Finally, we will have the opportunity to hear from a panel of experts on the extremely positive developments coming from the latest family business research. New studies are proving what we knew all along—family businesses have a stronger business culture and tend to outperform their non-family counterparts. Our experts will share their insights into why this is true.

As we move through these various presentations I hope that you will ask yourselves the following questions: “What is it that makes a family business last? What makes a family business successful? What can I learn from the successes of others?”
Consider what you can learn from the successes of:

- Johnson Family Business Enterprises
- Pella Corporation
- The Murugappa Group
- Franz Haniel & Cie
- Waste Management Inc.
- Fel-Pro Inc.
- Baird & Warner Real Estate, Inc.
- E & J Gallo Winery
- New York Times
- Wendel Investissement
- Gruppo Falck

Conference Demographics
One of our other traditions is to ask a series of questions to all of you present and then share them with the whole group. Having so many successful business people in one place provides us with a fantastic opportunity to find out some things about you and gain some insights about your family businesses. Sharing these results will give us all an opportunity, in a sense, to communicate efficiently with each other.

Audience Poll
(All responses are from Kellogg participants except where indicated.)

Have you attended this Conference before?

<table>
<thead>
<tr>
<th>Percent</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>57%</td>
<td>No, my first year</td>
</tr>
<tr>
<td>22%</td>
<td>One other year</td>
</tr>
<tr>
<td>21%</td>
<td>More than once before</td>
</tr>
</tbody>
</table>

What is your gender?

<table>
<thead>
<tr>
<th>Percent</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>70%</td>
<td>Male</td>
</tr>
<tr>
<td>30%</td>
<td>Female</td>
</tr>
</tbody>
</table>

Who are you?

<table>
<thead>
<tr>
<th>Percent</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>16%</td>
<td>Non-family manager/advisor/director</td>
</tr>
<tr>
<td>29%</td>
<td>Senior generation family member</td>
</tr>
<tr>
<td>40%</td>
<td>Next generation IN the business</td>
</tr>
<tr>
<td>15%</td>
<td>Next generation NOT in the business</td>
</tr>
</tbody>
</table>

How long has your family owned your business?

<table>
<thead>
<tr>
<th>Percent</th>
<th>Kellogg</th>
<th>IESE</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>4%</td>
<td>13%</td>
<td>0–15 years</td>
<td>0–15 years</td>
</tr>
<tr>
<td>39%</td>
<td>43%</td>
<td>16–50 years</td>
<td>16–50 years</td>
</tr>
<tr>
<td>41%</td>
<td>28%</td>
<td>51–99 years</td>
<td>51–99 years</td>
</tr>
<tr>
<td>16%</td>
<td>16%</td>
<td>100 or more years</td>
<td>100 or more years</td>
</tr>
</tbody>
</table>

If your family were the owners of Fel-Pro in 1997, would you have sold the company, too?

<table>
<thead>
<tr>
<th>Percent</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>52%</td>
<td>Yes, definitely</td>
</tr>
<tr>
<td>32%</td>
<td>Unsure</td>
</tr>
<tr>
<td>15%</td>
<td>Not likely</td>
</tr>
<tr>
<td>1%</td>
<td>Unimaginable</td>
</tr>
</tbody>
</table>

If you sold your family business, how well would the owning family continue to stick together?

<table>
<thead>
<tr>
<th>Percent</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>38%</td>
<td>As well as now, or better</td>
</tr>
<tr>
<td>28%</td>
<td>For the most part</td>
</tr>
<tr>
<td>22%</td>
<td>Much less</td>
</tr>
<tr>
<td>12%</td>
<td>Probably all drift apart</td>
</tr>
</tbody>
</table>

What enterprise do you feel is most important to keeping your family together long-term?

<table>
<thead>
<tr>
<th>Percent</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>55%</td>
<td>A family business</td>
</tr>
<tr>
<td>18%</td>
<td>A family foundation</td>
</tr>
<tr>
<td>11%</td>
<td>A family investment company</td>
</tr>
<tr>
<td>16%</td>
<td>A family office</td>
</tr>
</tbody>
</table>
How often during the past FIVE years have you had a professional outside valuation of the business?

<table>
<thead>
<tr>
<th>Percent</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>31%</td>
<td>Never</td>
</tr>
<tr>
<td>38%</td>
<td>One or two times</td>
</tr>
<tr>
<td>31%</td>
<td>Almost annually</td>
</tr>
</tbody>
</table>

Do you have a family office?

<table>
<thead>
<tr>
<th>Percent</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>30%</td>
<td>Yes</td>
</tr>
<tr>
<td>15%</td>
<td>Probably will in the near future</td>
</tr>
<tr>
<td>37%</td>
<td>Not in our plans</td>
</tr>
<tr>
<td>18%</td>
<td>A what?</td>
</tr>
</tbody>
</table>

Regarding “employee nepotism”...

<table>
<thead>
<tr>
<th>Percent</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>22%</td>
<td>We encourage it</td>
</tr>
<tr>
<td>57%</td>
<td>We accept it</td>
</tr>
<tr>
<td>13%</td>
<td>We discourage it</td>
</tr>
<tr>
<td>8%</td>
<td>We don’t allow it</td>
</tr>
</tbody>
</table>

Globalization And Internationalization
We are interested in attitudes toward globalization and the degree of internationalization.

<table>
<thead>
<tr>
<th>What’s your attitude toward globalization?</th>
<th>Percent</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kellogg</td>
<td>7%</td>
<td>10%</td>
</tr>
<tr>
<td>IESE</td>
<td>69%</td>
<td>65%</td>
</tr>
<tr>
<td></td>
<td>24%</td>
<td>25%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>What best explains your internationalization?</th>
<th>Percent</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kellogg</td>
<td>64%</td>
<td>30%</td>
</tr>
<tr>
<td>IESE</td>
<td>17%</td>
<td>9%</td>
</tr>
<tr>
<td></td>
<td>15%</td>
<td>44%</td>
</tr>
<tr>
<td></td>
<td>5%</td>
<td>17%</td>
</tr>
</tbody>
</table>

Selling Or Keeping The Firm
The Fel-Pro case, later, opens up consideration of selling the family’s business. As shown below, the older American firms are much less oriented to selling and care more about the preservation of the firm’s values.

<table>
<thead>
<tr>
<th>Might you sell your family business?</th>
<th>Percent</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kellogg</td>
<td>14%</td>
<td>19% Can’t imagine it</td>
</tr>
<tr>
<td>IESE</td>
<td>16%</td>
<td>17% Likely in next 5–10 years</td>
</tr>
<tr>
<td></td>
<td>54%</td>
<td>27% Not likely in foreseeable future</td>
</tr>
<tr>
<td></td>
<td>16%</td>
<td>37% Don’t know</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>If you were to sell your family business...</th>
<th>Percent</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kellogg</td>
<td>23%</td>
<td>36%</td>
</tr>
<tr>
<td>IESE</td>
<td>49%</td>
<td>38%</td>
</tr>
<tr>
<td></td>
<td>28%</td>
<td>26%</td>
</tr>
</tbody>
</table>

Nepotism
The presentation of Perspectives on Nepotism opens up many feelings about inherited privilege and position. In both the U.S. and Spain the issues are much the same.

<table>
<thead>
<tr>
<th>I worry what others think about me as fortunate inheritor.</th>
<th>Percent</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kellogg</td>
<td>11%</td>
<td>19%</td>
</tr>
<tr>
<td>IESE</td>
<td>34%</td>
<td>23%</td>
</tr>
<tr>
<td></td>
<td>27%</td>
<td>23%</td>
</tr>
<tr>
<td></td>
<td>28%</td>
<td>35%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>From your general observation and experience, which is MOST true?</th>
<th>Percent</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kellogg</td>
<td>52%</td>
<td>49%</td>
</tr>
<tr>
<td>IESE</td>
<td>13%</td>
<td>18%</td>
</tr>
<tr>
<td></td>
<td>35%</td>
<td>33%</td>
</tr>
</tbody>
</table>

Clearly, the Spanish companies do more intercontinental selling, while the U.S. firms import more.
Culture
Regardless of society, the business families think their companies are special places to work, even more so in the U.S.

<table>
<thead>
<tr>
<th>We believe our company is a very special place to work.</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Kellogg IESE</td>
<td></td>
</tr>
<tr>
<td>93% 77% Yes</td>
<td>No</td>
</tr>
<tr>
<td>7% 23% No</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>We provide more in employee benefits than the market requires.</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Kellogg IESE</td>
<td></td>
</tr>
<tr>
<td>61% 56% Yes</td>
<td>No</td>
</tr>
<tr>
<td>39% 44% No</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>We make a special effort to contribute to our community as a company.</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Kellogg IESE</td>
<td></td>
</tr>
<tr>
<td>67% 74% Yes</td>
<td>No</td>
</tr>
<tr>
<td>33% 26% No</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>We have a formal orientation for new employees to explain our culture and emphasize our values.</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Kellogg IESE</td>
<td></td>
</tr>
<tr>
<td>54% 63% Yes</td>
<td>No</td>
</tr>
<tr>
<td>46% 37% No</td>
<td></td>
</tr>
</tbody>
</table>

Curiously, in both countries the family culture isn’t promoted by many, despite their strengths and contributions. Though the U.S. firms feel even more strongly about their workplace attributes, they focus less on that in their training and orientations.

Close
The 2005 Kellogg Conference is the first to look for common attitudes and cross cultural views by family firms. We enjoy the opportunity to compare with the outstanding business families associated with IESE in Barcelona. We look forward to more shared activities.

John L. Ward is Clinical Professor and Co-Director of the Center for Family Enterprises at Kellogg School of Management. He has a B.A. degree from Northwestern University, M.B.A. and Ph.D. degrees from Stanford Graduate School of Business. He teaches family enterprise continuity and is an active researcher and writer on succession, ownership, governance and philanthropy. 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, Creating Effective Boards for Private Enterprises, Strategic Planning for the Family Business (with co-author Randal Carlock), and Perpetuating the Family Business: 50 Lessons Learned from Long-Lasting Successful Families in Business.
The concept that nepotism is a beneficial force in society is provocative and calls up strong and often contradictory feelings. While Americans claim not to believe in the notion of nepotism, they practice it extensively.

Adam Bellow, author of *In Praise of Nepotism: A Natural History*, has examined this practice from a historical and social perspective. His talk encompasses a look at nepotism in politics, entertainment and business.

Bellow is the son of Nobel Prize winning author Saul Bellow.
I picked up the *Wall Street Journal* not long ago, and there was an article praising Comcast as a company that is dynamic and well-managed; it referenced the family values of the Roberts family that control it. The family’s determinism, frugality and entrepreneurship were seen as contributing to Comcast’s success. And then a few pages later, the *Journal* ran a story excoriating another cable company, Adelphia Communications Corp., whose founder John Rigas and his son, Timothy, face accusations that nepotism and family greed contributed to the company’s downfall. These two articles emphasize the fact that we’re very ambivalent about the whole issue of nepotism.

Nepotism is a serious issue for family business.

Adam Bellow’s book, *In Praise of Nepotism*, reminded me how much nepotism appears not only in business, but in the realm of politics—and I think ambivalence exists there too. I’m sure there are people in this room who are pleased that our president, George W. Bush, seems to embody the same characteristics of leadership and dedication to public service as his father; yet, that same person may be very upset about nepotism as it applies to Bill and Hillary Clinton.

Nepotism is a serious issue for family business, and we’re lucky to have author Adam Bellow to give us some real insights into this issue.

---

**Famous Name—Advantage Or Not?**

Some might think that being the son of a famous writer would provide me with all kinds of opportunities, especially in publishing. Oddly enough, I thought so too. But that is not what happened. For one thing, my father had apparently stepped on a lot of toes back in the 50s and 60s when he was cutting a swathe through New York. People who had known my father might agree to look me over out of idle curiosity, and everyone was sure to let me know how much they admired his books. But secretly they hated him, and wouldn’t lift a finger to help his kid.

People who had known my father might agree to look me over out of idle curiosity, and everyone was sure to let me know how much they admired his books. But secretly they hated him, and wouldn’t lift a finger to help his kid.

Finally, I went to see Irving Kristol and asked for his advice. Kristol, as some of you may know, is a writer and editor who is considered the “godfather” of the neo-conservative movement. He was not a friend of my father’s exactly, but they had known each other in the 1930s when they were students at University of Chicago, and I think he agreed to see me out of some vestigial Jewish immigrant family impulse—a kind of ethnic nepotism, if you will. He sized me up as a sincere but soft-headed young man who hadn’t figured out what he wanted to be when he grew up, but who had the right background and possibly the right aptitudes to be an editor of nonfiction books. So he sent me to see a man named Erwin Glikes, who was the publisher and chief editor of a small serious intellectual imprint called *The Free Press*. It was Erwin who, after a couple of rigorous interviews, gave me my break. And a lucky break it was.

For one thing, I was hired as an editor essentially right off the street, without having to endure the long climb from editorial assistant to assistant editor, associate editor, and so forth—a three to five year process for most people. Instead I was shown into an office filled with manuscripts. The phone began to ring: people were demanding to know when I was going to put such-and-such a book into production. I started signing off on page designs and jacket art.
Agents and authors called with new projects to sell. I plunged into the work, learning as I went, and soon realized that I had found my vocation.

In an interview last summer I was asked a hypothetical question. Let’s say two people are applying for a job in publishing. One is named Bellow, and the other, equally qualified, is named Smith. Why is it fair that Bellow gets the job?

My answer was: You’re right, it isn’t fair. But it is rational. Entry level jobs are always filled on a superficial basis, and from a publisher’s perspective, it makes more sense to hire Saul Bellow’s son than the son of a dentist named Smith. Why? Because however brilliant and deserving Smith may be, the publisher already knows a lot more about me: he knows that I have been raised in a literary milieu, that I am likely to uphold the highest standards, and that I have undoubtedly been blessed with a wide network of acquaintances including writers, agents, editors and publishers. For an employer looking to hire someone who can jump-start a publishing career without a lot of training and guidance, these facts will be highly persuasive.

Famous Names Have Limits

Being Saul Bellow’s son did not prevent me from being fired from my job as editorial director of The Free Press when it was time for a management change.

A famous name may get you in the door but it is no protection against the verdict of the market. Being Saul Bellow’s son didn’t help me obtain better books, any more than it helped me get prettier girls in high school. Nor did it make me a better editor—or a more successful one. If anything, the bar was set higher for me. And despite my very enviable foresight in having chosen the right father, being Saul Bellow’s son did not prevent me from being fired from my job as editorial director of The Free Press when it was time for a management change.

Ambivalent Views Of Nepotism

I had been kicking around the idea of a book on nepotism for some time. What attracted me to the subject? Well, for one thing, no one had written a book about nepotism before—a startling fact in itself, and one that deserved an explanation. Moreover, nepotism is a practice that is shrouded in hypocrisy—everyone denounces it, and we have spent the last 200 years seemingly doing everything we could to stamp it out. Yet it continues to be practiced very widely. If something so unpopular goes on to this extent, I thought, there must be something to it.

Nepotism is a practice that is shrouded in hypocrisy—everyone denounces it, and we have spent the last 200 years seemingly doing everything we could to stamp it out. Yet it continues to be practiced very widely.

I also noticed that increasing numbers of young people were choosing to follow in their parents’ footsteps. And as I delved more deeply into my research, I soon realized that I was not alone—to the contrary, I was part of a massive societal trend. Barely six months after I signed my contract, George W. Bush and Al Gore announced their candidacies for president. Meanwhile the American press was shocked and amazed to discover that our country has known quite a few political dynasties over the years, and that even today, dozens of congressmen and senators are scions of political families. I could stand here all day reciting their names and still not exhaust the examples.

But this was merely the tip of the iceberg. The trend was also evident in other walks of life, perhaps most visibly in Hollywood, where nepotism has been a tradition since movies began. Thus in addition to household names like Jane Fonda, Liza Minelli, Vanessa Redgrave and Michael Douglas, we have a whole new generation of nepotistic successors, including Gwyneth Paltrow, Mira Sorvino, Jamie Lee Curtis, Anjelica Huston, and literally hundreds of others. Nor is the list confined to actors. Hollywood’s craft unions are filled with second, third and even fourth generation musicians, stunt men, makeup artists, editors and sound engineers. Television may be even more incestuous. What’s more, the same thing was occurring in other fields of entertainment, like writing and music. Even in the arena of professional sports—the last bastion of pure, unadulterated merit in our society—familial succession is exploding. No one would argue that Peyton Manning, Barry Bonds, or Kobe Bryant are playing professional sports on the strength of their family name.
Americans hate nepotism mainly in the abstract: they hate the idea of nepotism. But on a case by case basis, they are quite willing to accept it, honor it, and even celebrate it.

These trends had not gone completely unnoticed, but they had at best been apprehended piecemeal and haphazardly, and no one had explained why it was happening. Moreover, the public attitude about it was divided, if not downright schizophrenic. This is because Americans hate nepotism mainly in the abstract: they hate the idea of nepotism. But on a case by case basis, they are quite willing to accept it, honor it, and even celebrate it. The key to this distinction lies in how familial advantages are used. When people fail to redeem their advantages by real ability and effort, we call that nepotism and we condemn it very harshly. The taint of nepotism, once attached, is very hard to shake, and it is only the rare figure—like Sofia Coppola for instance—who manages to do so. But when nepotism works, we don't call it nepotism at all. Instead we call it family tradition. And we have many proverbs and expressions that convey our respect and approval of this: so-and-so is a chip off the old block; like father, like son; the apple doesn't fall far from the tree. These sayings express our sense of the value and goodness of following a family tradition.

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Documenting Nepotism
I thought all this was worth trying to document and explain, so I spent the better part of four years writing a book that tells the story of nepotism in human affairs from beginning to end.

To my surprise, the book was greeted by a thunderclap of moral indignation. Many people assumed that I was playing an elaborate practical joke. Others, taking me a bit too seriously, concluded that because I had something positive to say about nepotism I must therefore be a monarchist and a defender of the Bush administration. One person responded to my article in the Atlantic Monthly by writing, “This is an amazing article. Adam Bellow actually defends aristocracy. He openly speaks of a prejudice against nepotism! Doesn’t he realize that Bush is really rather subhuman and has no right whatsoever to rule?!!”

Believe it or not, there is a prejudice against nepotism, and like most prejudices it is based on little more than ignorance, ill will and ideology.

In fact, my book is not a polemic in favor of hereditary rule, but a history of family enterprise in politics, business, and culture. But, believe it or not, there is a prejudice against nepotism, and like most prejudices it is based on little more than ignorance, ill will and ideology.

Americans assume without any real factual evidence that nepotism involves not just hiring or appointing a relative, but hiring one who is objectively unqualified. In other words, your relative is assumed to be an incompetent dolt, unlike the first stranger you might pull off the street who undoubtedly has legal and medical degrees and a Ph.D. in astrophysics. This presumption flies in the face of two facts that we know to be true: that talents and abilities do run in families, and that even non-family businesses, including large corporations, prefer to hire the relatives of existing employees whenever they can.

Important Tool Of Immigrants
Another false assumption Americans make is that nepotism is a practice of the rich, which is to say that it has mainly to do with the transmission of status and wealth from successful entrepreneurs to their lazy sons, daughters, nephews or nieces. Yet this too flies in the face of established fact. For in reality, nepotism has been practiced much more extensively...
by the working and immigrant classes who used it to establish themselves in a harsh economic environment.

When Irish immigrants began arriving here in the 1840s and 50s, they were given a hostile reception. The sign “No Irish Need Apply” was posted in many shop windows. Did they turn around and go home to Ireland? Not on your life. In reality, nepotism has been practiced much more extensively by the working and immigrant classes who used it to establish themselves in a harsh economic environment.

Excluded from the institutions of mainstream society, they simply created their own. The most famous of these were the American Catholic Church and the urban Democratic machine. These were creations of an immigrant community—an expression of ethnic nepotism—and they served as ladders of social mobility, enabling their children and grandchildren to escape the ethnic ghetto and enter the middle class as unencumbered individuals.

Other immigrant groups did the same, notably the Jews, who came in large numbers in the 1880s and 90s. Faced with the same exclusion and prejudice that had hobbled the Irish, the Jews created their own self-sustaining economy, founding a thriving garment industry, a series of chain department stores, a group of successful financial and legal firms, and the Hollywood film and television industry.

Nor should we forget the labor movement. In most cases, the original charters of American trade unions specified that the sons of union members should be given preference over outsiders. This was considered right and just, because it was a way for the poor man to do for his son what the rich man did for his as a matter of course.

America was not settled by individuals but by families and larger groups of kin. Family tradition was preeminent in politics and business, in science, medicine and law, in scholarship and literature, and of course in the army and navy.

The problem is that the descendants of those immigrants and working men have forgotten their debt to the nepotism of their forebears. Americans have a flattering image of themselves as self-made men and women, and we like to think of our nation’s history as an inspiring saga of rugged individuals hacking a living out the soil of an untamed continent. But this is total nonsense. In fact, America was not settled by individuals but by families and larger groups of kin. Family tradition was preeminent in politics and business, in science, medicine and law, in scholarship and literature, and of course in the army and navy: Robert E. Lee came from a distinguished military family and during the Civil War he surrounded himself with sons and nephews who all held high commissions in the Army of Virginia. George S. Patton’s ancestors fought in every American war, MacArthur’s father was a general, and Custer got several of his relatives killed at Little Big Horn. The American West is often portrayed as a setting of extreme individualism, and it is true that many people went West to get away from their families and reinvent themselves. Yet a far greater factor in the settlement of the West was family enterprise and kinship. Thus for every gang of outlaw brothers—the Daltons, Clantons, James and Youngers—there was a family of Earps. Most western sheriffs practiced nepotism, for the simple reason that they could not patrol their huge territories by themselves. And who are you going to trust to back you up in a gunfight more than your own brother?

The Boston Brahmins

It is true that in our society people are free to compete as individuals on their merits, and this is a great historical achievement. Yet we are not merely a society of individuals but one of families and groups, and it is a harsh but unavoidable truth that people who compete at families do better than those who do not. Moreover, some groups are more nepotistic than others, and the more nepotistic your group, the better you are likely to do as an individual.

We are not merely a society of individuals but one of families and groups, and it is a harsh but unavoidable truth that people who compete as families do better than those who do not.

No historical example better illustrates the power of institutionalized nepotism than that of the Boston Brahmins. The founders of this powerful elite were a group of Essex County merchants who made their fortunes as privateers during the Revolutionary War. After the war they moved to
Boston and founded the great New England trading firms. Nepotism was pervasive in these firms, and first choice of employment went to children, nephews, cousins, and other relatives. Most of the great merchant captains started out as agents in their uncles’ warehouses. They went into business with their brothers, married their cousins, employed their nephews, and continued to intermarry among the branches of their families for several generations. But what made the Brahmins great was that they showed as much business acumen and flexibility in the second and third generations as they had in the first. It is the second generation that makes the dynasty, and the sons of the great merchant princes did not rest on their laurels but pioneered a new territory by founding the New England textile industry. In the single-minded pursuit of their business they developed New England’s transport and communications infrastructure, laid the basis for the modern banking system, financed the continental telegraph and railroad, transformed the physical topography of Boston, and founded, staffed and ran all the great educational and cultural institutions of Boston, turning their small provincial city into the Athens of the 19th century.

**Old Versus New Nepotism**

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Now, nepotism is a practice that is badly in need of distinctions, and in my book I introduce a very important one between what I call the Old Nepotism and the New. In America, the Old Nepotism reached its peak in the 1920s at the height of what is called the WASP Ascendancy. At that time, nepotism was still practiced in the patriarchal style of old New England. The patriarchal father was an absolute ruler in his home, and he decided where you went to school, what you would do for a living, and which cousin you would marry. If any of you have seen the movie *Dead Poets Society* with Robin Williams, which is set at a straight-laced New England prep school in the 1950s, you may remember that the plot revolves around the desire of a sensitive young student to become an actor, while his overbearing father insists that he go to Harvard, become a lawyer, and join the family firm. Needless to say, the young boy’s eventual suicide is laid to the father’s account, just as the suicides of Romeo and Juliet are blamed on the obstinate pride of their parents.

When people ask me when nepotism became a dirty word, I usually say that it occurred as a result of the Crash of 1929. The nepotistic WASP establishment was blamed for mismanaging the economy, and neither they nor the practice of nepotism have recovered their good name.

This kind of harsh, old-fashioned patriarchal nepotism finally died out in the 20th century, and it is no longer practiced today. (Except for occasional throwbacks like the overbearing tennis-father Richard Williams.) When people ask me when nepotism became a dirty word, I usually say that it occurred as a result of the Crash of 1929. The nepotistic WASP establishment was blamed for mismanaging the economy, and neither they nor the practice of nepotism have recovered their good name.

But that doesn’t mean that nepotism ceased to be practiced in America. It just came to be practiced in a less obvious and all-consuming way—a way that is more consistent with modern American mores. Thus while most people still prefer to work and associate with their relatives, we now stop short of marrying them.

After World War II, American business entered a meritocratic phase consistent with its corporate expansion and its new global reach, and in this period most large businesses adopted anti-nepotism rules in the interest of greater efficiency and transparency. America declared that it had finally achieved the Jeffersonian dream of a true meritocracy, and in a typically ham-fisted way sought to impose its meritocratic model on the rest of the world, with very mixed results. Yet a few decades later, as the post-war entrepreneurs began to retire, they increasingly sought to leave their businesses to their children. And over the last 20 years we have seen not an increase in anti-nepotism rules but rather their gradual contraction and abandonment. Much of this has to do with the emergence of women in the workplace. Indeed it is women who have mainly led the charge against nepotism rules, on the grounds that they are objectively discriminatory.
Instead of parents holding themselves out as examples for their children, today’s children validate their parents by following in their footsteps.

At the same time we have seen the emergence of a uniquely American form of meritocratic nepotism, and it is worth dwelling for a moment on the differences between the old nepotism and the new. The old nepotism involved parents hiring their children outright or pulling strings on their behalf. It was also, as we have seen, highly coercive. The new nepotism operates not from the top down but from the bottom up: it is voluntary, not coercive; it springs from the motives of children, not the interest of parents; it tends to seem “natural” rather than planned. Instead of parents holding themselves out as examples for their children, today’s children validate their parents by following in their footsteps. While not nepotism in the classic sense, it is rightly called nepotism because it involves exploiting the family name, connections or wealth. The method may be different, but the result is much the same.

No one can pick up the phone these days and get their kid a high-paying job, a record deal, or a spot on the national ticket. But more and more, that kind of intervention isn’t necessary. Growing up around a business or vocation—learning how it works, getting to know the people in it—creates a powerful advantage that is tantamount to nepotism, and when exercised unworthily it carries a similar stigma. Mainly, however, the new nepotism differs in combining the privileges of birth with the iron rule of merit in a way that is much less offensive to democratic sensibilities.

Growing up around a business or vocation—learning how it works, getting to know the people in it—creates a powerful advantage that is tantamount to nepotism.

Successors Choose Their Own Course

I have read literally hundreds of profiles of today’s successor generation, and one thing they all say is that their parents never pressured them; if anything they bent over backwards to encourage their children to go their own way, do their own thing, pursue their own individual dreams. Many of them did go off and try other things. Yet sooner or later, they all seem to have decided that writing or acting or politics or medicine or basketball or fireworks manufacturiing was something in their blood, and they came back of their own volition to take their place in the family business. Many speak of deeper bonds with family members, and the satisfactions that arise from sharing a common enterprise with parents, children and siblings.

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Another thing they all say is that while their parents’ name or family connections may have gotten them in the door, they had to prove themselves by working twice as hard and being twice as dedicated as anyone else. This is as much a reflection of the need for young people to feel that they have actually earned their success as it is of a need to offset the resentment and envy of others. It may have once been possible to coast along without pulling your weight—coming in late, taking long lunches, and leaving early to play golf—but no longer. The pressure on successors is extremely high, and for the most part it is a pressure they exert on themselves.

Nepotism Throughout History

Even the New Nepotism has problems. Talents and abilities do run in families, but not every family member is equally talented, and sometimes doting parents make mistakes or advance their children too quickly.

In this regard, the patterns observed in history continue to hold true. The adage attributed to Andrew Carnegie, “shirtsleeves to shirtsleeves in three generations,” turns out to have a solid basis in reality. And it is one of the things I typically say to those who are worried that the rise of
Yet while the public loves to watch a great family tear itself apart in squabbles over money, there is also something in us that respects them and regrets their passing. A good example was the decision a few years ago by the Pritzker real estate family to dissolve their common holdings. This gave comfort to those who fear the rise of an American aristocracy, but it was a serious blow to the city of Chicago, which will no longer be able to count on the Pritzkers to build its hospitals and libraries.

In addition to these internal checks and balances, there are also external ones that protect us from too much wealth or power in family hands. In politics, for example, there has lately been a huge increase in the number of family successors. Some have called this a threat to our democratic institutions. But while Americans yearn for a prince, they want nothing to do with a king, and political dynasties rarely flourish at the national level. None of the sons of Franklin Roosevelt managed to rise above the level of Congress and one of them finished his career as the mayor of Miami. The so-called Kennedy magic has entered a fallow period. And in the case of new pretenders, the democratic process serves to weed out the bad apples.

Family Businesses

In business, of course, the market performs the same function. It is the market that determines social outcomes in this country, and people who put their business in the hands of incompetent relatives soon end up paying the price. The Bronfman family has learned this the hard way, losing billions in assets in order to subsidize Edgar Jr.’s attempt to shift the family business from liquor (the Seagram Company) to entertainment overnight. Other examples abound, and they illustrate the central truth that nepotism, practiced badly, is largely a self-punishing offense.

The supposedly dysfunctional aspects of family life—demanding fathers, sibling rivalry, and intergenerational friction—can also be a positive source of ambition and drive.

This is not to say that families are always happy and harmonious. We all know they are not. But I would like to say a modest word on behalf of family conflict. Many people assume that the main problem with family-based enterprises is that they suffer from the emotional strains and distortions of family life, and that this is bad for business. Often this is true, and I wouldn’t want to minimize the
problems that can arise from such dynamics. Yet if we take off our Freudian spectacles for a moment and look at things as Joseph Kennedy or Mayer Rothschild did, we can see that the supposedly dysfunctional aspects of family life—demanding fathers, sibling rivalry, and intergenerational friction—can also be a positive source of ambition and drive. Many of our greatest businessmen and politicians (the Roosevelts and Kennedys for example) were motivated as much by family psychology as by idealistic or entrepreneurial visions. It is a serious distortion of our therapeutic age that we no longer understand this simple truth.

Three Simple Rules

Don’t embarrass me. Don’t embarrass yourself. Pass it on to the next generation.

What do we have to do to ensure that “good” nepotism prevails over “bad” in a family business? At the end of my book I have a chapter on the Art of Nepotism in which I lay out three simple rules derived from my study of family enterprise. They are: Don’t embarrass me. Don’t embarrass yourself. Pass it on to the next generation. These are the unwritten rules that have guided successful families for thousands of years.

Audience Questions

BARRY MERKIN:

Bellow’s book has been called the most provocative of the year. More than the general population as a whole, the family business people in this room have a very personal understanding of nepotism. Many have dealt directly with both its significant benefits and its serious challenges. To me, one of the most important thoughts in the book is Adam’s belief that it is necessary to understand that nepotism is a privilege, not a right. And that respect, gratitude and proper conduct are owed in return.

At this time, we’ll open the floor for questions, and I’ll lead with this one:

*Can you give us some examples of the positive aspects of nepotism?*

I have observed that nepotism really brings out the best in people.
you think it doesn’t really matter who you hire so you allow people to hire their nieces and give jobs to the friends of their children. But of course, many of these people are just passing through, and what you are doing for them is punching their ticket in the foundation world and giving them a very valuable foot on the bottom rung of this ladder, and they’re getting that opportunity because they know somebody.

All organizations are prone to forms of favoritism; whether they are family-based or not I find makes no difference at all.

All organizations are prone to forms of favoritism; whether they are family-based or not I find makes no difference at all. I fail to see the ethical distinction between hiring someone because they’re related to you and hiring someone because they’re the roommate of your daughter at college. It makes no difference at all, but people make a fetish out of the blood connection for cultural reasons that I think are nonsensical.

The bottom line is you need a mixture in business just as in our society at large. We think of America as a meritocracy and we hold everything that we do to this very high standard of equal opportunity and merit, but the truth is we don’t have a meritocracy and we don’t want a meritocracy. What we have is kind of a Swiss cheese, where you have pockets of merits and pockets of nepotism; that’s how we want it, and it works.

Can you tell us more about dynastic families, especially in the second and third generations?

In very wealthy, successful dynastic families you have exceptional family founders like Joseph Kennedy, who become extraordinarily successful and tend to be very domineering, very demanding and insistent that their children do what they tell them to do. It’s a very common thing. And the children are often very dutiful. In the family of John Adams, for example, you have a pattern that’s familiar. You have an extremely brilliant, successful family founder, John Adams, who also had a tremendous amount of family pride and ambition; he drove his sons very, very hard. He wanted them all to be public figures and presidents and secretaries of state. Of the four children in that family, one succeeded brilliantly, one committed suicide and two were drunks. What this story illustrates is that in these families there is often a tremendous amount of pressure and not everybody is happy, and I think neither you nor I would want to be a member of John Adams’ family.

In the Bush family, by the time you get to the third generation, you have a governor and a president. The Kennedys are even more egregious. Joe Kennedy was a very successful, somewhat unscrupulous, multimillionaire businessman. His sons were extremely accomplished, very talented, very attractive and appealing; dutiful sons, who wanted very much to live up to their father’s expectations and performed, I think, well beyond their father’s expectations. But then you have the third generation who are born into positions of wealth and privilege, some of whom may question who they are and, in many cases, act very badly.

A very typical strategy of third-generation prodigals is to keep people’s expectations low. They try to depress expectations so that when they reveal their glory everybody is suitably impressed.

Another facet in these families is the prodigal son. I use the word very precisely, because the prodigal, as you recall from the Bible, is not a person with bad character. He’s someone who’s in rebellion, and you cannot discount the prodigal. George W. Bush is a typical third-generation prodigal: somebody who acts out, behaves very badly, the family despairs, they think that it’s the dutiful son, Jeb, who’s going to be the standard-bearer in the next generation, and then George W. decides, “Oh, no, I’m going to be the family heir. I’m going to show you all.” A very typical strategy of third-generation prodigals is to keep people’s expectations low. They try to depress expectations so that when they reveal their glory everybody is suitably impressed.

Is it ever advisable to dissolve a family business?

Every human organization has a life cycle just as human beings do and very often our attempt to perpetuate an organization or institution that we love can be counterproductive. I see this in the publishing business with magazines, for example. Some magazines have outlived their moment in culture. Attempts to revive them or keep them relevant simply fail. You cannot inject life into something that no longer has the unity and cohesion and positive energy to keep it going. I think someone should write a book about how businesses can die with dignity because too many of
them die in a very undignified way, not by choice, but by necessity and in conflict and quarreling. This is a bitter legacy, but at this point, sometimes the healthiest thing to do is dissolve the company.

Did you generally find that family members were more successful in their family business when they first worked outside the business?

What I’ve seen is that when companies get to be a certain size there is always a crisis point where the need for professional management comes into tension with the desire to maintain family control. The problem is therefore, “If we want to preserve our business as a family business, how do we ensure that our children and grandchildren—our successors—are going to be as good as the best non-relative manager we could hire?” This is a serious challenge.

When companies get to be a certain size there is always a crisis point where the need for professional management comes into tension with the desire to maintain family control.

The family businesses that have succeeded in meeting this challenge are the ones who have instituted very rigorous apprenticeship programs. A very good example is the Asplundh Tree Expert Company, a third generation family business, founded by a couple of Scandinavian immigrants. They specialize in clearing branches away from power lines. This is a great international business. It is completely family controlled, and they have a very rigorous program for any family member who wants to join the business. First a job candidate must obtain an advanced degree, then work for a competitor for at least five years. After that, the candidate must have the sponsorship of at least two family members and board members. Everyone starts as a line operator cutting branches for a period of time, then gains experience by working in every division of the company. After continual vetting and sponsorship from family managers, the candidate is finally brought into the inner circle and given managerial responsibilities. It takes many years, and weeds out people who are not really serious or really capable.

While this is an extreme case, it’s not that uncommon for successful large family businesses to insist on an apprenticeship program, either within the company or outside.

From your research on the practice of nepotism, what have you observed as the best and worst results from a business perspective, and from a family perspective?

There was a study published in the Journal of Finance which presented findings that ran counter to some mythology that most people believe about family businesses. The myth being that family businesses are a luxury their owners cling to out of family attachment or vanity because family businesses are not really very good—they’re not profitable, they’re not well managed, they don’t have as much value and people don’t like working in them. The study found that this simply isn’t true—in fact, family-run businesses compared to their non-family-run counterparts are healthier and happier; they have more longevity, people like working in them better. Family businesses, for example, are less likely to lay off employees during an economic downturn. They are more paternalistic, in a positive sense.

It’s also revealing and interesting that women are finding more opportunities in family businesses and in some aspects are doing better than they do in the general business world. In a survey published around the same time as that article, participating family companies said that about 30 percent of them expected their next CEO to be a woman. This is a big differential in terms of the general business world.

A well-run family business managed according to a conscious policy of nepotism…is a very healthy thing.

A well-run family business managed according to a conscious policy of nepotism—and I think it’s best if it’s done consciously and openly, without apology, and with responsibility assumed for the consequences by all parties—is a very healthy thing. And it is possible to thrive and succeed on a basis of planned and conscious nepotism.

It is when people do not admit to themselves or other people what they are doing—when they avert their eyes from problems that bad blood can develop among family members—then, to resolve the conflict (in terms of the worst outcome for the business), it may have to be dissolved or divided. It seems to me that the companies that have addressed nepotism forthrightly and have developed very clear guidelines and policies for dealing with it are more successful in the long term.
RESPONSE TO NEPOTISM

The following are comments by Professor John Ward and a synthesis of Family Business Conference attendees’ responses to a questionnaire on nepotism.

JOHN L. WARD:

Business People From An Early Age
Adam Bellow offered us, I think, a very interesting socio-logical and philosophical perspective on how nepotism is not just a phenomenon, but is absolutely social glue for our societies. I’d like to follow up on a couple of other dimensions of nepotism.

Not long ago, I just happened to have an opportunity to be talking in a group with the two sixth-generation family members who are leading Chopard, the jewelry and watch company. It is about a 200-year-old company, and a very successful business. So I asked the brother and sister successors if they had special memories of growing up in their family business. The brother said, “Oh, I remember when I was seven years old my parents and my uncle took me to the watch-making place and I saw all these people with these white coats working with great precision, and from the time I was seven, I wanted to wear one of those white coats.” And his sister said, “When I was five years old and our grandfather was ill in the hospital I made him a gift—a watch made out of tin foil and cardboard, and brought it to him in the hospital.”

Nepotism is a competitive advantage because you’re learning things while growing up that we couldn’t possibly teach you in business school.

I think all of you here, who come from rich and deep family business heritages, can think of your own dramatic or poignant examples of what it was like for you to grow up with the family business and to have it get very much into your spirit, into your soul and into your mind at a very young age.

I am coming to the conclusion that one of the competitive advantages of a family business is nepotism. Nepotism is a competitive advantage because you’re learning things while growing up that we couldn’t possibly teach you in business school. This view came out clearly in your discussion groups, which I will summarize for you now.

Growing Up In The Business

I would argue that growing up in a family business, you are developing a great deal of idiosyncratic knowledge, a great deal of special knowledge: about perspective, about when to take risks, about memory and history.

Here, in order of frequency mentioned, are the characteristics that you found most important to growing up in a family business.

• You learned the importance of relationships.
• You learned about the work ethic and family values; the work ethic, in particular, was strongly enforced.
• You learned the advantages of taking the long-term perspective. Words like “patience” and “persistence” were used frequently.
• You discovered a passion for the business; a love for the “white jacket.”
• You learned to focus on cash. In fact, two groups said, “Growing up we learned to pay attention to the balance sheet not the income statement.”
• You learned how to think about risk: how to take risks and how to digest risk.
In business strategy we’ve got a concept that’s called idiosyncratic knowledge, which means there is a special knowledge that exists in organizations that allows them to do things better than their competitors. And I would argue that growing up in a family business, you are developing a great deal of idiosyncratic knowledge, a great deal of special knowledge: about perspective, about when to take risks, about memory and history. Many managers in many big companies have never been through two business cycles. But those who are here have probably been through multiple business cycles. Some of you have been through depressions and wars. Some of you have been through government expropriations and seen all of that history. Whether you lived it or heard about it growing up, it gave you a very special memory, a very special perspective, as well as a very special spirit towards people and towards a particular value system.

I want to encourage you to think about what it is that you are learning and what it is that you have learned growing up that gives you a very special competence, and then think about how you will transmit that knowledge to the next generation.

The Family View

Another issue we have been examining is how it feels to have inherited privilege. We asked you if inherited privilege means that you have to work harder. Your resounding, unanimous answer was, “Yes.” And you said that as inheritors, “We have to work harder.”

To whom much is given, much is expected.

So we asked, “Is that fair?” It was interesting, because I learned from reading your responses that was not exactly the right question to ask. I learned you accept that you must work harder than non-family business employees and you accept that as part of your privilege. You said, “There are some burdens on us, but there are also special rewards and special opportunities that come along with being part of a family business.” A strong theme that emerged was: To whom much is given, much is expected.

Several of your groups said that working harder than the ordinary employee is not a problem because if you love what you’re doing, it’s not an issue.

The Non-Family View

We also got rich feedback from the non-family members of your businesses—directors, advisors and executives. The non-family people in this room’s advice to the family members, particularly the next generation was, first and foremost: “Please get outside work experience.” The second most-mentioned piece of advice: “Please have an independent board of directors.” Next was: “Please treat the employees with respect.” Fourth most-mentioned was: “When generational succession or transition is taking place, please have the senior generation leave the business. Make the succession complete.” And the fifth point that was mentioned was: “If you need our help, if you have a question, if you’re in doubt, please feel free to ask us.”
Adam Bellow has been an editor for over 20 years. He is currently executive editor-at-large for Doubleday Books and was formerly editorial director of The Free Press. During his tenure at The Free Press, he edited many books that tackled controversial subjects, including The Bell Curve. He is the author of In Praise of Nepotism: A Natural History published by Anchor Books (a division of Random House, Inc.) in 2004. He has also written many articles and essays that have appeared in the Atlantic Monthly, Newsweek, the Wall Street Journal, the New York Times, the Los Angeles Times, the Financial Times, the Times of London, and Talk Magazine. He is a graduate of Princeton University with a degree in comparative literature and completed post-graduate study at the University of Chicago. He lives in New York City with his wife and children.

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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 an Ernst & Young Entrepreneurship of the Year Award.
Panel: Perspectives on Family Business Success

Why do some family businesses endure for hundreds of years while others do not? This distinguished panel of academic experts and business professionals examines the unique vision of some of the world’s best family businesses to see what makes them successful generation after generation.

MODERATOR:
M. V. Subbiah
Retired Chairman
The Murugappa Group, Chennai, India
Visiting Executive Scholar, 2005
Kellogg School of Management
Center for Family Enterprises

PANELISTS:
Harold James, Ph.D.
Professor of History
Princeton University
History Department

Isabelle Le Breton-Miller, M.Sc.
Senior Research Associate
University of Alberta School of Business
Centre for Entrepreneurship & Family Enterprise

Susan E. Tifft, M.P.A.
Eugene C. Patterson Professor of the Practice of Journalism and Public Policy Studies
Duke University
DeWitt Wallace Center for Media and Democracy

Jan von Haefen
Retired Supervisory Board and Foundation Chairman
Franz Haniel & Cie, Germany
This understanding of the importance of the human factor is what I have found to be very common in family businesses—that’s my best take-home from reading these authors’ books, as well as from the last year I’ve spent as Visiting Executive Scholar here at Kellogg.

HAROLD JAMES:

A Look At Three Families

The news that I’m going to present is mostly good news about what family businesses do for the society and the culture in general from which they come. What I’ve done is to look at three long-lived companies in three continental European settings: one in France, Wendel Investissement; in Germany, the Haniel Group, an enterprise of which Jan is a distinguished member; and the third in Italy, Gruppo Falck.

The Wendel family empire was started in Alsace over 300 years ago. The Haniel firm is 249 years old, and the Falck family has been in business almost 200 years. All three companies are examples of what the academic literature calls Rhineland capitalism, and that’s one of the reasons that I selected them. In the case of these specific firms this is not an abstract category, it is also a geographic one in that all these families, even the one that is active in northern Italy, have their family roots in the valleys of the Rhine River and its tributary, the Moselle, the industrial heart of inventiveness in Europe.

I didn’t select these families because they were in any way typical or particularly notorious. In Germany if you want notorious families you think of names like the Krupps or the Thyssens. Unlike the Krupps and Thyssens, these families still exist as practicing business families and have not descended into the playboy, jet-set world of the international chicanery that the Krupps and the Thyssens now represent. I also selected them because there were substantial commonalties for much of their history. That is, they were concerned with industries that were at the heart of the European industrial story over the last two centuries: energy, coal, iron and steel, and then the extension of iron and steel into mechanical engineering.

Transitioning The Business

Another common element these families share is that in the course of the last quarter of the 20th century, as the European steel industry hit one crisis after another, they moved out of steel and engineering and they became far more diversified and are now business conglomerates with a broad diversity of holdings.
The way that we look at the relative performance of the families can be measured against how well they transitioned from one form of business to the next.

The way that we look at the relative performance of the families can be measured against how well they transitioned from one form of business to the next. When I was doing this project, I often thought about which family business was doing better and which worse—it seemed quite simple—of the three companies, the one that recognized the impending steel crisis and exited more quickly fared best. The Haniel family, who began to exit from steel and engineering in the 1960s, before any of the signs of the European steel crisis, is easily the most successful of the three at the end of the 20th century and the beginning of the 21st.

By contrast, the Falck family, who remained longest in the steel business and still has a strong attachment to steel, paid a heavy price for this romantic attachment to an industry that was changing. If you go to their headquarters, even though they don't produce steel anymore, everything is covered with pictures of fiery furnaces and steel mills and workers rolling bars. The Falcks had a love affair with steel that went on and on until 1994. From 1990–1994 the company lost 440 billion lire [US$275,000,000].

When I asked the patriarch of the Falck family about these heavy losses he said, “You have to understand, professor, we are a wealthy family and we can afford to lose a lot of money.” This raises the question of what the family image is and how it identifies with a particular industry. The steel industry was at the pinnacle of the pyramid of prestige in European societies.

To give you another example, in the 1970s when the French family, the Wendels, were looking around for alternatives to their traditional business and thinking about what they might do, an outside advisor suggested they might make women's underwear. The family rejected this idea because it seemed inappropriate for a family that had been part of the royal iron and steel industry. In pre-revolutionary France, running an iron forge was one of the things you could do without derogating from your nobility; you could be a nobleman and you could run an iron forge. This was an aristocratic occupation and the Wendels didn't want to do anything else. Again, like the Falcks, it seems that their business suffered because they were attached to a particular tradition.

And what did the Haniels do? The Haniels diversified. They went into wholesale, and into pharmaceutical distribution in the 1960s and 1970s. The same time the Wendels were rejecting an occupation that they thought was demeaning of their status, the Haniels bought an enormously successful Swiss company, with presence all over Europe, that does professional laundering including primarily bathroom towels, the cleanable bathroom towels that you see all over Europe.

This is a long way away from the Haniel roots. So how did they envision this transition? There was certainly a vision that held it together and at its core was systems technology. The Haniels entered industries where in the 1960s and 1970s they could apply then-developing information technology—they saw radical gains in economies of scale and in economies of scope with their dramatically new businesses.

There must be a core where the family thinks of itself as being competent, but there is a stiff price to pay at moments of technical change if the family has too narrow or too restrictive a vision of that core.

There are concrete lessons here—it is important for a family to identify with something. There must be a core where the family thinks of itself as being competent, but there is a stiff price to pay at moments of technical change if the family has too narrow or too restrictive a vision of that core.

Another lesson is the story of technical change and what you need to do when you shift from one area to another; it's often linked to the transition between generations, because it is often a new generation that takes up a new technology. In the Haniel case, the various groups who grew up in different generations had different visions for the direction the business should take with the younger members pushing for more technological involvement.

The successful businesses are those that can remake themselves and can balance tradition and change. While change is inevitable, it is never easy.

A family business that has been around for two or three hundred years has seen a lot of conflict, things are not always harmonious, and there are many divergences of views as to
the family’s direction. The successful businesses are those that can remake themselves and can balance tradition and change. While change is inevitable, it is never easy.

One of the facets of the German story that differentiates it substantially from the Italian or the French story is the way in which the Haniels tried to extend themselves internationally and thought about competition, not just in the national setting, but globally in the 1960s. In Europe, where countries are small, thinking of business in national terms is obsolete. Companies must think in terms of the international extension of business and of competition as going beyond national frontiers. When companies compete in very different markets they gain new input; they see different requirements, and learn what works and what synergies can be applied outside the national model.

By contrast, it seems to me that both the French and the Italian cases focused too much on national politics. And the French answer was a very different one from the German answer. Instead of internationalizing, the French firm looked more and more to political contacts in France, since it always had a strong political tradition. They looked to politics rather than to the international market as they had done historically. But in so doing, they attracted negative attention, much opprobrium and plenty of controversy, which in turn gave the family a negative image in the press and spurred equally negative public reaction—all ironically while the family thought it was doing what was required and what was in the best interests of France.

Another interesting question to ask in reference to these companies is to what extent did government support aid in their longevity? Would they have survived as long as they have without government intervention? Steel was enormously important to governments, because it was the basis of the munitions industry, but before the First World War it was not subsidized. On the other hand, in the 1920s and 1930s and then again after the Second World War and up until the 1970s governments spent a lot of time and money supporting these industries, which served to trap many businesses that grew too dependent on government support and were eventually nationalized. The families that got out of the trap first were most successful. The Falck family succeeded in eluding the trap when it pioneered moving into high-quality steel, which helped it avoid the fate of the rest of the steel industry in Italy that was nationalized in the 1920s and 1930s. In the end, government support threatened the existence of these family businesses during a time of crisis for the steel industry.

The way in which the family and the family image accommodates a vision of change for itself and the way the family adapts its vision to international competition are critical to its success over the long term.

**ISABELLE LE BRETON-MILLER:**

**The Most Successful Form Of Enterprise**

As you might well know, family businesses are the most common form of organization. They comprise over 50 percent of the world’s biggest companies and also account for 80 percent of its small businesses. Yet the general impression many people have about family businesses is that they are capital-poor, talent-poor, conflict-ridden, unprofessional, nepotistic mom-and-pop operations. Many believe as well that they are sentimental, backward, tradition-bound under-performers—in short, hardly great enterprises.

Family businesses survive twice, if not three times as long as non-family businesses.

But that image has begun to change. Recently, academics have discovered that family businesses are out-performers, not under-performers; out-performers in revenue growth, market valuation, and return on assets. The other, very interesting part of the equation is that family enterprises also survive much longer than their non-family peers. So, place into context, please, that notorious statistic that asserts that only 30 percent of family businesses survive after the third generation. Family businesses survive twice, if not three times as long as non-family businesses.

But why is there this apparent family advantage? We believe it is because great family businesses act quite differently from their non-family peers. And paradoxically, what are often perceived as a weakness of family businesses are in reality powerful competitive advantages.

This we discovered as my husband and fellow researcher, Danny Miller, and I set out in search of great companies that have managed to sustain their successes, not for years, but for many decades. We found these successes in that surprisingly neglected group: major family businesses. The companies we studied had a billion dollars in sales or more, and had been market leaders for at least two decades. They were all over 45 years old, with the median age of 104 years old and at least two generations in the company.
Looking At Family Business In A Different Light

First, what we did NOT find in those great companies.

As academics we began by looking through the lenses of mainstream management theory. We never found what we were looking for! We didn't find much evidence of grand strategizing, formal planning activities, or competitive analysis; nor much glamorous diversification or modish changes in strategies. Bureaucracy was rare, as were complex organizational designs. Infrequent too were hyper-sophisticated, formal information and incentive systems. We did not find charismatic leaders (there were great leaders, but of modest visibility); nor any competitive “tournament” culture. These qualities were simply not hallmarks of family business.

So what did we find?

Management Philosophy

Family businesses, at least the great ones we studied...are more concerned with deep and persistent investment in the business and in its people.

First, we found a different management philosophy. The best family-controlled businesses have a very long time horizon. The rest of the corporate world is often focused on the next quarter, as that’s when they need to deliver. Family owners are not; their aim, often, is to pass on a healthy, productive business to the next generation. This desire for continuity allows family businesses to make strategic, competency-driven moves that baffle and ultimately best rivals who are more concerned with tactical, financially-driven practices. Our family businesses often embraced substantive social, economic or technological missions consistent with their desire for long-term relevance and viability. They excelled against competitors who obsessed about quick-fix expedients such as acquisitions to boost the top line, and downsizing and cost-cutting to enhance the bottom line. Family businesses, at least the great ones we studied, eschewed these tactics, being more concerned with deep and persistent investment in the business and its people.

If we look at CEO tenure and incentives in family-controlled businesses we find on average that CEOs serve 20, 25, or even 30 years. Elsewhere the average is three to four years, down from seven to 10 about 10 years ago. This trend, coupled with the dramatic rise in incentive pay, suggests why the incentives for CEOs outside of family-controlled businesses are often largely financial. Within our family businesses, CEOs had far more substantive incentives.

Four Pillars

When we looked at the practices of great family businesses, we found four driving priorities—we call them the four pillars—which support the strategies these companies are trying to implement.

The four driving priorities are: continuity, community, connection and command.

These great family-controlled businesses create a community by nurturing a caring collective.

The second pillar is the community priority—uniting the tribe. These great family-controlled businesses create a community by nurturing a caring collective. Here strong values are practiced, not just posted in the hallway. Values are lived, and orchestrate a great many decisions because they are powerful and resonate with ALL employees. Accordingly, these companies must be very selective in their
hiring practices. They socialize, we might even say, “indoctrinate” their employees in company values. These firms are also very caring of their people, sometimes to the point of having a “no-layoff policy.” By getting staff onboard and motivated, it becomes possible to favor an informal working environment built on cooperation rather than bureaucracy. The result of this caring attitude is that firms create true believers with lots of initiative—a loyal team of people working with the family to build the company.

The third pillar is connection, which extends the same caring concern beyond employees to the larger world. Firms build connections by securing mutually generous relationships. They are not interested in one-shot bargains or in being opportunistic, but in becoming “brotherly” partners solicitous of their clients, their suppliers, and the community. The companies network with and stay in touch with these parties over the long haul, striving always to be of service. Frequently, too, they act as model corporate citizens.

The fourth pillar is command. Leaders at these great family businesses take command by acting as unfettered stewards, rather than shareholder-servants. Leader discretion and independence may be among the greatest strengths here, underlying even the first three pillars. As a result, family-controlled businesses can act unusually speedily and courageously. They are freer to be unorthodox—and to go against traditional industry practices. We found, in fact, that our companies could be especially original in going about the renewal of their businesses.

Company Strategy Is Key
The great family businesses we studied made use of all four pillars. Two pillars, however, will tend to be major priorities and two will be supportive, which ones will depend on the company’s strategy. All four of the pillars must contribute, but two will bear the major burden for a given strategy.

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For example, at the New York Times, what is focal is carrying on the family dream and mission, which makes the continuity aspect of that business extremely critical—in this case, investment in journalistic excellence. To fulfill this dream, the Times must have a very strong community of employees supporting them. They need the support of those prize-winning journalists and their extensive network of bureaus around the world. So continuity and community are the two major pillars for a craftsman like the Times. The command and the connection aspects are also there, but as supports.

For Bechtel Corporation, the world’s largest civil engineering firm (they built Hoover Dam, the Chunnel beneath the English Channel, and the city of Dubai) the pillars of connection and command are the most important. Bechtel’s uppermost concern is connection to the outside world—with contractors, mega-clients, suppliers and governments as these are the sources of resources and growth central to Bechtel’s entrepreneurial strategy. Command is central as well, as bold, quick action and risk taking are necessary to land major deals in a highly competitive marketplace.

Interestingly enough, once companies establish their main pillars these tend to remain the same across the generations.

Winning companies find the right recipe for blending the four pillars and are always refining their focus to maintain equilibrium. This is an active process and the best companies learn how to mix these practices to create and sustain strategies that make them successful. Interestingly, once companies establish their main pillars these tend to remain the same across the generations. Often, the pillars persist because companies are quite stable in their mission and the underlying strategies they use to pursue it.

SUSAN TIFFT:

Tale Of Two Families
I am the co-author of two biographies of media families. The first is about the Binghams of Louisville, who owned the Louisville Courier Journal for about 70 years until a bitter family feud broke them up; they ended up selling the newspaper in 1986. The other family I wrote about is the Ochs-Sulzberger family, who has owned the New York Times for 110 years, and still actively manages it.

Because I am a journalist I have this conceit that we in journalism share, which is that newspaper companies and media companies are different from other companies. I believe this is so because of the public mission and the public trust that is involved in publishing a newspaper. I submit to you that they are very different because many of the concerns of family businesses that own media transcend the bottom line.
There are four lessons at least that can be derived from the experiences of these two media families, and the first is that Rube Goldberg had a point. The second is that a generation gap can be a chasm in ways you might not expect. The third is beware of the Harlequin Romance factor. And number four is it’s great to be rich, but it’s better to be lucky. So let me go through each one of these briefly.

Just Make Sure It Runs

The first lesson is the key to all of the others, in my opinion, and applies equally to the principal owners, the prospective inheritors and outlying family members.

The Bingham empire was seemingly impregnable and certain to be passed on to another generation. There was money in the bank, no debt, and a very sophisticated and carefully designed estate plan in place. The principal owner, the son of the founding patriarch, had voting control and had declared for years that the fundamental purpose of his life was to pass this paper on to the next generation. He also had a son in place who had been running the business for 15 years. Yet he sold the family business.

The words “family business” mean that all bets are off when it comes to assuming what will happen, because the entity involved is a combustible hybrid of very different and complex institutions.

My point is that the words “family business” mean that all bets are off when it comes to assuming what will happen, because the entity involved is a combustible hybrid of very different and complex institutions. The family part of it, with its freight from childhood and previous generations, has to be dealt with, which cannot be done formulaically. And yet in the Binghams’ case, it was. I’ll give you an example.

In the early 1980s, when the changing economics of newspapers threatened to hurt the business, the third generation son, who was in charge of the company, hired family business consultants, and that sounds sensible. The problem was that he followed their advice to the letter and didn’t question whether it fit the family’s particular situation or was even in his own best interest.

The consultants told the son that he needed an outside board of directors to meet the challenges of the changing climate for newspapers. And so the son tossed his two sisters, his wife and even his own mother off the board. He kicked off all the women. He felt they didn’t participate or add anything. And, in many ways, he was right. His one sister addressed her Christmas cards at the directors’ meetings, his wife did her knitting, and one sister, Sally Bingham, was always asking him inane questions. His mother was arguably the most savvy and smartest person in the room. But just in the interests of not appearing to discriminate, she reluctantly agreed to go, too.

Rationally, this made sense. But emotionally, it was a really stupid move, and very dangerous, because it was more important to make these non-involved family members feel like they had some participation, even if they didn’t have the professional or technical expertise.

The problem was that the son didn’t realize he was the head of a republic—not the head of a dictatorship—and he depended on the trust and goodwill of his sisters and his parents in order to rule.

The problem was that the son didn’t realize he was the head of a republic—not the head of a dictatorship—and he depended on the trust and goodwill of his sisters and his parents in order to rule. Several years later, when he needed their trust and goodwill, he didn’t have it and his father ultimately lost confidence in him and sold his birthright out from under him.

The third generation of the Sulzberger family hired consultants as well—a slew of them. And these advisors came up with an elaborate and complex family council and committee structure that pointedly gives a voice and a measure of power to uninvolved family members, including spouses. Whereas the Binghams ended up fighting over money, the Sulzbergers who stood the most to gain financially actively redistributed some of their wealth to make all family members feel equal and well-treated. The Binghams’ approach could have been lifted from a business school textbook. It was clean and neat and rational. And the Sulzbergers’ looks more like a Rube Goldberg jalopy. It’s not elegant—it’s cumbersome and very time-consuming—but it runs.

The lesson here is that the most important thing is not to make your business look pretty. It’s to make sure it runs. Take outside advice, but always tailor it to the needs and personalities of your particular family.
Bridging The Generation Gap

Lesson number two: the generation gap can be a chasm in ways you might not expect. Each generation in a family business conceives of ownership differently. The founder of the Bingham family company bought the *Louisville Courier Journal* in 1918 with money he was bequeathed by his rich second wife. Even so, he thought himself no less a self-made man than a wildcarder or a peddler who had worked his way up to owning a large department store chain. He bought the paper with his money, and it was his to do with as he thought, period. His original will divided the property evenly among his three children. But when he deemed his older children unfit to carry on, he rewrote his will and without any apparent qualm disinheritent them and gave the entire business to his youngest child, Barry Bingham, and died peacefully two months later.

Barry was not a founding patriarch. He was a second-generation inheritor. And that’s a very different position. Make no mistake, like his father, he considered the paper his, and of course in the end he exercised the ultimate owner’s rights because he sold out. But unlike his father, he saw his role as a steward who was expected to pass on the family jewels to the next generation of stewards. He brought up his five children to think of the paper not as something he owned and shared at his pleasure, but as something that ultimately belonged to them.

In the Binghams’ case the children felt a sense of entitlement, so much so that the professional staff told us they never heard any of the children say thank you for the gifts of stock they received from their parents.

This meant that in a sense the children were co-owners, in spirit if not in fact. That may sound like a good way to instill a tradition of family ownership, but in the Binghams’ case the children felt a sense of entitlement, so much so that the professional staff told us they never heard any of the children say thank you for the gifts of stock they received from their parents. And what was there to be grateful for? To the Bingham children, the parents were only giving something they viewed as rightfully theirs.

The Sulzbergers experienced the same generational tensions, but with an important difference. The family member who bought the *New York Times* in 1896, Adolph Ochs, certainly saw himself as the founding patriarch who owned everything. In fact, like many patriarchs, he found it difficult to let go of anything, and he left his heirs with a terrible tangled financial mess when he died. But because he had just one child, a daughter, the *Times* passed not to a son, but to a son-in-law, and the sense of trusteeship in the second generation was magnified. The daughter, Iphigene Ochs-Sulzberger, certainly felt like an owner, but her husband, Arthur Hayes Sulzberger, the publisher of the paper, felt that his job was basically not to screw up, and to pass the thing that had been entrusted to his care, the *New York Times*, on to the next generation. It wasn’t until Arthur and Iphigene’s son, Arthur Ochs-Sulzberger, known as Punch, became publisher in 1963, that a blood relative of the founder, Adolph Ochs, became a publisher of the *New York Times*. That confidence—the confidence of an owner and an inheritor—made it possible for Punch to make a bold and risky decision like publishing the Pentagon Papers.

But despite these generational differences, the Sulzbergers manage to make sure that everyone, trustee or inheritor, feels that shared sense of mission that comes with stewardship of a great institution. The point here is that every generation has a different perspective on ownership, and this can be a problem unless the central mission is kept just that: central.

Jealousy Destroys

Lesson number three: beware the Harlequin Romance factor. To understand what happened to the Binghams, you have to keep in mind that the family worked much like the solar system. The father in the second generation was the sun, and his five children revolved around him, and chased him and sought him and were jealous of each other’s imagined place in his heart. And he was as elusive as a deer. It kept his marriage a romance, but it made the family into a B movie melodrama. And it kept his children’s children effectively fighting over him until well into their 50s and 60s. It was silly and heartbreaking, and ultimately very, very destructive.

At the same time, there was a similar melodrama of jealousy and spurned affection going on at the highest levels of the professional staff. The object of this battle was the son who was in charge of the newspaper and involved a rivalry of two suitors for the favor and confidence of the family member who was running the company. One suitor was head of the business side of the company and the other was the executive editor of the newspaper. Ironically, it was their rivalry that eventually was the straw that broke the camel’s back and turned the tables against the son and convinced his father to sell out.
Strife among the professional staff can cause the collapse of a family business.

Strife among the professional staff can cause the collapse of a family business. Just because they’re grownups and are highly paid doesn’t mean that smart, talented people, the people who actually make the wheels run at family businesses, are not emotional, jealous, hurt, sensitive and altogether human. The lesson here is that it’s always personal. And in a family business, even though the top professional staff may not own stock or share the blood of the owners, they are not without great power.

**Luck—The X Factor**

Lesson number four: it’s great to be rich, but it’s better to be lucky. Some things, perhaps most things, are out of our control. Some people are lucky and some people are not. The Binghams, for instance, were terribly unlucky. Some people in Kentucky even thought that they were cursed because of rumors that the founding patriarch had murdered his rich second wife in order to get her millions. The family also suffered two early tragedies. One of these was the death of the oldest son in the third generation, the cocky heir who probably would have been able to knock heads and keep his sisters in line and keep the *Louisville Courier Journal* in the family. The other death was of the youngest son in the third generation, the person who was loved by everyone. He could have played the role of diplomat and probably helped keep the paper in the family. But because these two key players were gone, the one son who remained in the third generation had to step up to the plate, and temperamentally he was unsuited to the task. On top of that, he had to wage his own battle with cancer. Without his brothers, there was no one to lead and no one to be the peacekeeper.

The Sulzbergers, by contrast, have been very lucky. The founding patriarch, Adolph Ochs, had only one child, and she and her husband had only one son. In an era of strict patrilineal succession, that made life very simple. In addition, while the founding patriarch’s daughter had arguably been a terrible mother, she was a bang-up grandmother. And, just as important, she lived to be 97. That meant that she had a chance to really influence the 13 grandchildren of the fourth generation, the generation that’s now running and managing the *New York Times*. She was a living link to Adolph Ochs, to the man who actually bought the *New York Times* and brought it into the family. She pounded his values into them; binding them together as a unit and making them feel that their calling in life was to protect what they still call the family jewel: the *New York Times*.

To make this notion concrete, let me quote one of the consultants hired by the Sulzbergers. He told us that he asked all the fourth-generation family members (involved in the business or not) to rank their commitments in life. Their answers blew him away. All of them said their commitment to the institution, to their stewardship of the *New York Times*, was their number one commitment in life. Their number two commitment was to the family and their number three commitment was to their individual goals and aspirations.

**JAN VON HAEFTEN:**

*Turning Bad Luck Around*

The family I am from is the Haniel family that was founded in 1756. In a way, we were very unlucky, but that also meant that we learned how to survive. In our long spell of family history, there have been several wars in Europe. Early on, there were the French Revolution and the Napoleonic Wars. And during that time, a widow, with many young children, had to take over the company and lead it through these difficult years. While that was a difficult period, after the Second World War the company was really in ashes, and my uncles had to come together and start anew and build up from whatever was remaining, which wasn’t much. Over many generations we learned to survive and to use these challenges to find our opportunities, even in the most difficult times.

I think this willingness to reinvent ourselves is what kept us alive over that long and difficult period.
And so it happened time and again—and so we learned to reinvent our company, our family and start anew. I think this willingness to reinvent ourselves is what kept us alive over that long and difficult period.

The Will To Reinvent
During the last 20 years, we have completely remodeled our company. We were in the steel business but we were even stronger in energy, machinery, engineering, and especially coal. Now we are out of all these businesses and have changed the company completely around. During the last 20 years we have understood that we always have to see what our customers want and where the markets are going—we have to change with the markets, which have become very international. We have completely reorganized and changed our portfolio, bought new things, some were not good enough, so we sold them and made money in the process. But now we have a portfolio which is like a conglomerate—six divisions, all with strong positions in their respective markets.

The areas we are now involved in are: the repair of fire and water damage, where we are the only worldwide provider to insurance companies; we are the number one wholesale and retail distributor of pharmaceuticals in Europe; we are in recycling and trading in raw materials for the stainless steel industry, where we are number one in the world; we are very strong in building materials in the middle of the European continent, where we bought a number of companies over the last couple of years that were in distressed situations; we are in the work wear rental and washroom service industry; we are in business-to-business mail order for office, plant and warehouse equipment, where we are number one in Europe; and our 19 percent investment in the number three international retail company in the world makes us the leading shareholder.

Over these years we have realized the compound annual growth rate of 10 percent in sales, 13 percent in cash flow. This is 25 percent greater than the average of all publicly-traded European companies.

When we decided we wanted to go international and really build on those numbers, the first thing we did was we founded an academy where we send all our junior management for continuous training courses because we believe that excellent young managers who stay with us for a long time will guarantee our future. Our current CEO has been with the company for 30 years. We treat our professional management well. In a successful year, we pay them about one-third in fixed salary and two-thirds in variable remuneration. But we don’t go ballistic with enormous CEO salaries, like some of the major companies in the U.S. I think this is very unhealthy and breeds greed. We teach our managers and we teach our family to be low-key and to be modest, especially because we are very successful. And since we have been very successful, we try to be modest.

Careful Stewards Of Family Business
We carefully monitor the success of our companies, and when we feel the markets are turning, we are ready and prepared to sell. We are now in 30 different countries with only 25 percent of our sales coming from Germany. We have learned to be risk-averse, and our business has diversified because most of our family members have most of their wealth in our family company. We try never to be a pioneer, but we try to use new inventions, new technology and apply them.

Twenty-five percent of the annual profit is paid out to the family, which consists of 550 member-shareholders. Since 1870, none of us have been allowed to work in the company. Nobody from the family is in operations, which is very different from most other family businesses. This has proven to be very good, because it gave us a chance to hire the best managers we possibly could get in the international marketplace. We hire and fire our professional management staff. We control them, and we discuss strategy with them. We agree on major investments or disinvestments. And all of this is done through the supervisory board. We have a two-tier system by German law—the family is represented on the supervisory board with eight members as well as the employees being represented by eight of their members. The family members on the board are elected to serve five-year terms by a family council of 30, who in turn have been elected to five-year terms by family meeting.

We also have certain rules that are usually unwritten—one is when you reach the age of 70, you don’t stand for reelection—which is why I am now the retired chairman, and a younger cousin has taken my place.
Audience Questions:

What is the make-up of your shareholder base?
Jan: We have a young body of shareholders; about 20 percent are under age 18. The average age is 37 with the bulk between 18 and 50. Why do we have so many young and so many children as shareholders? Because we pass shares on to every family member so they understand from an early age that they are in a big family and can be proud of their professional ownership of an interesting, big company. This is a long-term perspective and it means long-term responsibilities.

As chairman involved in so many companies, how did you go about making decisions?
Jan: Normally the chairman is in constant contact with top management. That means being on the phone or answering e-mails; I got a lot of information forwarded to me. And usually once a week or so I went to see top management and we had meetings, and I was involved sometimes at the headquarters of the various companies. I tried not to interfere in the day-to-day operations of the business. If they asked me to make decisions that were not my decisions but management's, then I would refuse.

Now hiring and firing, of course, is a very important thing. We usually promote people from within our organization—we very rarely hire someone from outside. We know that everybody makes mistakes, and this is normal. The only thing we don't allow is if someone develops a bad character, then the rule is to get him out of the organization immediately, at any cost. Otherwise, we would rather have management operate through teamwork; if somebody has certain shortcomings we try to balance this within the team.

Subbiah, you also have a very large family business which is based in India, can you compare or contrast your business experience with the Haniel family's experience?
Subbiah: I can tell you that the main difference is that in Haniel's case, no member of the family works in the business. In our case, every male member of the family works, since only the male descendants can participate. The tradition in our family is that the girls born into the family are trained to go out and be close to their husband's family. And the girls that come into the family as in-laws are in charge of the foundation, which supports four schools and four hospitals. Male family members advance within the company only on merit which is decided by the professional managers who are their supervisors.

Is it unusual to see such a deep sense of family modesty and responsibility in relation to the family business? Why is it important?
Susan: I think one of the biggest differences between the Sulzbergers and the Binghams was that the Binghams felt they were better than their business, better than their town. They, in fact, were much better-educated than the Sulzbergers. Many of them went to Harvard. They were handsome, wealthy, involved in all sorts of cultural and social causes.

I think it was very important in the Sulzbergers' case that this was a Jewish family. Adolph Ochs, the son of Jewish immigrants, bought the New York Times in 1896. I think the word modesty can be applied here, too, and it is really key. I think that one of the reasons that the Sulzbergers have succeeded is because their founding ethos as Jews in New York City at that time was to keep their heads down and to be exemplars of the American dream, models of hard work and dedication. And I don't think they ever felt that they were better than their business. I think that they felt, and still feel, that their business is much better than they are. I think they are thrilled and honored to own the New York Times.

Harold: The point that Susan made about religion is one that I echo in regard to the three families that I’ve studied. In the French and Italian cases, a really profound sense of Catholicism creates a deep obligation to the wider world.
And in the German case, a kind of Lutheran pietism runs through the family history and also requires the sort of modesty in presentation, which I think assures that they won’t go into this kind of individualistic hubris that was described of the Bingham’s. Religion for these long-lived families is really a key aspect of the continuity.

Isabelle: I would agree. We found similarities in the more than 60 companies we observed. I think they feel an onus to take care of the company and pass it to the next generation. I don’t think they put themselves first.

I also want to mention the notion that they are not slaves of their shareholders. They feel responsibility to take care of everyone—all the stakeholders: the employees, their family, the community, the customer, the clients. François Michelin, when he was co-CEO of Michelin Group, felt he was responsible for every soul who worked in his company. Michelin is a public company, but if they go bankrupt, the entire family goes bankrupt because their liability includes the assets of the entire family. These great families feel responsibility for their companies and in what we saw, they also keep a very low profile. They are also, in many cases, physically connected with their companies—they live inside of them.

Jan: When I was elected chairman I went to the family and asked them what they wanted to do to further the vision of our family. They all agreed to start a charitable foundation with five million euros and now the endowment is up to 18 million euros. This is the culture within the family, but also the culture within the firm among the managers—it is a common culture that we share and try to develop.

Subbiah: I think it’s very similar in the Asian culture as well. We get together to pray, eat, live and work. It binds us together. Our reputation is more important than profits. So when it comes to reputation, we are willing to sacrifice profits. Profit you sacrifice for one year maximum. But reputation, once lost, is lost forever.

How do large business families ensure that all members of the family feel included?

Susan: The moment where the Sulzbergers had to deal with this kind of question came in the fourth generation, because essentially there were then four branches of the family, all with children. And they actually had long philosophical and practical discussions: “Are we one family or four?” That’s not just a kind of philosophical question. It really has very important ramifications. They all agreed, after much discussion and help from some family business consultants, that they were one family.

I think the strength and number one issue that comes from identifying as one family is in the sense of stewardship. They also do fun family things—they have the biggest family reunions I have ever seen in my life. The point is that there are lots of ways you can keep families together to make people feel a sense of inclusion.

Subbiah: We added a new member in the fifth generation just last night. And I’m sure by next week he’ll be a shareholder. As soon as children are born, we try to make sure that they are included and are given ownership in our family business. That’s as inclusive as we can get.
M. V. Subbiah is the 2005 Visiting Executive Scholar at the Center for Family Enterprises studying aspects of leadership related to families in business. Prior to retiring in May 2004, he worked for 43 years as a third generation member of his family’s business, the Murugappa Group, a $1 billion conglomerate headquartered in Chennai, India. The Group has 23,000 employees and interests in sugar, fertilizers, bicycles, steel tubes, roller chains, abrasives, plantations, sanitary-ware, financial services, nutraceuticals, bio-pesticides and outsourced technical publishing. He is a past president of the Association of Indian Engineering Industries, a predecessor to the Confederation of Indian Industries (CII), the largest Indian industry chamber. Until recently, he was CII’s chairman of the Family Business Council. He has been an active chairman of the Workshop of the Rehabilitation of the Handicapped Trust and treasurer of the Madras Crafts Foundation. Currently, he serves as a trustee of the Murugappa Family Foundation which operates four schools, four hospitals and a polytechnic and research center for bringing appropriate technologies to the villages of India. He serves on four boards and a rating agency in India. He has been recently elected to the board of the Family Business Network in Lausanne, Switzerland. Subbiah studied engineering at the University of Birmingham and has a diploma in industrial administration from the University of Aston, U.K.

Harold James is professor of history at Princeton University with focus on European economic history and modern German history. Some of his recent books include Deutsche Bank (1995), which won the Financial Times Global Business Book Award in 1996; The Deutsche Bank and the Nazi Economic War Against the Jews (2001), The End of Globalization: Lessons from the Great Depression (2001); and Europe Reborn: A History 1914–2000 (2003). His new book, Business Families and Family Business: Wendels, Haniel, Falcks and Continental European Capitalism, will be published fall 2005. Professor James is the chairman of the editorial board of the 55-year-old publication, World Politics: A Quarterly Journal of International Relations. He was educated at Cambridge University and was a fellow at Peterhouse for eight years prior to his tenure at Princeton. In 2004 he was awarded the Helmut Schmidt Prize for Economic History.
Isabelle Le Breton-Miller is a senior research associate at the Centre for Entrepreneurship and Family Enterprise at the University of Alberta School of Business. Her research, teaching and recent publications focus on managing executive successions in family business and creating competitive advantage by building human and social capital in family enterprise. She co-authored Managing for the Long Run: Lessons in Competitive Advantage from Great Family Businesses with her husband and collaborator, Danny Miller, M.B.A., Ph.D. Dr. Miller is research professor of strategy at HEC Montreal business school (Hautes Études Commerciales de Montréal) and research chair in strategy and family enterprise at the University of Alberta School of Business. His current research centers on building competitive capabilities and managing organizational change in family and non-family enterprises.

Susan Tifft is the Eugene C. Patterson Professor of the Practice of Journalism and Public Policy Studies at Duke University’s DeWitt Wallace Center for Media and Democracy. She is co-author of two family business biographies in the publishing industry. The Patriarch: The Rise and Fall of the Bingham Dynasty (1991) was included on Business Week’s list of Top Ten Business Books of the year and was selected by the New York Times as a Notable Book of 1991. The Trust: The Private and Powerful Family Behind The New York Times (1999) was listed on Time magazine’s Five Best Non-Fiction Books of the Year; Business Week’s Top Ten Business Books; the Christian Science Monitor’s Top 30 Notable Books, the New York Times’ Business Books Bestsellers List and it was also chosen as the New York Times’ Notable Book of 1999. It won the A.M. Sperber Biography Award as well as a citation for a notable contribution to the documentation of life in the United States from the Colonial Dames of America and was a finalist for the National Book Critics Circle Award in biography.

She has her undergraduate degree from Duke University and a master’s in Public Administration from the John F. Kennedy School of Government at Harvard University.
Jan von Haeften is the recently retired supervisory board chairman of Franz Haniel & Cie and the Haniel Foundation of Duisburg, Germany. He has spoken many times on the role of families in large family firms. Haniel & Cie is a 249-year-old family enterprise with over 500 family shareholders, 54,000 employees and €23 billion in sales. The Group does business in over 30 countries on five continents with six autonomous divisions: pharmaceutical sales; stainless steel recycling and trading; environmental clean-up; construction materials; work uniform and supply service; and, business-to-business mail order for plant and warehouse equipment. Mr. von Haeften has been active in the Council on European Responsibilities and has hosted the annual Haniel Lecture on pressing issues in global politics and economics that affect business and the wider community. He was the founder and executive vice chairman of The Lehndorff Group from 1965–1992 and was the chairman of the supervisory board of METRO AG of Dusseldorf from 2000–2003. He is a member of the international advisory board of the Institute for the Study of Europe at Columbia University and the advisory board of Wirtschaftswissenschaftliche Gesellschaft and der Humboldt-Universität in Berlin.
Decision-Making and Succession Planning

Wang Laboratories, Inc. was one of the largest, most successful and exciting companies in the United States during the 1960s and 1970s. But it turned into a colossal disaster when An Wang made an early and public commitment to have his son lead the company. This session draws on the Wang case to demonstrate methods for avoiding decision-making pitfalls in succession planning.

HOST:
David C. Blowers
President
Personal Financial Services Illinois
Northern Trust Corporation

PRESENTER:
Victoria H. Medvec
Adeline Barry Davee Professor of Management and Organizations
Executive Director of the Center for Executive Women
Kellogg School of Management
Succession Failure At Wang Laboratories

Timeline For Trouble At Wang Labs

Early 1980s: Cunningham is Number Two behind An Wang. Fred Wang is put in charge of R&D

President: In 1980, when the president, John Cunningham, learned that An Wang wanted to put his son Fred in charge of product planning of research and development, he told An Wang, “You can’t do this unless you’re there to watch over him.”

Board: Board member, Peter Brooke, a successful venture capitalist, was troubled by upper management’s “We know everything” attitude and disinclination to listen. When there were serious production quality problems, Brooke brought in a top-notch, high-level consultancy to meet with Cunningham, Fred Wang and others. During the meeting, Brooke was furious because Cunningham was distracted and Fred yawned. Afterwards, Fred told Brooke that the consultants didn’t “fit Wang’s culture” and therefore didn’t pursue the consultants’ advice.

1986: Fred Wang is named president and COO

Board: When board members discussed leadership at Wang Laboratories, An Wang said of Fred, “He is my son. He can do it.”

1987: Board is concerned

Board: Louis Cabot and other outside directors of the board met with An Wang privately about this five times in 1987, concerned that Fred lacked experience and judgment to have operational control of such a large, worldwide company. They suggested giving Fred a good title, even continuing to groom him for the future, but to hire the smartest, most experienced person to run the company in the near term.

Richard A. Smith, a board member from a successful family business, resigned from the board because he felt An Wang was not listening.

DAVID C. BLOWERS:

Dr. Victoria H. Medvec is Kellogg Professor of Management and Organization and also the Executive Director of the Center for Executive Women here at Kellogg. Professor Medvec is an expert on judgment and decision-making, with a particular focus on how people feel about the decisions they make. This seems very appropriate in the context of family businesses, where everyone has an opinion. Often in the corporate world, decisions are characterized as, “It’s not personal, it’s just business.” But we all know in family businesses, it’s always personal.

In addition to traditional business media like the Wall Street Journal, the New York Times, the Washington Post, and even the Today Show, Professor Medvec’s work can often be found in scholarly journals like Psychology Review, the Journal of Personality and Social Psychology, and Organization Behavior and Human Decision Processes. Her current research explores both independent decision-making and interdependent decisions within the context of negotiations. Professor Medvec’s consulting activities bring her in touch with a wide range of executives at leading corporations in the U.S. and around the world. She is often asked to consult in merger and acquisition situations where she is able to combine her expertise in negotiations with her keen insights into psychological warfare.

It is my distinct privilege to introduce Dr. Victoria Medvec.
When Is A $20 Bill Worth More Than $20?
We are going to start with an auction. What we are going to auction off today is not some beautiful painting but this very nice $20 bill. It’s a lovely $20 bill, don’t you think? There are some rules to my auction. The first rule is this: bidding starts at one dollar and will proceed in one dollar increments. No jump bidding. This next rule is very important. I’m not going to decide that you are paying too much for my $20 and call my auction to a halt. I really am going to give you this $20 and I really am going to take your singles. There is no cartel or collusion allowed. You are not allowed to talk to each other. It’s like in any auction you’ve ever gone to before: the highest bidder will pay what he bid and in exchange he will get my $20. The only thing that makes my auction slightly different from other auctions is my last rule: the second highest bidder must pay what he bid.

Generally speaking I can sell my $20 bill for $100, and in a room like this I can usually sell it for upwards of $200.

Generally speaking I can sell my $20 bill for $100, and in a room like this I can usually sell it for upwards of $200. Why would somebody pay me more than $20 for this $20 bill? Why is it that frequently I sell it for $100, $150? Last week I sold one for $170. Why would somebody pay me $170 for this $20 bill?

I think it has to do with ego, pride, not wanting to lose, competition and paying attention to our losses, which are characteristic of something called escalation of commitment. We have escalation of commitment when we commit to a course of action, the action does not produce a return, and in fact may even produce a loss, yet we decide to commit even more resources in an effort to turn the situation around. Once this escalation gets started, it is very difficult to stop.

How to Diagnose Escalation of Commitment
• Commitment of resources to a course of action
• Action not producing return, may produce loss
• Decision is made to commit further resources in order to “turn the situation around”
• Process may repeat and “escalate” several times as additional resources are invested

Escalation In Succession Planning
What does escalation of commitment have to do with succession planning? Can we make a connection between escalation of commitment and the collapse of Wang Laboratories, Inc.? In the mid-1980s, An Wang, company founder, chairman and CEO, made a commitment to his oldest son, Fred. He had a strong desire to have his son run the business and he made a public commitment to having his son succeed him as company leader.

You are more likely to see escalation of commitment when people have made a very strong public commitment about something.

Public commitment is one of the things that fuels escalation of commitment. We are more likely to see escalation of commitment when people have made a very strong public commitment about something. Let’s say a family business owner publicly commits to his offspring becoming the future leader of his business when the child is 20 years old and the owner is 50 years old, but that transition isn’t going to happen for 20 more years; what can happen in the interim is something quite frightening, which is a failure to update. People often fail to take into account new information. Escalation of commitment is driven by this tendency towards a failure to update information.

Once people make a public commitment to something, they are very reluctant to change their minds, even when objective information emerges suggesting that they may be wrong. They tend to focus on that original commitment and stick to that initial decision.
As I said, escalation of commitment is driven by a failure to update and by the tendency to invest even more resources as the losses grow in an effort to turn the situation around. The further we get into the process, the more we have invested in wanting our son or daughter to run the business, the more likely we are to escalate.

Escalation situations happen all the time. But what makes escalation issues so highly charged in the succession arena is the emotional attachment to the decision.

Escalation of commitment doesn’t just occur around succession issues. Many of us have seen escalation situations in our business investment decisions or in starting a new division. If the new division isn’t going well, we think, “Let me just put a little bit more money into it and surely I’ll be able to turn it around.” Escalation situations happen all the time. But what makes escalation issues so highly charged in the succession arena is the emotional attachment to the decision. Similarly, the pride and ego that might cause somebody to pay $170 for my $20 bill may have played a role in An Wang’s insistence on his son running his business. Ego, pride, public commitment may all have fueled Wang’s escalation of commitment to his son.

Let’s look at our auction once again. Think how hard it would be to stop at $100. It would be very difficult to stop at $100 because it would be difficult to rationalize to ourselves why we had not stopped earlier when our losses were lower. “Why didn’t I stop at $80? Why didn’t I stop at $70 or $60 or $50 or $40 or $30?” And the inability to rationalize to ourselves why we didn’t stop earlier actually fuels the escalation. We keep going because the losses have now grown and it’s hard to explain to ourselves why we did not stop earlier.

See any similarities in the Wang case? Not only did they lose money, but once Fred was put into senior leadership positions, he didn’t always perform well, and there were real objective data suggesting he might not be the perfect person to run the company. So why didn’t they stop before escalating to the point of making Fred the president and the COO, with the eventual goal of having him run the entire organization? Think about how hard it is to stop once we have already invested. It is hard to rationalize why we didn’t stop earlier, before our losses were at such a high level.

An Wang had a plan, which was his older son would run the business and his younger son would later have the opportunity to run the business, but the younger son was much younger, so the plan was, “Let Fred run it for X amount of time and then we’ll have someone else run it.” He definitely was focused on this, but there was a clear indicator here that he failed to update and take Fred’s poor performance in senior positions into account.

How Can Escalation Of Commitment Be Avoided?

- Get several perspectives—avoid tunnel vision
- Redefine the situation
- Change the decision criteria—it’s not “the same old problem” but a “new problem” to be dealt with
- Diversify responsibility and authority
- Define/redefine accountability
- Set a limit of commitment—be willing to “cut your losses”

Exit Strategies

In a family business it is very hard to step out. In succession situations, in addition to putting people into positions, giving them increasing amounts of authority, truly updating and evaluating them, we also want to create exit strategies. We want to create review points with built-in exit strategies that allow us to maintain face and credibility should our decision change.
An exit strategy will allow us to shift from what we had intended and desired should it become clear that the appointed child would not be the perfect person for the leadership role. Or maybe it's a professional leader that we have personally hired and said is the right person to run the business; even when it's a professional manager in that position it is often hard to change course. We need to make sure that we are creating those exit strategies and review points and building them into our system.

We want to create review points with built-in exit strategies that allow us to maintain face and credibility should our decision change.

**Set Criteria**
We also need to set our criteria and lay it out ahead of time. Ask ourselves what we expect to see and what we will do if we don't see the level of behavior that we expect. Do we send that person for some training or more education or do we offer him or her a different experience? If we do not set criteria up front, it is easy to fall into an escalation situation where we are attached to our earlier decision rather than updating and taking into account the new information that we get along the way.

Another important consideration in succession planning is that the business our child will eventually take over may be a very different family business from the one we are currently running. Complexity is going to grow over time, and our business may be a far more multifaceted organization at the time of leadership transition than it was at the time we made our initial decision.

**Avoid Confirmation Bias**

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**Implications:**
- Decisions become self-fulfilling prophecies
- How much can we learn from success?

One of the things that fuels the escalation of commitment is that we tend to seek confirming information; often we overlook or discount disconfirming information.

As individuals we seek confirming information and we are really good at saying what is good about our idea. We don't ask what is wrong with our idea or seek the disconfirming information. This is a key issue in succession situations. We tend to find all the reasons why we should be promoting the person we want to run our business and we gather the confirming data to suggest that this is the right person. But is there also information that would suggest this is not the correct person?

We tend to hold disconfirming information and confirming information to different standards of proof. In fact, we hold disconfirming information to a much higher standard of proof. If we have a particular successor in mind and we’re talking about this individual in a board meeting we may say, “I think he’s going to be great for this business. He’s got exactly the right set of skills and an unsurpassed knowledge of our industry. I think he fits really well with the culture of the business.” We are often willing to accept all of that confirming information at face value.

We tend to hold disconfirming information and confirming information to different standards of proof. In fact, we hold disconfirming information to a much higher standard of proof.

But what if someone says, “I have a concern about his ability to lead a team in a challenging situation. I don’t see much evidence that he has really led his team well in crisis situations.” What do we say in response to that disconfirming piece of information? We say, “Where is the proof? Where is the evidence, the hard facts to support that?” We often want to see the proof for the disconfirming side, whereas we are willing to accept the confirming side at face value. We hold disconfirming information to a much higher standard of proof, and that causes us to fall into this confirmation trap, where we only gather information that confirms our initial hypotheses, our desires, our interests.

**Non-Family Viewpoint**

There were people on the Wang board who had disconfirming views of Fred. But to what extent did An Wang consider those perspectives of fellow board members and to what extent did he pull out that information? The disconfirming evidence from the board—Fred’s questionable performance, customers’ concerns about him, and
negative media reports—were all overlooked because An Wang wanted his son to be his successor and he gathered the data to suggest that it would work. He sought out confirming information.

In addition to listening to the views of non-family board members and executives, it is important to identify the feelings of the employees as well. Not that the employees should select a successor, but employees certainly have information that might be useful in selecting one.

Know What You Don’t Know

Overconfidence
We paradoxically express more confidence in estimates of events where we are less familiar than with events where we are more familiar.

Can Affect:
• Decision-making power
• Data interpretation

This highlights something that I want to examine briefly, which is the relationship between expertise and confidence. When I use the word “expertise,” I don’t mean broad knowledge and overpowering intelligence, but rather closeness to the current data. In general we would expect that the more people know, the more confident they are. The closer to the data they are, the more they know about a situation and the more confident they should be. There should be a positive relationship between expertise and confidence but there is actually a negative relationship. The less we know, the more overconfident we are.

When we know a lot, we are not overconfident because we know there is much more that we need to learn; we are aware of what’s missing in our knowledge, and where we are weak. When we are not very wise, one of the things we are not aware of is how much we don’t really know. I often say, “We know just enough to be dangerous.” Those are the truly overconfident people.

There should be a positive relationship between expertise and confidence but there is actually a negative relationship. The less we know, the more overconfident we are.

How do we gather data to reduce this overconfidence bias? In the context of a company operating in many different markets with many different operations going on, where might we gather some data on how this person would operate as the leader? On whether people respect him? The other top executives in a family organization might be very careful about saying anything negative about the pre-selected leader unless care is taken in how we collect this information.

If we are going to talk to employees, we have to be sensitive to the fact that they may not want to offer up disconfirming information if they could feel threatened by it. We want to get data from people who are close to the source, but we also want to think about what channels we use to gather that information.

In the Wang case, the employees in Fred’s troubled division would have been a useful source of data. They might have been able to identify the problems and Fred’s challenges in handling them. Had An Wang actually looked for it, employees could have provided quite a bit of disconfirming information; not only were key employees leaving, but others were actually telling An Wang of their concerns. That’s a dangerous move. If an employee is willing to come and tell us that he doesn’t think our son is the one we should choose, we might want to take that seriously, because the information is of great personal cost to that employee; yet in the Wang case this information was overlooked.

The further removed we are, the more overconfident we may be in our judgments because when we are far away from the data we don’t know what it is we don’t know.
Who might be the most overconfident on succession issues? The current chairman, the current CEO and the current board may actually be the ones who are most prone to overconfidence. That is because they are far removed from the situation, and the further removed they are from the situation, the more overconfident they may be in their ability to assess whether or not the chosen person will do a good job. As I said earlier, that does not mean by any stretch of the imagination that the employees should be selecting the successor. Clearly, the board should be playing a role in selecting the successor; but it also means that part of the process should be to include data from those who are closest to the situation. We want to make sure that all the information is not derived solely from people who are far removed from the situation. We want data from customers and employees because we want to guard against overconfidence. The further removed we are, the more overconfident we may be in our judgments because when we are far away from the data we don’t know what it is we don’t know.

**Anticipate The Unexpected**

An Wang thought he could put his son in the leadership position since he would be the protective umbrella under which his son would operate. But then, An Wang was diagnosed with cancer, and that drastically reduced his ability to serve in the protective role. As the case shows, An Wang paid a significant price for not seeking disconfirming information (such as not paying attention to his board, and not listening to the employees). The business went under. I think that An Wang had the intention to still be there in some capacity but when he wasn’t, Fred wasn’t equipped to take on the leadership role. And the key question is, were there indicators to suggest that this would be a problem, and, if so, was attention paid to those indicators?

I hope none of you who are in family businesses have a succession decision announced that goes more than five years out from now, where it’s clearly apparent to everyone who the successor is meant to be. Why am I hoping that? Because making public commitments about succession early on is a dangerous move. People do not want to lose face or credibility over a questionable decision, yet most don’t update their information. Once a public commitment is made, people start to gather information to support their positions. In order to avoid escalation situations, I discourage making commitments too early.

**Availability Bias**

Another succession concern is called availability bias. Availability bias suggests that information that comes to mind easily is judged to be more likely. The more easily we can come up with an example, the more we overestimate its likelihood of occurring.

For example, how many of us as parents have considered flying on separate airplanes from our spouses to lessen the chance of an accident happening to both parents? Yet, how many of us, when traveling by car, have ever considered driving in separate automobiles? We are more likely to die in an automobile crash than in an airplane crash. So why is it that we are flying on different airplanes, but not traveling in different cars?

I would argue that availability bias is playing a role. When airplane crashes occur they are very salient to us. Death and airplane crashes, that message goes together for us because they are highlighted on the front page of the newspaper. We see all the people who died. And in most
when Johnny was 10 and he burned down the house and they think, “Would I really let Johnny ever run the business? I mean, look what he did to the house.” Independent directors bring in an external perspective, a different view. It’s not that they have less availability bias, they just have availability bias about different sets of events.

One of the challenges is that the family has a lot of shared history, and that means they have a lot of shared availability bias. Their availability bias is all pulling in the same direction. They anticipate that what they have seen before will occur again and they ignore the base rate for the likelihood of that actually occurring. They overlook that base rate and pay attention to how salient and how easily information comes to mind. An external board, those independent directors, helps to control for this availability bias.

Framing The Data

Let’s look at how we are collecting the data and the frame that we’re using in discussing the situation. Framing effects play a role in the decisions we make. When data are framed as losses people tend to be risk-seeking. When data are framed as gains, people tend to be risk-averse.

For example, my friend and I have been betting on basketball. Because I don’t know very much about basketball, I owe my friend $600. So I say, “How about if we go double or nothing on the championship game?” Notice that the bet sounds pretty good to me because I am in the domain of losses and when I am in the domain of losses I am risk-seeking. I prefer the risky chance of losing more rather than accepting a certain loss. That bet may not sound so good to my friend, though. He’s got 600 of my dollars in his pocket. He’s in the domain of gains. When we are in the domain of gains, we are very likely to maintain the status quo.

How does framing apply when thinking about succession planning situations?

The frame that we are using in considering a situation may affect our judgment, because if we are paying attention to losses...we are more likely to move away from the status quo. If, on the other hand, we are paying attention to gains...we are very likely to maintain the status quo.
Succession planning is not always about making a new decision; it does not always occur at the transition point of moving from one leader to another. Succession planning may be centered on whether the current leader is the right person to remain in the job. It may be centered on an evaluation point when considering if this person should continue in his role. My concern is that if the succession frame is focused on our losses, it may affect our judgment—profits are down, we are losing money and customers—I predict that we are more likely to make a change. We are more likely to move away from the status quo when we are paying attention to losses. If, on the other hand, we are focused on gains—we have added business, increased profits—we are very likely to maintain the status quo. The status quo may not be perfect, but it is not uncertain. The person who is holding the status quo position definitely has an advantage because we like the status quo, in fact, in order to move off of that status quo, losses are going to have to loom very large.

However, both of those situations could be occurring at the same time. It could very well be that we are losing money, but adding new customers. It could very well be that we are making gains in profitability, but our costs are going up dramatically. Those situations could be true at the same time. Our decision is going to be influenced by the set of facts we focus on, because when we pay attention to losses, we are going to be more risk-seeking; when we pay attention to gains, we are going to be more risk-averse.

Framing An Action

Framing
- Changes the “problem” but not the data
- We are risk-averse to gains
- We are risk-seeking to losses

Let me give you an example of framing an action in a board situation. Because my specialty is negotiations and decision-making, I was brought in by the president of a company division to help him make a presentation to his board. His division’s business condition totally changed due to an external environmental factor. It was unexpected and it was horrible for business. This was in a medical company and they were losing doctors left and right. The division president anticipated that unless he got a major infusion of cash from his board, he would be out of business in nine months.

His problem with the company board was its reputation for being slow to act; it generally took about nine months for the board to make decisions on giving cash to any of the divisions. This was a big concern to him. I went in to meet with him and he thought he was mostly ready for the board but he just wanted me to shape his comments a little. He proceeded to show me his slides for the presentation which said, “Currently we have this amount of market share, and if you give us this additional influx of money we can take advantage of that and we can grow to having this market share. So, here are all the benefits to you giving us this cash.” And he listed the benefits.

I told him that we were going to toss those slides and talk about losses. We needed to say, “We used to have this many doctors. Over the past month we have lost this many doctors. Given what we have seen, we are going to lose this many more doctors over the next month, and by six months from now we will have no more doctors.” He said, “We don’t talk like that in this company. We do not talk about the down side. We talk about the opportunities, the benefits, the advantages. That’s how we talk around here.” And I said, “That’s why it takes your board nine months to make any decisions.”

A culture that focuses on the upside is usually risk adverse and slow to make changes.

When you have a culture that highlights and focuses on gains, opportunities, benefits, advantages, the upside—you tend to see a very risk-averse culture that will be slow to make changes away from the status quo.

I said to him, “You know what, you told me it usually takes your company nine months to invest in anything, and you told me that in nine months your division will be dead and you will be out of a job. What do you have to lose?” In saying this, I was framing the problem for him. I wanted him to pay attention to his losses because I was trying to generate some risk-seeking behavior.

We changed all the slides. He made the presentation and at the end of it the board asked him to step out of the meeting. Ten minutes later his board came to him and gave him all the money he requested. He was shocked but I wasn’t surprised at all because framing is extremely powerful. We must pay attention to how the board is being shaped by the frame in which they are considering the data. Framing does not change the data; framing changes the question that we are asking.
In addition, in succession evaluation decisions, think about the frame you are applying, because the frame may be affecting the decisions you are making.

Thus far we have talked about the importance of getting disconfirming information, avoiding escalation traps, making sure that you are updating, not making public commitments too early, setting up decision criteria for someone before the public commitment to them is made, and creating exit strategies where you can shift away from the current decision if you gather data that suggests it’s the wrong decision. We have talked about the importance of controlling for availability bias, watching out for the frame that’s being attached and making sure that we are getting data from those who are close to the situation and who are not overconfident. We have pointed out the importance of the customer and the employees in bringing that data into the discussion since they are closest to the situation at hand. All of these are important, but then we have to think about the board meeting. I would argue that Wang Laboratories could have done all of that, and we could still have had An Wang stand up in front and say, “I know my son can do it. He’s my son and I want him to lead the organization,” and we may have ended up in exactly the same situation. So what else do we have to do? We have to think about how that board meeting is being run and how data is being collected in board meetings.

Gathering Unique Information
What I’ll discuss next is not descriptive of boards around the world today, but I think it is prescriptive. It is not how it is currently done; it is how it could be done better. I think a huge failing of the most recent board regulations like Sarbanes-Oxley is that it pays a lot of attention to who is in the seats, as though the problem in corporate governance is who is in the room. That may have been a problem in yesteryears, but I think a far greater problem today is what the people in the seats are doing when they get there. How is the board meeting being run? How is information being collected?

We have to think about how to overcome common information bias and how to circumvent the common information effect to extract the unique information that each board member possesses.

Another bias to which you should attend is called the common information effect. This is a huge concern in boardrooms because we put together boards as experts. We gather our experts, who possess diverse knowledge from a vast array of businesses and industries, and we believe that this collection of experts will do a far better job guiding our company and making decisions than any one person could do alone. But the problem, when we gather this group into a room, is what they generally talk about—the common knowledge, the stuff they all already know, rather than their unique expertise, which is the reason you put them in those seats in the first place. We have to think about how to overcome common information bias and how to circumvent the common information effect to extract the unique information that each board member possesses.

One way to get out unique information is private collection of data. Have the board write things down before it is talked about. Why? Because once they write it down, we gather their unique thoughts before they hear the discussion and everyone else’s views. We capture that unique expertise and we make sure that it becomes a part of the discussion. Once the conversation starts, we get caught up in the common knowledge, the stuff we all already know, and the conversation starts to get anchored around the first point. Whatever the first point is, that’s the tangent that we’re on now. Capturing the unique information prior to discussion allows us to steer the conversation in a different direction.

Writing down thoughts prior to discussion prevents something called hindsight bias. Hindsight bias happens once I’ve heard Speaker One’s point. After I have heard his point, I can’t actually tell you what I was going to say, because my pre-Speaker One thought and my post-Speaker One thought have now been assimilated. I can’t pull out that unique view I held before I heard his point.
Magnitude Of Opinion

When we publicly collect information, we never know how strongly people feel.

One of the biggest disadvantages of public discussion in the boardroom is that we never know how strongly people feel. We have no magnitude measure—we may think we do by watching how aggressive they seem, how loud they are, how passionately they speak—but that is all completely confounded with personality. So really, we do not know how strongly people feel. If there is someone who is quiet on our board but has a very strong opinion, we may think that his opinion is not nearly as strong as the person who seems really passionate and animated and loud but really has a kind of moderate opinion. We are going to misinterpret that the louder opinion is stronger. When we publicly collect information, we never know how strongly people feel.

When a decision is not black or white, magnitude matters.

Does that matter? I think it matters quite a bit, especially for the CEO. I think that by the time a decision reaches the CEO, it is not black or white. If it had been easy, somebody else would have decided. By the time it gets to the CEO level, by definition it is a hard decision. By the time something reaches the board level, it is absolutely a difficult decision and it is not black or white. When a decision is not black or white, magnitude matters.

Imagine that we have three options for the successor of our business, and I say, “Mel, who do you think it should be?” Mel says, “I think it should be Person One.” And I say, “Joan, who do you think?” Joan says, “It should be Person Two.” And I say, “Adam, who do you think?” Adam says, “Definitely Person Three.” What do I know? I know that three of my board members don’t agree. But if I say, “Before we talk about it, take 100 points and divide them between those three options.” I see Mel likes Person One better. He would give 40 points to Person One, 30 points to Person Two and 30 points to Person Three. I see that Joan likes Person Two better. She would give 30 points to Person One, 40 points to Person Two and 30 points to Person Three. But Adam has a very strong feeling about Person Three. He would give zero points to Person One, five points to Person Two and 95 points to Person Three. I want to know what Adam knows. I want to know if he had a conversation with somebody or has seen some data that I have not. I want to know what is causing him to have this strong of a view.

Magnitude is missing in most board discussions. We never know how strongly people on the board feel about a particular discussion.

Magnitude is missing in most board discussions. We never know how strongly people on the board feel about a particular discussion. Knowing the magnitude of his board’s feelings could have benefited An Wang in his succession decision. There were many mistakes that were made: public commitment, an announcement too early, escalation of commitment, not updating, not taking into account new information and moving the son out of challenging positions. Lots of mistakes were made. Some of the board members saw the mistakes and clearly did not support this decision. Some were strongly opposed. But did An Wang ever have a sense of how strongly opposed they were? That’s what you have to wonder. Private collection brings out a lot of information that public discussion overlooks, and in particular it brings out that unique expertise and the magnitude of people’s feelings, the strength of their viewpoints.

I hope this was helpful and that it will remind all of you that one of the most critical decisions you will make is choosing a successor for your family business leadership. It is an important decision and you need to pay attention to these biases, and, more importantly, to how you can overcome these biases to make sure that you are making the best possible decision for your family business.
Victoria H. Medvec is a member of the Management and Organization Department at Kellogg, where she teaches courses such as Leadership in Organizations and Negotiations to M.B.A. students, as well as specialty programs to executives worldwide. She received her B.A. from Bucknell University and her Ph.D. in psychology from Cornell University. Her research focuses on judgment and decision-making, with a particular emphasis on how people feel about the decisions they have made. Current research explores both independent decision-making and interdependent decisions within the context of negotiations. She has won four teaching awards at Kellogg and in 1999 was named to the Adeline Barry Davee Chair.

David C. Blowers is responsible for all personal and private banking, trust/fiduciary and commercial banking services provided through Northern Trust’s main Chicago complex and 19 financial centers in the metropolitan area. He 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 vice chairman of the Chicagoland Chamber of Commerce; a trustee of Network Chicago; a trustee of the Music and Dance Theatre Chicago; a director of the Friends of Prentice and also the Heartland Literary Society. 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 and the Exmoor Country Club.
Panel: Family Values and Great Business Culture

Business leaders from Baird & Warner Real Estate, Inc. and Pella Corporation examine the role of enduring core family and business values in the success and longevity of their companies. For six consecutive years, Pella has been rated one of Fortune Magazine’s 100 Best Companies to Work For, and Baird & Warner won two awards in 2004, including a Fortune Small Business/Winning Workplaces Best Bosses Award for current president Stephen W. Baird, a Kellogg School of Management graduate.

Kellogg student members of the Family Enterprise Club chaired and introduced the panelists.

FACILITATOR:
Barry Merkin
Clinical Professor of Entrepreneurship
Management and Strategy
Kellogg School of Management

CHAIRPERSONS:
Christopher Gallo
KSM Class of 2005
E. & J. Gallo Winery
Modesto, California

Charles Farver
Chairman
Pella Corporation
Pella, Iowa

PETER H. “P.J.” Huizenga, Jr.
KSM Class of 2005
Huizenga Capital Management
Oak Brook, Illinois

Jennifer Alter Warden
Senior Vice President
Baird & Warner Real Estate, Inc.
Chicago, Illinois
BARRY MERKIN:

 Permit me to introduce this session on a personal note. Many years ago, I achieved the rank of Eagle Scout. I was extremely proud of the accomplishment. It had taken years of very determined and serious effort, but I felt rewarded by the learning and experience I had gained. It never occurred to me, however, that those same principles that I learned in scouting as a youngster would be helpful decades later in business.

 Again and again, I had pledged to be trustworthy, loyal, helpful, friendly, courteous, kind, obedient, cheerful, thrifty, brave, clean and reverent. Somewhat automatically, I had repeated those words hundreds of times. On occasion, I took a few minutes to understand their meanings, but only about as much as is possible for a 14-year-old.

 Many of us now realize the extent to which wisdom is wasted on young people and it was only years later that I began to fully understand the power of these concepts. It is not an exaggeration to say that any person or group of people, any organization or company or state or country would be stronger by embracing this set of principles. A fact, I believe, that has always been true but now seems to grow more significant with each passing year.

 The point is this. There is no question that these “Boy Scout” principles are more likely to be found in family businesses than in other organizations. By embracing these principles into its culture, family business has attained sustained strength and ongoing success.

 To express this lofty theory in a more tangible way, here’s one way I look at it in real life. Given the choice, I’d always try hard not to compete against a family business.

 CHRIS GALLO:

 I’m a co-chair, along with P.J. Huizenga, of the Family Enterprise Club, which was founded in 1999 by three Kellogg students, among them was my cousin Stephanie Gallo.

 My family’s business was founded in 1933 by my grandfather Ernest and his brother Julio, in Modesto, California. In the beginning, the family didn’t know too much about the wine business or about growing grapes. As the family story goes, the brothers went to the library in Modesto and checked out two books on winemaking from the University of California at Davis that they found in a pile in the library basement. With the books in hand, they immediately got to work building the company.

 From the beginning, each brother gravitated towards the area of the company where he felt most comfortable. My great uncle grew the grapes and made the wine, and my grandfather went out and sold it.

 The brothers were quite forward-looking and continuously focused on improving the business. Julio would spend his efforts in the vineyard experimenting with various grape-growing and winemaking techniques, while Ernest looked to the market for consumer trends. They knew that most of their research would take years to yield a useful result. Most of their research was not meant to benefit the next fiscal quarter, but rather the next generation of family winemakers. As a family company, we’ve been able to sustain this long-term view. Perhaps the most fundamental value that they instilled in the company was a tradition of respect for each other and for the employees. Ernest and Julio realized they were two very different people. They had very different personalities, interests and skills, but they realized, in Kellogg fashion, that these differences made them a stronger team. And they used these differences to lead the company towards success rather than to tear it apart.

 As a family company, we’ve been able to sustain this long-term view. Perhaps the most fundamental value that they instilled in the company was a tradition of respect for each other and for the employees.

 An essential part of this respect was honesty. They were always forthright with each other. While this could be very difficult and painful in the short term, in the long-term they had a stronger relationship.
Those of us in the third generation realize that we are all very different people with different interests; but because of the foundation of respect and honesty instilled in the company by our grandfathers, we are able to get along and work well together.

P.J. HUIZENGA:

With a horse and wagon, my great-grandfather began picking up trash on the streets of Chicago 110 years ago. The garbage industry was socially disgraceful and the business stunk—literally! He was looked down upon by everyone, including other immigrants because of his profession.

But he thought differently about the industry. He saw an industry that could provide steady cash flow for his family and where he didn’t have to work for anyone, but could be his own boss. He also saw an industry where he could grow the business to bring in his sons someday.

Since he was his own boss, he didn’t have to work on Sunday, which was a perfect fit for a Calvinist. My great-grandfather incorporated those Calvinist values into his business: In anything and everything you do, Do it with hard work and pride to honor your Creator; Establish strong relationships with family and friends; Have unwavering faith in God; Learn from life’s lessons; Don’t be afraid to think differently or act differently; Don’t be afraid to take risks; Be a servant leader, treating your employees the way you’d want them to treat you, namely, with respect and honor; and Give back to your community, in terms of time and resources, humbly.

My father and uncles used these values… transforming what was once Huizenga & Sons Private Scavenger, into Waste Management, servicing over 27 million residents around the globe.

These values were passed to each generation through my great-grandfather’s example and through family get-togethers. My father and uncles used these values to take advantage of an opportunity they saw within the garbage industry—transforming what was once Huizenga & Sons Private Scavenger, into Waste Management, servicing over 27 million residents around the globe.

Since then, my family established a family investment office and has applied those same values to that endeavor, investing in hedge funds, private equity, oil and gas and real estate. We’ve been fortunate to have been a part of companies such as Waste Management, Blockbuster, Boston Chicken and many others.

Passing down family values from generation to generation has helped to make a highly successful business culture for us. I don’t think we would have attained the level of success we have without these core values.

I now have the great pleasure of introducing our first panelist, Jennifer Alter Warden who represents Baird & Warner which has been recognized as one of the finest places to work in America. Baird & Warner is the largest independent real estate brokerage company in Illinois and the oldest in the country. It employs 1,850 professionals in 31 offices, with annual revenues exceeding five billion dollars. The firm has been owned and operated by five generations of Baird family members, dating back to 1855.

The Baird’s don’t stand on their laurels. According to Baird & Warner’s president and CEO, Stephen Baird, “People don’t buy from us because we’ve been in business forever, although our stability and reputation help greatly. People buy from us because we’re progressive, innovative, competitive and aggressive in the marketplace today. Nobody can run their business on reputation alone.”

Jennifer Alter Warden, ironically, comes from a third-generation family business, but she chose to go off on her own. Jennifer now is senior vice president of Baird & Warner and a member of the firm’s executive committee.
JENNIFER WARDEN:

Baird & Warner, A Market Leader

I am speaking to you today in Steve Baird’s stead while he is out of the country. Steve is the fifth-generation owner of the oldest independent real estate brokerage in the country.

In 2004, we had the honor of receiving two very prestigious awards. One was the Ernst & Young Entrepreneur of the Year Award and the other was a Fortune Small Business/Winning Workplaces Best Bosses Award, which went to Steve who is our president and CEO.

Steve has responsibility for the day-to-day activities of the business, although his father, John Baird, who just turned 90, still comes to work every day. At the beginning of the year John said that he was going to take Wednesdays off. I think he’s taken off one so far.

Baird & Warner is celebrating its 150th anniversary this year. But, as we all know, old doesn’t necessarily mean successful. And in reflecting on our history, I’m struck by how each generation has taken the company in a new direction, reinventing it to keep pace with the changing marketplace.

Incidentally, in case you were wondering how a 150-year-old company could win an Entrepreneur of the Year Award, we actually wrote the application pointing out that we needed to reinvent ourselves about every quarter of a century and that required a number of entrepreneurial skills.

“Good Will is something we cannot buy in the open market. It has to be earned—and nothing will acquire it quite so rapidly as Courtesy, Cheerfulness and Respect.”

—WYLLYS BAIRD, 1925

Core Company Values

While our current business model bears no resemblance to what it was in 1855, or even 1955, the family’s core values are so distinct that they’ve been passed to each Baird generation virtually intact. Themes we’ve heard repeatedly at this Conference include integrity, honesty, empowerment, and open environment. They coordinate nicely with our values of courtesy, cheerfulness and respect. It may sound corny, but the Bairds believe in these values and they live them everyday. It’s simply who they are, and, by extension, who we are as a company. You’ll find honesty in our deep commitment to ethics and professionalism. Upon joining our company, our agents go through a two-week training program that focuses not only on sales and service, but on the importance of treating clients honestly and ethically and upholding the law. We also provide our office managers with on-going training tools to reinforce the same principles. And we have an attorney on staff who travels throughout our network, keeping agents abreast of the law.

You will find integrity in our willingness to stand up and do the right thing even at the risk of losing business. John Baird did just that in the 1960s when he became an advocate for open housing and urged the passage of civil rights legislation that would ban racial discrimination in the rental or sales of homes. This was very controversial at the time.

Steve manages by empowering his staff. Because of his style our staff is now full of people who love the challenge of a blank slate and love having an opportunity to make their mark.

Steve is very accessible and encourages an open environment. Anyone can stop by his office anytime. He returns his own voicemail and e-mail, and he’ll talk to anyone about anything, from motorcycles, to fly fishing, to business, of course.

Giving Back To The Community

Another important Baird value is commitment. The Baird family’s commitment to the community is legendary. While their affiliations with civic and philanthropic organizations are too numerous to name, their commitment to community plays out in the workplace in a very tangible way. The Bairds felt so strongly about giving back to the communities
that made us successful that the company started a charitable initiative called the Baird & Warner Good Will Network. Through this network, we take a small sum from each real estate transaction, shared by the agent and the business, plus mortgage transactions, and contribute the money to a fund that makes grants to organizations that provide shelter. Not only is that a reflection of the family’s commitment to community, it’s also a good illustration of the empowerment value at work. This initiative is run almost entirely at the grassroots level, so that the selection of the charities, the coordination of the fundraising and the activities are done primarily through agents in our local offices. Empowering agents and employees to do this has not been the easiest way to administer this initiative. But it has undeniably driven its success, because the level of participation in our offices is so much higher than if we had just selected the charities from the top down.

Promoting The Core Values
How do we promote our values among our 247 staff members? To some extent a lot of this is intangible. It’s passed along by osmosis, by simple daily events, by mentoring, by observing the golden rule. But we also have formal tools in place. Every year we present a Good Will Award to the individual who most personifies the qualities that are identified in our Good Will Statement. This is the jewel in the crown to which people aspire.

We also use our intranet; we’ve taken the newsletter to an interactive level, and continually highlight stories that reinforce our values. And, in terms of encouraging an open environment, Steve goes to each office to chat and share a bag lunch with our agents at least once a year.

Let’s look at ethics and professionalism. We had more than 18,000 real estate transactions last year and fewer than five legal issues. We are the envy of our industry.

The all-important question is: How do these values translate into business? Let’s look at ethics and professionalism. We had more than 18,000 real estate transactions last year and fewer than five legal issues. We are the envy of our industry, and we are sought out by error and omissions insurance carriers. How about empowerment? In an industry that’s not necessarily known for paying top dollar, we have a bevy of highly-talented managers, both men and women. These managers have been captured by Steve’s vision and by the opportunity to help design something great. When it comes to securing a loyal workforce, we’ve found it’s not always about money. You will have loyal workers if you give them opportunities to see their work come to fruition.

We generate plenty of publicity with the Good Will Network because agents from 31 offices are helping organizations in their communities. We can directly track agents who have asked to join our company through reading about the Good Will Network, and sellers who have listed their properties with us because they want to do business with our kind of company.

I asked Steve if he thought his values were reflected in the organization, and he said, “After a period of time, organizations take on the character of their leaders. You can’t hide in a family business because your organization will reflect it. Ultimately, everything will come out in the wash.”

I think keeping the family’s values relevant to the organization is a fundamental challenge for those of you with your name on the door, or, in our case, on the yard sign.

CHARLIE FARVER:

Pella’s People
I will not present you with myriad numbers, statistics or empirical data. We’re a company driven by metrics, passionate about process, striving to consistently improve and vigorously competing every day for more market share. However, underlying our measured and calculated efforts are our culture and values, those things that keep the people of Pella safe, striving to improve, respectful of each other, with special emphasis on alignment and making everyone feel like an owner.
“Pella Corporation is not windows and doors. It’s not facilities and equipment. Pella Corporation is people.”

Overview
Pella has 11 manufacturing locations—five in Iowa, six outside of Iowa, with our newest plant being built in Macomb, Illinois. When we advertised the opening of the plant, we were looking for 250 new employees. In the first week, we had over 9,000 people pick up an application.

We go to market through two channels—our Pella distributed sales network, and over 1,200 Lowe’s and Menards stores and a number of Pro Dealers including 84 Lumber. We transact business primarily in the United States, Canada and a limited world market. We are a world-class team of people committed to making high-quality innovative products based on the needs of our customers. About half of our market is new construction, half is remodel and replacement. Eighty percent of our market is residential and 20 percent of our market is multi-family and commercial.

How and when did this all start? Our founder, my mother’s father, Pete Kuyper, purchased a company in 1925 that had a patent on an innovative and proprietary product called a rolling window screen, which we renamed the Rolscreen. It was and still is one of our most innovative products.

Then in 1937 we started making windows. Our first casement windows embodied some of the numerous innovative design features that we’re still selling in our products today. We recently totally redesigned our designer line, which incorporates the Rolscreen into between-glass shades and blinds and window fashions. Our early innovations still have a prominent place in our product lines today.

Transition To Professional Management
We went through a catastrophic period of time...here we were, a family company left without our family management that had been in place for over 50 years.

We transitioned out of being a family-owned and managed company in the early 1980s. We went through a catastrophic period of time when my father retired from the business and then, unexpectedly, my uncle and grandfather died. And here we were, a family company left without our family management that had been in place for over 50 years.

At that time my mother became chairman. We had a strong outside board of directors. We promoted the professional manager within our company to lead the company as president and CEO, and thus began the transition from family-owned, governed and managed to family-owned and professionally-governed and managed. Our current board of directors consists of seven outside directors, two family directors and two management directors.

Honoring The Core Values
My grandfather was a very prolific writer, and in 1972 one of his friends collected, catalogued and put together many of his writings from over the years. These bits of wisdom, some from as far back as 80 years ago, continue to permeate and weave through our company and culture. Family values are the foundation for the culture that lives at Pella. It guides our thinking, our actions and how we treat people. This idea, these philosophies, these core values—our vision, our mission statement, our imperatives are communicated to every new employee within the first week at Pella Corporation. We refer to this as our total competitiveness system and it is posted on the walls, and referenced in meetings. We talk about them all the time.
Family values are the foundation for the culture that lives at Pella. It guides our thinking, our actions and how we treat people.

The core values are the building blocks for this system. They are the bricks; they are the foundation of our company. Briefly, here are our core family values.

**Human Institution And Integrity**
First, we are a human institution that values teamwork, safety and respect for the individual. Our employees learn to value the diversity within our company. We spend considerable time on ethics training—with the recent sad events in the corporate world and now the Sarbanes-Oxley legislation, we felt it was time to specifically state our code of corporate ethics. We have a Pella ethics statement from our president and CEO, Mel Haught, which is now translated and transmitted to all of our team members. It appears in our annual report. It also contains a message from our corporate legal department which makes the ethical requirements for a Pella team member eminently clear. If you violate any of these areas—trustworthiness, respect, responsibility, fairness, caring and citizenship—you can get a pink slip out of our company in a hurry.

**External Focus**
Second, we stress an external focus that measures our actions by how well we satisfy our customers. We emphasize an outward-looking, marketplace, customer-based focus.

**Simplicity And Continuous Improvement**
We reward simplicity over complexity and action over bureaucracy. We have continuous improvement team meetings. We involve every member from every aspect of our company in these events. Year in and year out, we take our culture of continuous improvement into the field, we bring in our vendors, and we bring in our customers. It’s been a tremendous tool for boosting productivity and involvement.

**Sharing**
We share 25 percent of our pre-tax profits with employees, which is much more than we share with our shareholders.

We are very keen on sharing as well. My grandfather handed the first retirement check from our profit-sharing plan to a team member back in 1953. We share 25 percent of our pre-tax profits with employees, which is much more than we share with our shareholders. But it’s a great investment and it pays huge dividends every year. Our team members know that our profit-sharing plan is based on productivity and our continuous improvement process. They know that as they invest with us in making our processes more productive, in reducing waste, and bringing in new ideas from throughout the company they will gain firsthand the rewards of those investments.

My grandfather also said, “We must give our best effort, put in an honest day’s work, figure out how we can do things better and how we can build better products. Then when our children and grandchildren get a job at Rolscreen in the year 2000, they too will say it’s a good place to work and I’m proud of my job.” He made that statement in 1962, when we were called Rolscreen Company, and thank goodness we are still carrying on his dream in 2005, and hopefully for many years to come.

Pella’s Core Values Emphasize:
- Human institution
- External focus
- Teamwork
- Continuous improvement
- Safety
- Rewarding simplicity over complexity
- Respect for the individual
- Shared rewards
- Total integrity

**Investing In Communities**
I’ve mentioned that innovation is extremely key to our company, with design and production of innovative products based on our customers’ input. Also key is our commitment to the communities where we live and work. Our foundations invest heavily in the communities where we operate, which are expanding at a pretty significant rate. We have 11 manufacturing facilities. We also have sales subsidiaries that we own, and we spend significant time and foundation dollars re-investing in those communities. We have a matching gifts program as part of our foundation so our employees can invest with us—and it is subscribed to heavily. We place a lot of emphasis on education—both educating internally for leadership, for development—and in promoting scholarships in the communities in which we operate.
Charles Farver joined Pella Corporation in 1974 at the company’s Chicago-based subsidiary, Pella Windows & Doors. In 1976, he joined Pella’s distributor in Denver, Colorado and became its president in 1980 when Pella Corporation purchased it. He served as an associate director of Pella Corporation from 1979–1985, when he was elected director. He became co-chairman in 1992 and chairman in 1998. He has an economics degree, cum laude, from Colorado College, and an M.B.A. from University of Denver. He serves on boards and foundations with a focus on improving the various communities where Pella Corporation facilities are located.

Jennifer Alter Warden is a senior vice president of Baird & Warner Real Estate, Inc. and a member of the firm’s executive committee. She oversees marketing, technology, training and e-business as well as other new initiatives. A 1976 graduate of Oberlin College, Jennifer received an M.B.A. in management from Northwestern University’s J.L. Kellogg Graduate School of Management. She is a board member of a local non-profit organization that provides job training and placement called Harborquest, and a member of the board of trustees of the Francis W. Parker School in Chicago, Illinois.

Measuring Effectiveness
How do we know if this is working? How do we know if we are effective, if these cultural things that we know and feel and sense, are really getting down into the organization where can we see measured results?

One way is to ask, “Okay, is there anything we’re missing?” As we look at these core values, we’ve got to test them every once in a while by asking this question. We didn’t have a manufacturing plant outside of Iowa until the mid-1980s. So we were a very homogeneous company of white men. And recognizing this issue, we thought, “We’ve got to begin to drive some diversity into this company.” Our expansion outside of Pella, Iowa has helped us to do this, at the same time, we’re still facing challenges in some of our Iowa plants. We now have a five-year-old, highly concerted diversity initiative in place that is beginning to add greatly to the culture of our company.

We had five plants receive a perfect safety award this year. That’s zero lost-time hours.

Another area we can effectively measure is our safety record. Safety is a huge priority in our company because we have many dangerous jobs—we’re cutting wood, glass, steel, and stamping parts. We want our employees to be safe. We embraced our team and said, “Help us make this a priority.” And they’re now doing this. If we come up with a new machine, a new operation, a new process, they’ll be the first to tell us if they see something that’s not safe in that area. We had five plants receive a perfect safety award this year. That’s zero lost-time hours. And in our Pella plant we are currently running over two million continuous man-hours without a lost-time accident.

We can also see that our values are being transmitted throughout the company at Christmastime when we have many fundraising campaigns for those less fortunate. In addition, our team members raised over $350,000 for juvenile diabetes research last year. These are accomplishments of which we are very proud and speak to the fact that our family values are alive within Pella.

Finally, Pella has been listed as one of Fortune’s 100 Best Places to Work for the last six years.

We are celebrating our 80th anniversary this year. This is our motto: “Times change, but values remain.” We hope we can keep it going at least another 80 years.
Chris Gallo is a third generation member of the Gallo Wine family. He earned his B.S. in fermentation science from the University of California at Davis in 1996. Prior to attending Kellogg, he worked in various roles at his family’s business including winemaking, sales, and marketing. His most recent role was as assistant marketing manager for Gallo’s operations in Verona, Italy, where he was responsible for strategy, planning, and brand promotions in the Italian and Maltese markets. For his summer internship, he worked for a non-family firm, Speakeasy Ales & Lagers in San Francisco. After graduation in June 2005, Chris plans to work in Gallo Winery’s import division.

P.J. Huizenga is a principal at Huizenga Capital Management (HCM), founded in 1990 as the personal investment office of the Peter Huizenga family. He is a fourth-generation member of a family garbage business that began in Chicago as Huizenga & Son Private Scavenger. Third-generation family members turned it into Waste Management Inc., today servicing over 27 million residential and commercial customers around the world. HCM began investing in private equity such as Blockbuster Video and Boston Chicken, and continued to diversify into hedge funds, real estate, oil and natural gas. Prior to joining HCM, P.J. worked in Andersen’s transaction advisory group and was responsible for conducting financial due diligence for M&A, carve-outs and loan facilities on more than 40 companies in over 15 industries. His B.A. is in accounting from Hope College. He serves on the auxiliary board of The Art Institute of Chicago and on the Greater Chicago Food Depository’s investment committee.
The Kellogg School of Management names the Johnson family of Racine, Wisconsin its 2005 Kellogg Award for Special Contributions to Family Business recipient. This annual award recognizes a business family that has made very significant, generous and personal contributions for the benefit of other families in business.

Five generations of the Johnson family are honored for their willingness to share their expertise with others along with their outspoken advocacy of family business. They are the first U.S. business family to receive this distinguished recognition.

The Johnson Family Business Enterprises consist of four wholly independent businesses with annual revenues of nearly $9 billion and 26,000 employees worldwide.
Not only do we teach, understand and explain to students about family business, our emphasis is on running this institution like a family, where we care about every person who belongs to this group. That is what makes Kellogg a very different school.

As the dean of the school, if there is one thing I would like to do it is to maintain and strengthen the Kellogg culture, and try to learn from people like all of you how we can create successful organizations which are family run, while at the same time creating a culture of mutual respect and trust, of caring and sharing.

With this in mind, we are pleased to present the 2005 Kellogg Award for Special Contributions to Family Business to a family that epitomizes these qualities, the Johnson family.

LLOYD SHEFSKY:

Champions Of Family Business
Kellogg School of Management and its Center for Family Enterprises are honored to name the Johnson Family of Racine, Wisconsin as the 2005 Recipient of the Kellogg Award for Special Contributions to Family Business. Each year, this unique award recognizes a business family that has made very significant, generous and personal contributions for the benefit of other families in business. The Johnson family’s contributions are especially notable and uniquely broad. Their very personal film, Carnuba: A Son’s Memoir, has been shared openly with many family business audiences and serves as a model for developing an honest history for both one’s business and one’s family. Their advertising and branding as a family business strengthens the resolve of many families in business. And, their outspokenness about family business ownership has lifted and emboldened others, as well as affected general public perceptions of family business. Further, the interviews the family has granted, Sam Johnson’s book The Essence of Family Enterprise, and the case study written by the Kellogg Center for Family Enterprises have been valuable educational resources to families and to family business students.

Their outspokenness about family business ownership has lifted and emboldened others, as well as affected general public perceptions of family business.
A Brief History
The Johnson Family Business Enterprises started five generations ago in 1886 in Racine, Wisconsin, when founder Samuel Curtis Johnson purchased the parquet flooring operation at the hardware company where he worked. When his customers asked him how to best preserve their new wood floors, he made his own product, Johnson's Wax, which became a steady success, outpacing the sales of the flooring, and becoming one of the first national brands. His son, Herbert, joined the business in 1888 and in 1906 the name of the firm was changed to S.C. Johnson & Son. Herbert took over after his father died in 1919, then died suddenly himself in 1928 at age 60, at which time his 28-year-old son, HF, took over. HF’s son, Sam, started work as his father’s assistant in 1954. In 1966, after his father suffered a debilitating stroke, Sam, age 37, became president of the $171 million business. Under Sam’s leadership, the business grew to become the four separate main businesses that exist today within The Johnson Family Business Enterprises: SC Johnson, a consumer products company; JohnsonDiversey, an institutional products and services business; Johnson Outdoors Inc., a recreational products business; and Johnson Financial Group, a global banking and financial services company. Together these businesses generate nearly $9 billion in annual revenue and employ over 26,000 people in 110 countries worldwide.

Courageously Sharing Their Story
There are many honors given to family businesses. Usually it’s because they are very successful businesses or they have been around a long time or they are very well known. Clearly, the Johnson family qualifies under every one of those standards. However, here at Kellogg we have additional standards. We recognize families who have helped other family businesses and their families. We recognize families that celebrate family business. We also honor families who have demonstrated leadership and a willingness to share their experiences. The Johnson family has been the embodiment of that kind of sharing.

They have courageously documented the secrets of their family and business...They have opened their doors to others in family business.

The Johnson family’s contributions are both very notable and very unique. With the making of a very special and deeply personal film, Carnauba: A Son’s Memoir, the Johnson family has created a touching masterpiece. It is much more than just a great movie. It is an honest history. They have courageously documented the secrets of their family and business knowing that thousands of people will see the film.

They have opened their doors to the Kellogg Center for Family Enterprises by allowing us to work on their business case study. They have opened their doors to others in family business as well, and we think that is extremely important.

Perhaps the most important aspects of the recent Johnson family tradition are their commercials. How touching that every one of them says, “a family company.” That’s quite a phrase. Is it a positive? Is it a negative? For many years, people perceived claiming to be a family business as a potential negative. But the Johnson commercials have brought family business into a positive light. They express pride in being a family business. They express the positive elements of being a business that makes products with a family business behind it. All of this has made it very easy to select the Johnson family for this award.
ACCEPTANCE COMMENTS BY HELEN JOHNSON-LEIPOLD

Five Generations

On behalf of five generations of our family, I want to thank the Kellogg Center for Family Enterprises for this wonderful honor. My mother, Gene Johnson, is with me today to accept this award. My brothers, Curt and Fisk, and my sister, Winnie, send their regrets for not being able to join us today, as well as their appreciation to the Center for this recognition.

My great-great grandfather, the first Samuel C. Johnson, started the family business in the back of a hardware store...The first year profits totaled $268 and change.

My great-great grandfather, the first Samuel C. Johnson, started the family business in the back of a hardware store. It was originally a parquet flooring company with four employees. The first year profits totaled $268 and change. Soon, he was making wax in his bathtub because customers wanted something to keep those parquet floors looking beautiful. For three generations, wax was our forte—our bread and butter. We put wax in everything we could think of to keep floors and furniture clean and shiny.

My great-grandfather, the first HF Johnson, understood the power of marketing, and in the early 1900s he did something very few household product companies were doing—he placed ads in national magazines. Business really took off and Johnson Wax became a staple of American homes.

My grandfather, HF Jr., brought science and technology to the forefront of our business. The wax we used to put in bottles, he put in spray cans. The products worked even better, and we sold even more. We went from being a household staple to a household name.

Then, the fourth generation of our family took over, my father, Sam Johnson. What he brought to the company was the vision that in order to continue to grow, we need to be constantly innovating the way we look at our business. That meant diversification and innovation. It also meant new disciplines and processes so that “Johnson” was always a name that stood for quality products that worked and were safe, and were better than what was out there. We went from being a wax company to a household consumer products business. And, household products grew into commercial products and services, and then to outdoor recreation products, and believe it or not, to financial services. As our products and business interests expanded, so did our geographic footprint, and so did our family.

Business Leaders

All of our businesses are leaders in their markets.

Today there are four separate, wholly independent Johnson family businesses, each run by a fifth generation Johnson, with annual revenues of nearly $9 billion. We have 26,000 employees across 110 countries and our products are sold in countless more. All of our businesses are leaders in their markets:

- In consumer products, we are number one in 14 different product categories worldwide from glass cleaners to plastic storage bags.
- We are the number two global provider of sanitation and hygiene products and services to the commercial marketplace. Chances are Johnson products cleaned the hotel you slept in or the restaurant you ate at last night.
- We’re the number one maker of canoes, kayaks and fishing motors, and number two in the world in scuba diving equipment.
- Johnson Financial Group is the fastest growing financial services and community bank in Wisconsin, reporting double-digit growth year-on-year for the past six years.

Top 10 Secrets To Growth And Longevity

I’m going to share what I think are the top 10 secrets to our growth and longevity. I certainly don’t think we have all the answers, but I hope that some of what we’ve learned over five generations is helpful.
It must be meaningful innovation where the difference is relevant and the value is clear to both customers and consumers.

Ten years ago, our commercial business sold cleaning products. Today, we provide hygiene solutions and safety solutions that leverage and package our expertise along with our products.

**Use And Protect The Family “Brand”**

Secret three—build, protect and leverage the brand equity of the family name. Our name is our corporate brand. It has been built into a powerful brand equity over the years. It is our personal Good Housekeeping Seal of Approval. That’s why everything we sell has to consistently meet the highest standards for quality, performance and safety. One of the big reasons we were able to easily expand into bug killers was the enormous amount of consumer trust and brand equity we’d built over the years in the Johnson name. The great thing about brand equity is that it helps you when things are going great, and protects you when they aren’t.

Actually, my first assignment at SC Johnson was to launch a new product that flopped after only eight months in the market. Nice way to start a career in the family business! On top of that, I found out later that Dad knew it was going to fail. I asked him why he didn’t say anything and stop it. He told me, “Sometimes if you don’t fail, you don’t move forward.”

A strong brand equity protects you when you fail. This allows us to learn from our mistakes and move on.
Good Will Is Key
Secret four—“Earning the good will of the people is the only enduring thing in any business; the rest is shadow.” I wish I had said that, but it was from a speech my grandfather made nearly 80 years ago. Our focus on our people is a solid business strategy that has created enormous employee loyalty and real bottom-line benefit. Let me tell you a couple of stories.

Ten years ago, our oldest international plant was losing money, big time. A lot of executives wanted to shut it down. Dad asked them, “If you had to keep it open, how would you make it work?” They said it couldn’t be done. Dad said, “Try. People there rely on us.” Today the plant is a short-run, specialty production hub and one of our most profitable and productive plants.

Loyalty and commitment among employees …directly translates into productivity and ultimately profitability.

When U.S. companies shut down in Chile because they were prime targets for firebombs, our Chilean employees boarded up the plant and kept 24-hour guard for two weeks. No one asked them to do that—they just did. Consultants tell me they’ve been offered a fortune by companies searching for the secret to creating that kind of loyalty and commitment among employees because it directly translates into productivity and ultimately profitability.

Enduring Values
The fifth secret—sustain values and principles. In the midst of five generations of change and evolution, our family’s values and guiding principles have not changed.

I believe our values ensure we are companies that people want to work for, companies people want to work with, and, ultimately companies whose products and services people want to buy. And, I believe the reason our values have endured, is because for five generations the family has led and managed our business, providing a rock-solid foundation and consistent direction for the enterprises.

I believe the reason our values have endured, is because for five generations the family has led and managed our business, providing a rock-solid foundation and consistent direction for the enterprises.

Balance Tradition And Change
That leads me to secret six—balance tradition and change. Or, said another way, know what to change and what not to change. One of the hiccups for family businesses is sticking too close to tradition, and creating and protecting sacred cows without keeping an eye on the future. The reality is that the world is constantly changing, and the marketplace is becoming more and more competitive all the time. We have to continually get better at what we do and how we do it in order to compete and win.

The outside perspective and advice from our independent directors is critical to keeping us in touch and on top of the change that’s happening all around us. We work really hard to maintain a culture that embraces change as the way to protect our most important traditions. We have to be willing and able to let go, when we need to, in order to ensure that the business we hand over to the next generation is strong and capable of growing. But, we also need the insight to know what to protect and carry forward.

Succession Is Based On Desire
The seventh secret—each generation must join the family business because they want to, not because they feel they have to. Dad and Mom never pushed nor prodded us. They exposed us to the company, involved us in what it was doing, and let us find our way there. Of course, the company was the main topic of discussion at the dinner table, and Dad made it sound very exciting and very special. I know he really wanted us to take over the businesses. He also realized from his own experience that we had to join by desire, not by demand. Dad knew that along with the fun and excitement of the business, personal sacrifice and enormous commitment would be required.
The Johnson Rules

Earn your way up. You have to prove yourself capable of the job. Running a family business isn’t a right or a privilege.

Secret eight—I call it The Johnson Family Employee Rule Book—this kicks in when the next generation comes on board. There are three simple rules. First, earn your way up. You have to prove yourself capable of the job. Running a family business isn’t a right or a privilege. You must be qualified to lead in order to be considered for leadership. Second, no two members of the same generation will work at the same company at the same time except in training. Today, I think we have a stronger partnership and four healthy and growing businesses because each of us is running a separate part of the enterprise. Third, total commitment to the ultimate goal behind all the family businesses is required. That goal is to invest for the long-term and maintain family ownership in lieu of short term gain.

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<th>Johnson Rules</th>
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<td>1. Earn your way up</td>
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<td>2. Spread those of the same generation among different companies</td>
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<td>3. Be totally committed to the ultimate goal</td>
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Formalize Communication

Secret nine—create a formal communication forum and decision-making process. We have a family business council that meets regularly. It includes the family, and a small select group of family advisors. This is where we come together to really dive into issues and opportunities facing the enterprises individually and as a whole. When big decisions, tough decisions need to be made, this is where we make them. If the family reaches a stalemate, then we turn to our family advisors to cast a single, deciding vote. It’s a democratic, majority rules process, and it works for us.

Here’s why: Although we support one another, and are committed to the same values, vision and goal, we are still different people with different perspectives and ideas on things. Naturally, there are times we are going to disagree. The family business council gives us a forum to discuss things openly and freely, and a process to resolve any differences of opinion in private, not in public. This ensures consistent and united family leadership and clear, focused direction to our troops, which is so critically important.

When Dad was here, he would break the tie, or make the call, we really didn’t have to negotiate the tough decisions among ourselves. Now we do. So, we’re meeting more often, and tackling a broader range of topics. We have a family office that helps facilitate the process, and provides the expertise and support we need to help us reach the decision that is right for us.

Put Family First

Secret 10—family comes first in a family company. This is the most important rule. You have to keep the family together. Dad always said the family is the company and the company is the family and never the twain shall be torn apart.

Dad always said the family is the company and the company is the family and never the twain shall be torn apart.
I know I’m prejudiced, but I think we have a great family. And, it’s because of Mom and Dad—they were a great team. Dad was a business success because he had an incredible partner in Mom. She is my role model as a parent, and her leadership and involvement in our community has been a real inspiration to me.

Although the Johnson family controls and runs the family business, we make sure our extended family shareholders feel a part of it. There are 17 shareholders in my generation, and 47 in the next, and all of them need to be engaged, aligned, feeling good about what’s going on and listened to. This is not easy, and it gets harder as the generations get bigger and bigger, but family comes first in a family company.

The first anniversary of Dad’s passing is coming up soon. Many people wrote wonderful things about him after he was gone. One of my favorites was in a column in a small newspaper. The writer said that in his life, Sam Johnson had mastered the art of the deal, and more importantly, the art of being human. This is the lesson we all live by.

In closing, on behalf of my family, thank you once again for this wonderful honor.

THE SAMUEL C. JOHNSON FAMILY

HELEN JOHNSON-LEIPOLD
Chairman and CEO
Johnson Outdoors Inc.
Chairman
Johnson Financial Group
Chairman
Johnson-Keland Management

Helen Johnson-Leipold graduated from Cornell University and began her career at Foote, Cone & Belding in Chicago in 1979, directing the advertising for consumer packaged-goods companies, including Kraft and Beatrice Foods. She joined SC Johnson in September 1985 and served in a variety of sales and marketing positions before being named vice president of Consumer Marketing Services, Worldwide in 1992. Helen moved to Johnson Outdoors, a leading global outdoor recreation products company, as executive vice president in 1995. She returned briefly to SC Johnson in 1997 as vice president, Personal & Home Care Products. In March 1999, Helen was elected chairman and CEO of Johnson Outdoors Inc., and in July 2004, was also named chairman, Johnson Financial Group, the $3.2 billion dollar global financial services company founded by her father, Samuel C. Johnson. Helen also serves as a director of S.C. Johnson & Son, Inc. and JohnsonDiversey, Inc., and is the only member of her family to serve on the boards of all the family enterprises. She is chairman of Johnson-Keland Management (the Family Office), Chairman of The Johnson Foundation and trustee of The SC Johnson Fund, Inc. She serves on the boards of The Prairie School, Sustainable Racine and the Cornell Athletic Advisory Board. Helen is founder and chairman of the board of Next Generation Now, a child development and family support program.

IMOGENE JOHNSON
Matriarch
The Samuel C. Johnson Family

Imogene Johnson is the matriarch of the Johnson family with four children and 15 grandchildren and step-grandchildren. She and her husband, Sam Johnson, met while at Cornell University and were married for 50 years until he passed away in the summer of 2004. She started her career as an engineering mathematician at Ryan Aeronautical in San Diego, California, working as a pioneering computer programmer on the first vertical take-off aircraft. Mrs. Johnson is the founder and board chairman of the Prairie School, an independent co-educational institution, educating over 650 students from pre-kindergarten through 12th grade and celebrating its 40th anniversary this year. The Imogene Powers Johnson Ornithology Laboratory at Cornell University is named in her honor. Sam Johnson spoke of Mrs. Johnson’s important role in the family business. He recalled that when his children were in their teens and twenties, his wife was the cheerleader for the business. He said he did not want to direct his children too much, but his wife communicated enthusiastically that the family business was a great enterprise offering many opportunities for them to contribute professionally, personally and as a family.
Lloyd E. 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 teaches entrepreneurship courses at Kellogg. Thirty-five 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 also a certified public accountant. Professor Shefsky is the author of *Entrepreneurs are Made Not Born*, a book that has been translated into six 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 that 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. He has a J.D. degree from University of Chicago Law School and a B. S. degree from DePaul University.

Dean Dipak C. Jain has been leading the Kellogg School of Management since July 2001. He is also the Sandy and Morton Goldman Professor in Entrepreneurial Studies and a professor of marketing, where he has been a member of the faculty since 1987. He earned both his B.A. and M.S. degrees in mathematical statistics from Gauhati University in India. His Ph.D. in marketing is from the University of Texas. His areas of research include the marketing of high-tech products, market segmentation and competitive market structure analysis, cross-cultural issues in global product diffusion, new product diffusion and forecasting models. During his career at Northwestern, Dean Jain’s teaching honors include the Sidney Levy Award for Excellence in Teaching in 1995, the John D.C. Little Best Paper Award in 1991, Kraft research professorships in 1989–90 and 1990–91 and the Beatrice research professorship in 1987–88. In addition to his positions at the Kellogg School, Dean Jain has been a visiting professor of marketing since 1989 at the Sasin Graduate Institute of Business Administration at Chulalongkorn University in Bangkok. In 2003, he was appointed as a foreign affairs advisor for the Prime Minister of Thailand. He is a member of the editorial board of the *Journal of Marketing Research*. He has served as a consultant to IBM, Sears, U.S. Cellular, AT&T, Motorola, Harris Semicon, Eli Lilly, Thomsen Electronics, Phillips and Hyatt International. He also serves as a member of the board of directors of Evanston Northwestern Healthcare, Hartmarx Corporation, John Deere and Company, The Northern Trust Company, Peoples Energy and United Airlines.
Live Case Discussion: Fel-Pro Inc.

This session looks at the sale of Fel-Pro Inc. in 1998 and the subsequent establishment of a family office by one branch of the owning family.

In an interactive conversation with the audience, members of the Lehman family offer insights into why they sold the business and talk about the opportunities they have since pursued.

Fel-Pro was universally renowned for its innovative human resource practices and leadership in work-life balance.

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

COMMENTATORS:
Daniel D. Bayston  
Managing Director  
Duff & Phelps, LLC

R. Hugh Magill  
Senior Vice President of Personal Financial Services  
Northern Trust Corporation

SPEAKERS:
Kenneth Lehman  
Managing Partner  
KKP Group LLC  
Chairman  
Winning Workplaces  
Evanston, Illinois

Paul Lehman  
Vice Chairman  
Winning Workplaces  
President  
New Prospect Foundation  
Evanston, Illinois
Less effective practices or cautions:
Employees may prefer cash instead of the gift of a holiday ham or turkey.

Once begun, employee benefits cannot be easily undone, even if they are unrealistic and unsustainable, and once they turn into entitlements they are less effective.

What was your reaction to some of the most unusual Fel-Pro employee benefits?
There were many very creative benefit ideas and practices in place.

How did the CEO determine if the cost of a benefit provided enough positive return to be a justified expense?
Some benefits might be seen as paternalistic and may have caused employees to lose their sense of personal responsibility.

Benefits may have been non-sustainable or unrealistic given the competitive market and increasing pressure on margins.

There seemed to be a high cost for the benefits in relation to payroll.

The emphasis on benefits contributed to the success of the company and created a loyal workforce.

How much and in what ways is it wise to openly share company information with all of your employees?
It is important for company leadership to come to a decision or group consensus first before sharing information with employees.

Leadership needs to beat the rumor mill and get their message out quickly once it is decided upon. But they must keep in mind the impact that it could have on their stakeholders, including customers; not just their employees.

Generally, more information is better but some, like financial or personal family information, should be held more closely than other types of information. Conflict should be kept behind closed doors.

The following questions were discussed by Family Business Conference attendees in small groups prior to the presentation. Here is a summary of audience responses.

How do your family’s values affect the culture of your company?
Family values play a role in the kind of employees we hire.

Our company’s integrity and reputation are tied to our values.

We encourage a good family/work life balance for all of our employees.

We put families first and have flexible work schedules to accommodate family activities.

We all believe in the same family values, therefore, we are able to develop a cohesive long-term view for where the company should be going.

Do you believe that special people practices pay off financially? What kinds of people practices do seem to pay off and what kinds of people practices don’t seem to pay off?
People practices that pay off:
Special awards and luncheons for a variety of reasons boost moral.

Student scholarships and summer camp opportunities for families of employees increase worker loyalty.

Benefits that focus on the physical and emotional health of employees make for a healthier, happier, more productive workforce.
If you have a union shop, don’t share any information that you do not have to.

A newsletter is an effective tool for disseminating information to the company at large.

**What are your views on the family’s decision to sell Fel-Pro? What would you have done or considered differently?**

We agreed with the decision that was made because the risk of trying to maintain success at the same level was too great, both in terms of finances and the family culture, which appeared to be risk-averse.

Exporting the all important family culture overseas would have been extremely difficult.

By selling, they were able to use some of the profits to continue spreading their family values and employee friendly vision to the wider marketplace.

The next generation of family owners are disinterested in continuing the business.

Family has other interests it wishes to pursue beyond the business.

Large purchase offer is made.

Criteria for evaluating buyer:
Family may be able to maintain some meaningful role in the new organization.

Buyer shares similar company/family values with the seller.

Buyer has the necessary resources and capabilities to take the company where it needs to go in a changing marketplace.

Employees would be better off under the buyer than with present family ownership.

**If you sold, would your extended family all stay together?**

Yes, because:
We share a family mission first and foremost, and we are a very close family in general.

There’s strength in numbers and we would have a lot more strength and energy to pursue our goals if we stayed together.

We share a common legacy and values and we want to perpetuate it.

Our family office binds us even more closely than our family business.

We are a young business and a fairly small, close-knit family.

Maybe not because:
Our business is a large part of our identity and we’d have to work hard to stay together.

We are a very large family with many branches. We have 170 members including spouses. Some of our extended family would likely stay close and some would not.

**What would be the criteria you would use to decide whether or not to sell your family business, and what criteria would you use in evaluating the buyer?**

Criteria for selling:
Dimming future economic outlook threatens the company’s viability.

Too much debt and an unwillingness to continue to carry that debt make selling attractive.

There is a lack of family interest or lack of family harmony.

Criteria for evaluating buyer:
Family may be able to maintain some meaningful role in the new organization.

Buyer shares similar company/family values with the seller.

Buyer has the necessary resources and capabilities to take the company where it needs to go in a changing marketplace.

Employees would be better off under the buyer than with present family ownership.
What do you believe are the advantages of keeping an extended family together?

Staying together assures continuity of family values.

The individual has a chance to focus on being a part of something bigger than oneself.

A family office provides financial benefits to its members.

Staying together encourages strong family ties and close relationships.

There are more opportunities for philanthropy if resources are pooled.

What family office services are appropriate to provide family members, and what services do you think are inappropriate for family members to receive?

Legal counseling for family is appropriate.

Financial management is an appropriate and important aspect of a family office.

Secretarial and concierge services for business or family related events is appropriate.

Career development support is a good use of office resources.

Wellness assistance is acceptable.

Personal services such as babysitting, laundry, lawn mowing, etc. should be avoided as inappropriate.

What ideas did you find particularly interesting about how the KKP family office functions?

They offer their members group health insurance coverage.

They developed a website to help continue the family’s vision.

Philanthropy and outreach activities continue.

What are some of the most tricky, complex decisions or policies that anyone with a family office has to make?

First and foremost, deciding if it makes sense to set up a family office.

Clearly defining the mission at the outset and deciding what the family office wants to accomplish.

The roles as well as the rules for the family members must be clearly delineated.

Deciding how the family office will interact with the family company, if it still exists, and how to keep family engaged if no family company exists.

Deciding how to distribute capital, cash and/or profits fairly among family members.

Deciding how to allocate family office resources and staff.

What specific issues or concerns do you see for the future of the case family?

Keeping a sense of family identity, cohesiveness, and shared history will be a challenge.

How will the younger generation stay involved with one another without the glue provided by the business?

Will the next generation resent that the current generation sold the business?

The family may experience a sense of loss at not being involved with the growth of the company any longer.
JOHN WARD:

It has been our privilege to write a real live case about a family’s experience; this is indeed a very special gift to all family business educators, now and in the future. When we held our first Family Business Conference in 2002, there were few current cases on family businesses existing in the educational environment. Therefore, one of the things the Center for Family Enterprises began, with the great support and encouragement of our co-sponsors, was to build family business cases that can be studied by students and professionals alike.

The Center for Family Enterprises began... to build family business cases that can be studied by students and professionals alike.

We are honored to have two representatives of our co-sponsors with us, Dan Bayston of Duff & Phelps and Hugh Magill of Northern Trust, to share their special insights and comments on the Fel-Pro case.

DAN BAYSTON:

Issues To Consider When Selling
Our firm is often called upon to assist families who are considering the sale of their business. My presentation will focus on how we begin the discussion with our clients so they best understand the various implications of their decision. The decision to sell isn't just important to shareholders—the decision is important to a broader group of stakeholders both inside and outside the company, including management, employees and customers.

The decision to sell isn’t just important to shareholders—the decision is important to a broader group of stakeholders both inside and outside the company.

I am going to examine several strategic options that the Lehman family may or may not have considered in making their decision to sell their company, Fel-Pro. Since I was not involved in the discussions that led to the sale, I will present a third party view of the ways their company could have funded expansion or how value could have been maximized while the business was at its peak. The company did in fact discuss the possibility of tapping the public markets for financing. The company also had a strong balance sheet that could have supported some debt financing. This of course comes with various degrees of risk, which the family may not have wanted to take. As we know, the family ultimately sold to a strategic buyer, Federal Mogul. In today's market, we find that there is a blurring between traditional strategic buyers and financial buyers. Financial buyers have made so many investments in various industries that they act in many ways like strategic buyers in what they are willing to pay for a business and how they view potential synergies.

Analyzing Benefits For Shareholders

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<th>Fel-Pro Case Study (A)</th>
<th>Duff &amp; Phelps LLC</th>
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<td><strong>Strategic Alternatives: Stakeholder Benefit Analysis</strong></td>
<td>Maximizing Return</td>
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<td>Status Quo</td>
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<td>Sale to Strategic Buyer</td>
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<td>Sale to Financial Buyer</td>
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<td>Going Public (IPO)</td>
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The table above examines the implications for shareholders in terms of what might be expected from the various strategic alternatives with respect to maximizing return, allowing for expansion of the business or enhancing the liquidity on
their investment in the company. With respect to maximizing return, a sale of the company or an IPO would likely have a positive impact. In terms of status quo and maximizing returns, I have assessed this alternative as neutral. However, a good case might be made that if the family had not sold, the return would be negative. But without the proper facts, I wasn’t going to make that assumption. All of these elements are very important in terms of understanding the opportunities that were available to Fel-Pro.

In terms of expansion of the business, I have assessed the alternative of a sale to a financial buyer as neutral. Some financial buyers come to the table with a fair amount of previous cash commitments while other financial buyers aren’t necessarily interested in further significant investments in the business. That can have a material implication for the future of the business.

Analyzing Benefits For Other Stakeholders

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<td>Debt Financing</td>
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This table examines the implications of the various strategic alternatives for various stakeholders of the company.

The status quo alternative could be viewed as positive for the management team and employees. However, one could make the case that if something wasn’t done to improve the business of Fel-Pro, the long term outcome may have been less positive for these stakeholders.

A sale to a strategic buyer is regarded as neutral because our experience has been that a sale to a strategic buyer is positive for some management and employees and it is negative for other management and employees. With respect to a financial buyer, most likely the outstanding diversity of employee benefits that Fel-Pro provided would not have continued over the long term. The theme for financial buyers is “cash is king.” When the business starts to suffer a bit, financial buyers look at cutting costs, including those types of benefits.

What happens to the customers? In the near term the implications are probably neutral. But longer term, the customers needed additional expansion of Fel-Pro’s business to adequately serve their needs.

If the company had chosen to fund growth through debt financing it could have been a positive for customers, especially if it helped support expansion. But if a company takes on too much debt, it certainly would not be positive for the customers longer term, because it could negatively impact the future stability of the operations. Some of these things are obvious, common sense issues. But as one thinks through all of these components, one can come up with arguments on all sides for how they might have affected Fel-Pro’s decision. Your family might face similar issues concerning your own business in the future.

Analyzing Financial Risks And Rewards

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An analysis of the financial risks and rewards of the various strategic alternatives is presented above. From a valuation perspective, I have rated the status quo scenario for Fel-Pro as neutral. However, I suspect that had we dug deeper,
we might very well have concluded that under a status quo scenario the valuation implications for the company five years down the road might have been negative. These are considerations that are critical in the ultimate analysis of what constitutes the proper decision for selling a company.

With respect to dividends, if Fel-Pro remained private and borrowed money to fund expansion, dividend payments could have been put at risk depending on how much money was borrowed and the future performance of the company. Banks are willing to lend money, but they are not going to let companies pay out a significant amount of that money in dividends if the business is not meeting financial targets.

Banks are willing to lend money, but they are not going to let companies pay out a significant amount of that money in dividends if the business is not meeting financial targets.

Another option which might have been considered is a leveraged employee stock ownership plan (the ESOP). We regard leveraged ESOP transactions as being corporate finance vehicles, as opposed to a broad employee benefit plan. In Fel-Pro's case an ESOP transaction might have provided the liquidity necessary for shareholders and might have been an excellent addition to their employee benefits.

Summary Observations
The proper valuation of the business is critical in any ultimate decision—because if you go into the process with unrealistic expectations, you and others are going to be disappointed. This in turn may cause you a lot of pain with your family, your employees and your management group.

The proper valuation of the business is critical in any ultimate decision—because if you go into the process with unrealistic expectations, you and others are going to be disappointed.

A common mistake companies make concerns the timing of seeking an independent third-party valuation. Many companies approach this issue at a time when it is being forced upon them due to unforeseen circumstances, as opposed to being proactive and valuing the company within the context of a strategic planning process that evaluates the strengths, opportunities and risks of the business and how this relates to their company's value over time.

Looking back at the Fel-Pro decision process in 1996 and 1997, they were well-advised. They had the input of experts from a cross section of disciplines, not just managers of business, but lawyers, financial advisors and others who were very knowledgeable about business transactions. This was very positive for the overall decision-making process and helped them to avoid some of the common mistakes that we see made during the sale of a business.

HUGH MAGILL:

Post-Sale Opportunities
It is a privilege to participate in this year's Conference, to recognize a great company, Fel-Pro, and its remarkable owners, the Lehman, the Weinberg, and the Morris families. While Dan spoke about the conditions involved in selling a company, I will be looking at the family experience after the sale, in particular the Lehman family and their establishment of a family office. While these are closely interrelated, they're really separate events, with the latter representing a transition from a family business enterprise to a family financial enterprise.

The Lehman family negotiated this transition very capably, and this is not an easy thing to do. There are many stakeholders to consider, as well as complex tax, financial planning and business issues. In a sale situation, time is of the essence, but care must be taken to discuss the family's future well-being, too.

**Sale of a Family Business**

**Provides a Catalyst**
- To re-visit the family's values and goals
- To reconsider the family's financial and philanthropic opportunities
- To re-examine business responsibilities, social and fiduciary relationships

**Unlocks Capital**
- Which alters the dynamics of these responsibilities and relationships
One of the most fundamental questions to answer is whether or not the family will continue to work together financially. In other words, will there be a family financial enterprise? A business’s sale should be seen as a catalyst for reexamining some fundamental family issues, such as: What do we value as a family and how will we achieve it? What opportunities do we want to pursue, entrepreneurially, financially, philanthropically? How will various relationships change as a result of the sale?

As they considered both changes for the foundation and for establishing a family office, this led to the formation of the KKP Group LLC and produced a blueprint for that group that covered such issues as its mission and its goals, its staffing and membership, and its compensation and expense structure.

Defining The Family Office

I would define a family office as a group of professionals ranging in size from as little as one or two individuals to as many as 90 that may or may not include family. These individuals are charged with the responsibility of coordinating and overseeing various aspects of the family's financial, business and charitable activities.

In planning for a family office, I believe it’s necessary to think comprehensively about all the services that are essential to the family’s well-being. First, how will the family office be structured and governed? Who will have responsibility for its oversight? What financial and fiduciary services are needed and who will provide them? How will the family’s financial goals be achieved? Who will develop asset allocation guidelines? Who will hire asset managers and report their activities to the family? What boundaries should be established regarding personal services to family members? How will risks be managed? And probably most importantly, how will communications be handled and family members of all ages be educated about the family’s legacies and its goals?

Wealth Management

Comprehensive Wealth Management—Essential Family Services

The Lehman family case study provides us with some excellent insights into how these decisions can be made. First, they developed a family mission statement. Second, they reassessed the mission and the activities of the family’s New Prospect Foundation, which led to the formation of three new family foundations, refinement of their grant-making guidelines, and a new initiative to continue Fel-Pro’s innovative employment practices, Winning Workplaces.

Now, running through all of these issues is the central phenomenon of any family business sale: liquidity. It is sometimes hard to predict how liquidity will affect the dynamics of these issues, and probably more importantly, how it will influence family relationships.

The sale of the business is ripe with opportunities for new business ventures, myriad investment alternatives and charitable pursuits.

Let me pose another question: Subsequent to the sale of a family business, how will family members relate to each other? This may seem simplistic at first glance, but indeed, after some reflection, I think it’s a fairly complex question. The sale of the business is ripe with opportunities for new business ventures, myriad investment alternatives and charitable pursuits. To explore these alternatives, I think it’s wise to seek the counsel of consultants to guide the family through both the changing family dynamics and the new opportunities. And here I’m using the term consultants rather broadly, to include not only the family’s traditional advisors, but specialists, such as a family office or a charitable consultant, which the Lehman family did involve in their decision-making.
Overseeing and coordinating a family’s wealth is a big undertaking with a broad range of approaches. For families who are still running their businesses, many of the services are handled by employees of the business, in conjunction with advisors. After sale of the business, some families will look to a trusted employee to oversee family affairs in conjunction with family advisors and their financial institution. In either event, families of substantial means should give careful consideration to establishing their own family office, as did the Lehman family.

There are between 4,000 to 5,000 family offices worldwide with at least 3,500 in the United States alone.

There are between 4,000 to 5,000 family offices worldwide with at least 3,500 in the United States alone. To achieve the proper cost efficiencies, the minimum family net worth to establish a family office should be in the range of 75 million dollars.

Family Office Structure
Finally, family offices can be structured in several ways including: the single family office, which serves just one family, such as the KKP Group; the commercial family office, which is a long-established family office that has “gone public” and now provides its services commercially; or the multi-family office, which serves multiple, sometimes unrelated families.

Live Discussion
At this point, Ken and Paul Lehman were introduced and participated in an in-depth question and answer session with the audience.

Has the culture of your organization survived the acquisition?
Ken: There are two answers to that question. The culture at Fel-Pro has not fully survived, but I think it has partially survived. On the other hand, we have established a new culture at KKP and Winning Workplaces. And I think in many ways we have replicated the former business culture in miniature.

We have reinvented the culture in a much smaller setting.

We thought of ourselves as a corporate family at Fel-Pro. Now we think of ourselves as a small office family. We utilize some of the techniques that we utilized at Fel-Pro to facilitate that family feeling. And we’ve learned some new ones, too, that work in a much smaller setting. We have monthly lunches where the 10 employees of KKP and Winning Workplaces get together to celebrate birthdays and anniversaries of employment as well as other special events. We have reinvented the culture in a much smaller setting.

What did you anticipate the company was worth and was that expectation matched?
Paul: We did a valuation and I believe we thought the company was worth less than we got for it, so we were very pleased with the final sale price.

Ken: We did not regularly value the company so we got ranges of value from several potential investment bankers. We had at least three sets of values to consider.

Why did you have such generous employee benefits? Did you do it because you believed there would be a good return on the investment?
Paul: We never looked at them solely as a return on investment. One of the things that my dad and my uncle did in the early 1960s was to air-condition the factory. It allowed people to come to a much more pleasant working environment, but how do you put an ROI on that? That said, we fundamentally believed that what we did was good for the
bottom line. We had lots of positive indicators in that we were consistently profitable, we had very high rates of customer satisfaction, and we had a highly-satisfied, highly-motivated workforce.

There is a lot of information on our Winning Workplaces website that further substantiates the relationship between good people practices and business outcomes, quality, customer service, employee turnover, employee retention.

Elliot Lehman:¹ I know we had enough qualified people around us to assure that we did the right thing both financially and ethically for the good of the company. But I want to talk about our company from a little different perspective than financial.

Often, people would come and tell me about the great reputation Fel-Pro had in the wider community as a wonderful place to work. Now, do I know that this contributed to us in the way of profits? I have no idea. But I do know that it was gratifying—it was gratifying to us as individuals and as business people.

I think when we were getting ready to sell the business we not only focused on the money but also on how we could do the right thing by the people. We had this feeling that if we did the right thing by people, they would do the right thing by us. This was one of the guiding principles in our company. And it was gratifying and self-satisfying—I can’t help but believe that our company had real economic value since we had such wonderful morale in our company and employees who closely identified with it.

Ken: We did it based on common sense, and we never looked for outside proof. The only thing we required was that it was working for us. But I understand that there is an emerging body of scholarship and data, which now supports good people practices—in particular I know about a Wharton study that concludes that investments in people return at two-and-a-half times higher rate than investments in plant and equipment. For us, it was just common-sense, the golden rule. That’s all we needed.

Danny Miller:² I would like to add that from a researcher’s point of view, I can support what you are saying. A Korean colleague and I did a study quite recently about Korean businesses that invested in their employees—if they invested higher than their industry average, the employees did indeed perform well and their performance was more stable over the long run. So these businesses had higher and more stable returns over a longer period of time than companies that invested at the average. The wonderful thing is that you can do well by doing good, which is really a win/win situation.

Did you consider the potential risks to your employees and other stakeholders due to the sale?

Ken: We considered the risks to all involved. The decision to consider the sale was one big assessment of risk. And we felt that the external conditions in our industry were a risk to all of our stakeholders. So to not objectively and dispassionately take a look at what risk was represented would have been irresponsible.

Federal Mogul said they were in the process of trying to build a major global automotive parts company and we were told that they were going to model all of their people practices after ours.

To ease some risk, we created a special employee bonus at the time of the sale and continued to fund a number of benefits for a five-year period. In addition, as a condition of sale we insisted on the maintenance of all of our benefits for a two-year period, with the exception of daycare and summer camp where we were able to get a one-year commitment. In our negotiations with the buyer, we were told that they valued our brand and they valued our whole business approach. Federal Mogul said they were in the process of trying to build a major global automotive parts company and we were told that they were going to model all of their people practices after ours.

Paul: We definitely felt that the status quo would lead to an unfavorable outcome for all of our stakeholders.
When you considered selling, what were the most important considerations, both on the business side and on the family side?

Ken: I was of the opinion that the more risk we took on, the more likely it was that family relationships would be at serious risk. And so we did things over the years that were very moderate, manageable risks, but what we needed to do to move ahead was extremely risky. It would have involved a completely different attitude toward debt. It would have certainly been risky in terms of how our culture and values would translate into a global company. And I think that it would have been harder to walk the tightrope between family and business. While I don’t think the sale was inevitable, I think given the composition of the family members who were inside the company as managers, and our appetite for risk, it was the right decision for our three families.

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Paul: I would say that in 1990 we would never have said it was inevitable. But by 1997, globalization had really taken hold in our industry—the market forces were incredibly complex. We were the last privately-held major supplier in our industry.

Ken: You know, in the absolute sense, I don’t think you can say it was inevitable. If we had had the appetite to completely reinvent our company, maybe we could have done it. But it was probably inevitable for our family.

Dennis Kessler: I would agree with what Ken is saying—it absolutely was not inevitable. Yes, the marketplace had changed significantly, but we always put a lot of faith in strategic planning and looked first at the business case, then second at the family case. And when the business case was presented to us and we and our staff did strategic planning, we saw the kind of change in risk and company culture that we would have to make to continue in business. And then the family met and we asked, “Is this where we want to go? Is this what we want to pass on to our children?” It was very difficult for all of us. But we looked at it from a family perspective—with the condition of the marketplace in 1998 it became clear it was time to sell.

Was there a time earlier—maybe some years earlier—when you could have foreseen the rapid market changes that would have made a difference?

Paul: We recognized much earlier than 1998 that our cost structure had to continue to get much more efficient. Our customers were demanding more of us during the 1980s and the 1990s; it wasn’t something that happened overnight. And there was a time in our history—I would say it was maybe the late 1980s—when we totally shared the concern that some of our benefits were a bit paternalistic, that perhaps the things that we were doing were no longer getting the bang for the buck they had before and that maybe our employees were just expecting these things. But that wasn’t really their problem—it was our problem—that we weren’t sharing current marketplace conditions with our workforce. Our sales force who were out with customers knew, but the rank and file didn’t understand. And at that point we tried to improve communication with a monthly newsletter about our business and our business conditions, and we had management meetings about our business. We reinvented a lot of our programs. Profit-sharing may have been seen as a pension plan, but we made very clear how it was a profit-sharing plan. We used variable compensation, and team-based compensation. We had a company-wide bonus that was based on both customer service and financial objectives. We had to figure out different ways to make our benefits most efficient, because we were not just going to turn them off.

Someone asked whether we could have sustained our benefits had we not sold. My answer is: I don’t think we could have sustained our benefits, but I think we could have sustained a great workplace.

We had to work with our employees to help them understand how their practicing healthier lifestyles would not only be good for them, but it would save money for the company and increase profit-sharing. So we were doing lots of things to address this and it was certainly no overnight fix.
Someone asked whether we could have sustained our benefits had we not sold? My answer is: I don’t think we could have sustained our benefits, but I think we could have sustained a great workplace.

Since the sale of the business, do you feel that the family has grown closer or drifted apart?
Ken: The extended family has grown further apart. Now we get together the way most families get together, on family occasions. I don’t see Dennis every day like I used to, but I’m certainly going to see him at my daughter’s wedding on Saturday. We’ve become a more conventional family. We’re not an extended business family anymore.

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The Lehman family office was a new venture for us. At first we had some of the same stresses and tensions encountered in an operating business, but we worked our way through them, and we realized that we were better off together than we were separate. We know we’ve all benefited by banding together. We know we’ve all benefited by banding together.

Is philanthropy something that you were raised with as children?
Ken: My parents started the New Prospect Foundation, but Fel-Pro was also regularly funding three family foundations during the business years. And our folks were very wise. When the New Prospect Foundation was founded, I was a young adult, not yet married. I think Paul was in college. They involved us in philanthropy from that point on. We had a family board and they wanted us involved. We did some interesting things in those early years and learned the importance of this dimension of our lives. We enjoyed it. I’m extremely proud of my children who have their own independent civic identity now. A question asked earlier was, “What happens to your identity when you sell the family business?” First, it gives you the opportunity to create new identities.

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Second, to any of you whose sole identity is connected with your family business—you have the challenge of doing more and expanding your identity. I don’t think you should become so invested in your family business that there’s nothing else with which you closely identify.

Why did you create just the Lehman family office, not a family office that included the other branches of the family?
Paul: I think while we all felt that we had worked together successfully, it didn’t mean that we had to continue our lives bound so closely.

Ken: When we had the operating business, there were the insiders who were part of the management team, and they were members of all three family branches. When the company was sold, that community dissolved. Each family migrated to its own family unit. And that was what was comfortable for us.

How much should a family office cost to operate?
Ken: The family office should cost between one and one-and-one-half percent of assets under management; ours is closer to one percent. And by banding together and by the more favorable custodial rates, management fees, access to the best managers we can find, it’s well worth the cost in our mind.
Do you feel more like an investor or do you feel like an entrepreneur? And where does the money come from for business ventures?

Ken: I think the answer is different for each of us. I feel more like an investor, but Paul has become an entrepreneur, and so has my son Peter. When Paul invests in his business, he’s investing his money. He can hold out a portion of what his family owns and do what he wants to do. And Peter’s business is the same—he invested his money. The family is not bankrolling an individual family member’s dream. There is no need to do that. Our financial interests are really well-aligned with our current structure.

Paul: The sale of the company allowed me to have another career. I have an adventure travel company, which has been a dream of mine, and it’s really been fun. So there is definitely a life after Fel-Pro.

How did you decide what to invest in as a family office?

Ken: Our sister’s husband is a financial professional, a securities analyst, but apart from him, we didn’t have any biases regarding investing since our knowledge base was at ground zero. And so we didn’t have conflicting philosophies—we didn’t have any philosophy—we set about educating ourselves as to how to diversify, how to construct a balanced and diversified portfolio, how to do private equity, and how to select managers. We were also ably assisted by many outside advisors.

We didn’t do everything right. We structured ourselves initially so that anyone with a bias could make a heavier bet on one asset class and a lighter bet on another—we had five asset classes. But we have changed that. Now we’re like a family mutual fund, anyone who invests with us gets the same portfolio. This structure provides a much greater administrative simplicity and a really strict alignment of interest.
R. Hugh Magill is a senior vice president serving as group head of Personal Fiduciary Client Services. He oversees Illinois trust administration and is responsible for management of the Personal Trust Department and the Estate Settlement Services, Guardian and Securities Custody Divisions in Chicago. He received a B.A. degree, cum laude, from St. Olaf College and a J.D. degree from University of Minnesota Law School. He serves on the boards of the University of Minnesota Law School, the Creator Arts Center and several foundations. He is on the advisory board of the Cabrini Green Legal Aid Clinic, the site council for the Gaylord Building of the National Trust for Historic Preservation, and is a scoutmaster with the Boy Scouts of America.

Kenneth Lehman is a managing partner of KKP Group LLC, the family office for the Lehman family and chairman of Winning Workplaces, a not-for-profit that helps organizations become great places to work. Before organizing the family office, Ken was co-chairman of Fel-Pro Inc., a family owned and managed Skokie-based automotive gasket manufacturer that was sold in 1998. He received his B.A. in English literature at Johns Hopkins University, and his M.A. in sociology at Northwestern University and served in the U.S. Peace Corps. He serves on several corporate and civic boards, including CARE, Public Radio International, WBEZ FM, and University of Chicago Hospitals.
Paul Lehman is vice chairman of Winning Workplaces and president of New Prospect Foundation, the Lehman family foundation. He is also managing partner of Austin-Lehman Adventures, a travel company. Prior to that, he had an 18-year career at Fel-Pro where he worked in leadership roles in purchasing, human resources, strategic planning, sales and marketing. He began his career as a social worker and served as the director of a community-based youth service agency that helped inner city teenagers with drug problems. He received a B.A. from Middlebury College and a masters in social work from the University of Chicago. Paul serves as president of the board of Northlight Theatre in Skokie, Illinois and is on the advisory board of the Council for Adult and Experiential Learning's Chicago Workforce 2.0 Project.

NOTES

1 Elliot Lehman, third generation and father to Ken and Paul, spent 56 years at Fel-Pro Inc. where he was co-chairman. He was widely celebrated for his industry and civic leadership. Elliot earned numerous management awards, helped develop training programs for the socially disadvantaged, and has been a long-time advocate for children. He joined in the discussion from the audience.

2 Dr. Miller is research professor of strategy at HEC Montreal business school (Hautes Études Commerciales de Montréal) and research chair in strategy and family enterprise at the University of Alberta School of Business. He was an invited expert panelist for the Conference.

3 Dennis Kessler is a fourth generation member of the Fel-Pro owning family and a former member of company management. He commented from the audience.
Ken Lehman and David Weinberg, co-chairmen of Fel-Pro, were pulling their papers together for the offsite strategic planning meeting when *Fortune* magazine’s first “100 Best Companies to Work For” article reached their desks in January 1997. Renowned for its innovative human resource practices and leadership in work-life balance, Fel-Pro was ranked fourth best in the nation in the article. Ken and David talked fondly of how hard the family had worked since 1918 to create not just a family business, but a business that cared for its employees as if they were members of a large extended family. All the hard work had paid off as they looked around the conference room at the awards Fel-Pro had received for its exemplary employee relations programs, in addition to awards for product quality and customer service.

Today, however, the awards seemed bittersweet. As they spoke of their children and grandchildren, Ken and David found themselves wondering what was best for both the Fel-Pro family and their own families. They finished gathering their files and headed out the door for the strategy session that might permanently change Fel-Pro’s future. They were going to discuss with their advisory committee whether it was time to sell Fel-Pro.
Company History
In 1918 the Western Felt Company was busy making felt horse blankets for the World War I cavalry when it was approached by Ford Motor Company with an opportunity to make felt seals and washers for its Model T. Not wanting to be distracted from the war effort but wishing to get the business nonetheless, Western Felt management approached one of the salesmen, Hugo Herz, with a plan. Western Felt offered to forward the orders from Ford and provide a source of felt if Hugo would produce the seals and washers. Seeking an energetic younger partner to help him, Hugo engaged his son-in-law, Albert Mecklenburger. Thus Felt Products (later known as Fel-Pro) was born in a small warehouse on Chicago’s West Side.

Throughout the 1920s and 1930s the company focused on customer needs, innovation, and ease of use. Fel-Pro expanded its product line to include metallic gaskets, which required heavier stamping and more complex technology. It created innovative packaging for its product lines to help parts stores and garages better organize their inventories. It also boxed complete sets of gaskets, washers, and seals—thereby offering all of the sealing products needed for a given repair in a single carton.

Fel-Pro survived the Depression and joined the next war effort in the early 1940s, making gaskets for tanks and military trucks. Most of its business at that time was focused on defense work. During World War II, the Japanese occupied most of Southeast Asia, cutting off supplies of natural rubber, which was critical for sealing. In response, Fel-Pro introduced synthetic rubber sealing products which greatly outperformed cork, at the time the other alternative to natural rubber and also in short supply. This achievement allowed Fel-Pro to make inroads with engine manufacturers. Fel-Pro also entered the chemical products arena by providing lubricants for airplane propellers.

Following the war and under the direction of Albert’s sons-in-law, Elliot Lehman and Lewis Weinberg, Fel-Pro experienced rapid growth as it began to manufacture multilayer head gaskets and offer a full line of gasket-related products to the independent automotive aftermarket and to original equipment manufacturers (OEMs). In the 1960s the company began to pursue the heavy-duty diesel OEM market. The next decade’s focus was technology and innovation. Fel-Pro developed what would be considered the industry standard in head and manifold gaskets. During this time, Fel-Pro became known as the high-quality leader not only in technology and manufacturing, but also in customer responsiveness and innovative packaging.

In the 1980s and 1990s Fel-Pro continued to increase its brand share and market leadership. The fourth generation was beginning to take an active role in running the company and formalized the organizational structure to better manage this growth. International expansion included licensing agreements in Japan and the purchase of a gasket company in Mexico. At the same time, the company’s manufacturing operation in Skokie, Illinois, had developed into a 1.25 million-square-foot facility on 56 acres employing over 2,000 people.

By 1997 Fel-Pro’s business had been segmented into four distinct units: the Gasket Business, FP Diesel, FP Performance, and Fel-Pro Chemical. The Gasket Business, which sold a wide selection of gaskets and related products for various automotive, heavy-duty vehicle, and industrial equipment applications, was further segmented into domestic aftermarket (68 percent of gasket revenues), international aftermarket (7 percent), and original equipment, which included assembly line products and gaskets sold through the engine manufacturers’ service divisions (25 percent). Fel-Pro had captured close to a 70 percent share of the domestic aftermarket, which was the most important driver of sales and profits for the company. Its total Gasket Business sales of $361.5 million accounted for more than 72 percent of the company’s revenue.

FP Diesel was a major supplier of replacement gaskets and engine parts, such as pistons, valves, and liners, for heavy-duty diesel engines manufactured by Caterpillar, Detroit Diesel, and Cummins Engine. This division began with the acquisition of a customer in 1989. Its revenues of $93 million were achieved in less than a decade through rapid intrinsic growth and further acquisitions. FP Performance sold high-performance gaskets and torque converters to the auto enthusiast and professional racing markets. Its combined product lines brought $21 million in annual sales to the Fel-Pro group. Finally, Fel-Pro Chemical manufactured, marketed, and distributed specialty lubricants, sealants, adhesives, epoxy, and urethane repair materials and lapping compounds to industrial distributors domestically and internationally. Its 1997 revenue contribution was about $38 million.

In total, the Fel-Pro group had sales of $500 million with earnings before interest, taxes, depreciation, and amortization (EBITDA) of $82 million (see Exhibit 1 for historical performance). Fel-Pro operated with virtually no debt on its balance sheet (see Exhibit 2 for Fel-Pro’s mission and goals).
Family History

Hugo Herz had two daughters, Erna and Clara (see Exhibit 3 for Herz genogram). When Hugo started the business with Erna's husband, Albert, the ownership was split evenly between the two. When Hugo died, his shares were distributed evenly to his two daughters. Therefore, Erna and Albert owned 75 percent of the business and Clara owned the remaining 25 percent. Clara married Ed Morris and had one son, Robert. Clara worked in the Fel-Pro office for many years as the office manager. Robert (Bob) was an engineer who worked in the design and manufacturing of the company's rubber gasket line. He eventually ran advertising and cataloging for the aftermarket business.

Albert and Erna had two daughters, Sylvia and Frances. Sylvia met Lewis Weinberg in Chicago through a family connection and they married in 1938. Frances met Elliot Lehman on a blind date while both were attending University of Wisconsin; they married after college. Both Elliot and Lewis went into the business at the end of the Depression despite having other career interests. Elliot studied journalism in college and had originally planned to enter his family's printing business. Lewis had been an aspiring musician, interested in both writing music and playing various instruments. Both, however, were drawn to Fel-Pro by the respect they had for their father-in-law, who offered them management opportunities. Elliot's business career was interrupted by World War II, when he served in the Navy as captain of a submarine chaser in the South Pacific.

By the time Albert died in 1961, Elliot and Lewis had been running the company as co-presidents for a number of years. The ownership structure had evolved to 39 percent Lehman, 39 percent Weinberg, and 22 percent Morris. The division of responsibilities between Elliot and Lewis was clear: the Weinberg clan made the products and the Lehman clan sold them. Elliot ran external functions, such as marketing and sales, and Lewis ran internal operations, including manufacturing, human resources, and engineering. Bob Morris continued his work in advertising and cataloging. According to the family, the relationships worked well. As Lewis's son David explained, “Elliot and Lewis beat the odds by working together beautifully and putting the needs of the company ahead of their personal needs or the interests of their respective families. They operated fairly independently but succeeded by sharing information with each other when it was critical to make decisions together.”

Elliot, Lewis, and Bob each had two sons and a daughter. Barbara, David, and Daniel were born to Sylvia and Lewis. Frances and Elliot had Ken, Kay, and Paul. Bob and his wife Beverly had Ellen, Bruce, and Richard. As the children grew, the families tackled the issue of family participation in Fel-Pro. Lewis said, “We decided together that our children would have the opportunity but not the obligation to go into the business with assignments based on their skills. Children who elected not to participate, however, would not be denied equal dividend benefits because of their choices. We would find a way to make it fair.”

The transition to the next generation was more complicated because of the increased number of family members in the business. Of the fourth generation, five family members decided to enter: Ken and Paul Lehman, David Weinberg and his brother-in-law Dennis Kessler, and Richard Morris. Generally each member assumed responsibility in his family’s area. When Lewis and Elliot were ready to retire as co-presidents and stay on solely as chairmen of the board, the successors decided that they, too, could run the company together. A role was carved out for each of the four Weinberg-Lehman members, and the “Office of the Presidents” was created. Ken ran sales, marketing, and distribution for the aftermarket, as well as the FP Diesel and Fel-Pro Chemical profit centers. David managed manufacturing. Paul headed up human resources and administration. Dennis led OEM sales and marketing, and technology and engineering. Richard worked in the same area as his father, running advertising and cataloging for the aftermarket.

After two years, the group recognized that operating with four presidents was not effective. As Ken observed, “We were tilting too much toward family harmony rather than business sense. We all wanted it to work, but it simply was not an efficient system to lead by a consensus of four executives—each of whom had his turf that he wanted to protect.” The four presidents decided that only two—one representative from each family—should run the organization. Ken and David were chosen to serve as co-chairmen and Elliot and Lewis retired to the position of chairmen emeritus. Dennis and Paul maintained their roles as president (see Exhibit 4 for new corporate structure). The family acknowledged some tension in the transition, but seemed to deal with it quickly. As Paul explained, “We were all committed to making it work. We did what we had to do and checked our egos at the door. The business needs prevailed, and we found a solution as we always had.”

Ken and David had leadership styles of their own. “We were very collaborative,” Ken commented. “We addressed company employees together. We conferred with one another regularly. Our style was one of open
communication. We frequently consulted both family directors and non-family advisors.” As early as the 1970s they had established an advisory committee of nonfamily experts to help with strategic decisions and accountability. There were four advisors: Paul Lederer, an automotive industry expert who eventually became Fel-Pro’s chief operations officer (COO); Alan Muchin, Fel-Pro’s external corporate attorney; John Herrmann, an investment banker; and Fred Sturdivant, a management consultant and former business school professor. Later, when Paul Lederer took on a full-time position as COO, Bill Wade joined the advisory committee as its automotive expert.

By the 1990s there were 40 family shareholders in total (including the fifth-generation children). Nine had management positions: Lewis, Elliot, and Bob; the five fourth-generation members; and Dennis’s son Keith, the sole fifth-generation Fel-Pro employee. In order to inform and educate the other owners about Fel-Pro business issues, the families established an annual family forum. This was an opportunity to bring shareholders together to share Fel-Pro’s strategic vision. All shareholders over the age of 18 and their spouses were encouraged to attend. The meeting usually hosted 20 to 25 people. According to David, these were friendly events: “The inactive owners had entrusted the day-to-day operations to the active family members. Rarely was there dissention in terms of direction or strategy.”

This was partly attributable to a generous dividend policy established by the Fel-Pro families. The goal, as Lewis and Elliot had envisioned earlier, was to enable family members to pursue personal aspirations—whether in Fel-Pro or outside the company—while maintaining comfortable and financially secure lifestyles. Throughout most of its history, Fel-Pro had not found a need for a formal liquidity or redemption policy.

Family Values Build A Corporate Family
From the beginning, Fel-Pro was a company that valued and served its employees. It was no surprise that it emerged as a model of best management practices. Elliot summarized the family philosophy in this way:

“We always felt that our people should be treated fairly and with respect and dignity. We also believed that our employees were inherently hardworking, quality-minded, and sensitive individuals who wanted to do right for the company and themselves.

We were rewarded many times over for treating them decently. They returned our trust with a sense of loyalty, flexibility, a willingness to change with the times, and a devotion to our customers. This made Fel-Pro a place where good people wanted to work and a successful company.

The family agreed, however, that it was no one generation or family member who established the strong values at Fel-Pro. As Dennis Kessler explained, “The Fel-Pro culture of strong employee relations was a tradition set in place by the founders. We all lived by it, and each generation added something new and special.”

Described by Elliot Lehman as “one of God’s noblemen,” Albert Mecklenburger (known as “Pop Meck”) was a German immigrant who quietly and diligently managed his employees with dignity and decency. Albert’s door was always open, and he led with a quiet persuasion that was respected by everyone. Initially Fel-Pro’s reputation as a good employer was not based on formal benefits and employee relations programs. It was too small a company and did not have the funds to offer extensive benefits. It was known, however, for its respect for employees and its interest in their lives. At Fel-Pro, there was always a sense of partnership between employees and management.

When Lewis and Elliot took over from Albert, they began to put into place the programs for which Fel-Pro would earn its reputation as a good place to work. Early on, Lewis established the Employee Forum. He recognized that employees needed a platform from which their voices could be heard. An institution at Fel-Pro for over 50 years, the Employee Forum was a monthly face-to-face meeting of family management, supervisors, and hourly workers. First run by Lewis and subsequently by David and Paul, the meeting lasted for two hours during the workday. Each work group elected a representative who attended the forum, voiced group concerns, and reported back to his or her peers. Concerns raised during the meetings ranged from requests for hotter soup in the cafeteria to complaints about the rust on steel coming from Fel-Pro’s suppliers. Each issue was taken seriously and addressed. The meeting’s minutes were distributed to all employees, along with actions taken in response and items that had come up since the meeting.

Another major benefit was the creation of Triple R in Cary, Illinois. In the late 1960s Albert’s older daughter, Sylvia, pointed out that most Fel-Pro employees were inner-
city Chicago residents who had limited options for recreation. They lived near parks in disrepair that attracted gang activity, and were uncomfortable venturing outside their communities. Their children had few constructive resources in the summertime. At her suggestion, Fel-Pro responded by buying 200 acres of undeveloped land 40 miles northwest of the plant and developing it as an “employee park” named Triple R. Amenities included a swimming pool, volleyball courts, and picnic facilities. Triple R offered a day camp for employees’ children at a minimal cost. The children were picked up by bus at the plant and returned in time to meet their parents at shift change. Activities were abundant, ranging from swimming lessons in the Triple R pool to farming in the Triple R garden.

Paul Lehman, who ran human resources for a number of years, recalled attending employee picnics: “I remember walking around with my dad as a kid meeting people from all backgrounds, races, and creeds. It really felt like a family. When my father approached me to enter the business, he told me that I would be able to do more for people by working at Fel-Pro than in my role at the time as a social worker. I realized he was right.” It was with this mentality that the next generation of Fel-Pro members took on the responsibility for not just continuing but improving employee programs.

In the 1980s and 1990s Fel-Pro expanded its programs in four main areas: work and family benefits, career and personal development, life management, and health and wellness. Each new employee was given a binder known as “Fel-Pro Facts” explaining services offered and ways to take advantage of them.

Work and family benefits included a 24-hour information hotline for pregnant mothers, $5,000 toward the legal costs of adoption, a $1,000 treasury bond for employees’ newborns, the first on-site daycare center in a manufacturing facility in Illinois, a lactation center, tutoring services for employees’ children with special learning needs, and scholarships of $3,500 per year for any employee’s child attending an accredited college or university. Fel-Pro also offered child development and parenting seminars, college counseling, elder care referral services, and emergency care assistance for employees with sick children. Benefits represented 41.1 percent of payroll.

Personal development and life management services encouraged formal and informal education for Fel-Pro employees. The company provided up to $3,000 per year to take college-level classes and up to $6,500 for graduate courses. Employees were encouraged to make use of in-house personal career counseling to help them develop skills for current and future jobs. They could get loans to finance personal computer purchases and were offered free annual tax preparation assistance.

The health and wellness plan rewarded workers for leading healthy lifestyles. They had access to a wellness center—a state-of-the-art exercise facility located in the middle of the factory. The employee assistance program helped find solutions to personal problems, such as drug or alcohol dependence, stress, marital issues, and family matters. By stopping smoking, exercising regularly, doing volunteer work in their community, or completing coronary risk assessments, employees could earn credits to purchase extra vacation days, reduce their share of health plan premiums, or extend their overall benefit coverage.

Beyond these programs, Fel-Pro strove to maintain a real sense of community, one in which information was equitably shared. Top management conducted quarterly meetings to tell all employees about the business’s performance and customer needs. The company published the *Fel-Program*, a family-centered newsletter that covered everything from births and college graduations of employees’ children to factory and office team bowling scores. *Open Lines* was a bimonthly, business-oriented publication that focused employee attention on customer trends, quality issues, cost-saving initiatives, and new product lines. Fel-Pro even employed a half-time sculptor who created works of art out of discarded gasket materials. The goal was always to create an inclusive and welcoming environment for everyone.

While these programs reflected strong social conviction, the owners also felt that they made good business sense. As Lewis explained, “The more we gave, the more we received in ingenuity, productivity, and cooperation. Our employees were very motivated to help us succeed.” When Fel-Pro air-conditioned the factory in the late 1960s and then opened its onsite daycare center in the early 1980s, absenteeism dropped significantly. Average absenteeism was three days per person per year. Total annual turnover of 5 to 9 percent was very low compared to similar industries. Controllable turnover, a measure of the number of employees who left the company because they did not like their job or found a better opportunity, was virtually nonexistent at 2.4 percent per year.

Attracting the best employees was easy. When Fel-Pro agreed to hire family members of employees, the system became self-policing. No one would recommend someone who would not appreciate the job or work hard. As Bob
O’Keefe, who spent 49 years with the company and ran the day-to-day operations of the human resources department, explained: “I had three sons, three daughters, and a son-in-law who worked at Fel-Pro. All of us felt privileged to be part of the Fel-Pro family.”

At the Employee Forum, complaints about the quality of the hot sauce on the break cart were routinely outnumbered by suggestions on process and operational improvements that would save Fel-Pro millions of dollars over the years. In fact, the company was profitable every year since it began archiving financial records in the 1940s. Returns consistently beat the competition and auto industry averages.

Overall, it was clear that the partnership of management and employees was working, and the relationship was mutually beneficial. This was confirmed in a 1993 joint study completed by the University of Chicago’s business and social service administration schools that linked employee participation in Fel-Pro’s benefits to better job performance and responsiveness to change. Those employees who took most advantage of Fel-Pro’s programs consistently had the best performance evaluations and fewest disciplinary notices. Furthermore, they were more likely to initiate improvements in their work area and participate in implementing changes in the workplace than those who did not take advantage of the many programs the company offered.

Looking At The Market
In 1996 the advisory committee began asking David and Ken some pointed questions about the future of the gasket industry. Dramatic changes were occurring in the automotive sector. Some key trends of particular concern were gathering momentum.

First, automotive and heavy-duty engine quality was improving rapidly. Engines were more robust, causing repair rates to decline. In the past, an automobile had often required engine repair every 25,000 miles. Now, in many cases, no major work was required for as many as 100,000 miles. The Fel-Pro engineering department completed a study estimating that by 2005, 70 to 85 percent of engines might never require major repairs, significantly decreasing the demand for aftermarket parts.

Second, the industry was experiencing consolidation. Distribution of aftermarket parts was now controlled by six to ten large organizations, such as NAPA, Carquest, AutoZone, and Advanced Auto. Small local and regional privately-held parts distributors were being replaced by large national organizations with increased purchasing power. Richard Morris explained: “By my estimates, we would have had to become a $2 billion company by the year 2002 and a $10 billion company by 2010 to keep up with competitors who were growing and rapidly consolidating the market by acquiring other companies. It was clear we would have to go out and get public equity to fund expansion, and that would have changed the nature of our business.”

Third, the automotive component parts business had become a global industry. To achieve lower manufacturing costs and serve a global market, manufacturers were moving abroad and building factories in Latin America and Asia. OEMs were starting to request that Fel-Pro make parts in the countries where they were assembling engines, including Brazil, China, Mexico, India, and parts of Europe. There was hesitation at Fel-Pro to globalize all at once. The fear, as Ken noted, was that the hands-on style of the management team would be difficult to implement abroad. It would be impossible to “walk the factory floor” to ensure that high-quality products were being produced. David concurred that there was discomfort with the idea of giving up control. This was a tightly held family business that had succeeded through close attention to detail. A global strategy would require partnerships, joint ventures, and other new forms of relationships. New cultures would need to be mastered. Could the Fel-Pro formula for success be replicated globally?

Taking all this into consideration, Ken and David agreed it was time to take a step back and consider where to take Fel-Pro.

The Meeting
Ken, David, their COO Paul Lederer, and advisor Fred Sturdivant gathered to discuss this multiplicity of market forces and Fel-Pro’s response to them. The question they were trying to tackle was simple: Was Fel-Pro at its peak value as it was currently configured in light of the declining automotive parts market and the current investment environment? If it was, how much risk would accompany a decision to remain an independent business entity?

Their biggest concern was the potential decrease in the sale of gaskets to the automotive aftermarket. Fifty percent of Fel-Pro’s revenue came from this product line, and a greater share of its total profits. Capturing more market share would be difficult, given that they already had 70 percent of the market. This would force the company to look elsewhere for growth.
The most dynamic growth came from FP Diesel. Fel-Pro had already started to supply repair parts for heavy-duty diesel engines. The lifespan of a heavy-duty diesel engine was much longer than an automobile engine. Often these engines would change ownership multiple times. Ultimately they might be sent overseas. Fel-Pro had begun selling repair parts to the second, third, and fourth owners of these engines. Fel-Pro’s heavy-duty OEM customers, such as Cummins and Caterpillar, saw this as a threat to their own repair parts business. They did not like the idea of their suppliers’ working both sides of their product lifecycle. The engine manufacturers felt they should be supplying—and ultimately profiting from—the repair parts business for their engines. Tension existed between the players and was a cause for concern.

The pressure to become a global company was also an issue. OEM customers were putting pressure on Fel-Pro and other parts suppliers to set up manufacturing and distribution facilities in the countries where the original equipment engines were being built. To really take the company global, Fel-Pro would need to invest $50 million to $100 million. This would involve a combination of joint ventures and acquisitions around the world. It would also require Fel-Pro to take on a significant level of debt for the first time ever, which left management feeling uneasy. Some senior management felt further discomfort because their strength was more in the aftermarket than OEM.

Fel-Pro Chemical and FP Performance were not experiencing dynamic growth, and it was difficult to determine whether they would, even with additional investment.

As the meeting came to a close, all the issues had been addressed. Ken and David reviewed the problems that they could not immediately solve. Projections revealed slower growth than in previous years. Their customers had increased bargaining power as they had consolidated, allowing them to squeeze profit margins that formerly had been very attractive. The company was not ready to commit to a global expansion strategy. It was becoming more difficult to compete on cost when other manufacturers were going abroad for labor. It seemed as though Fel-Pro’s market value was at its peak, and this provided an unprecedented opportunity.

As they left the meeting, Ken and David both had questions. Were they ready to retire from a company where they had worked for nearly all of their professional lives? What was best for the family? Would selling really be the best option for the employees?

What they did know was that the family had always worked through tough decisions together in the past, and they would continue to do so. It was time to get the family together and go through the options. Ken reflected, “It’s getting increasingly difficult to walk the tightrope between hard-headed business sense and family issues. We all have emotional ties with the business, but after all, we are running a business here. And from a business standpoint, it seems the time to sell is now.”

NOTES

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### EXHIBIT 1:

**HISTORICAL SALES AND EARNINGS, 1992–1997 (IN THOUSANDS)**

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<td><strong>$51.1</strong></td>
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* Figures are calculated net of corporate costs.

### Fel-Pro Group Revenue

![Fel-Pro Group Revenue Chart]

- **Gasket Business**
- **FP Diesel**
- **Fel-Pro Chemical**
- **FP Performance**
EXHIBIT 2:

FEL-PRO MISSION AND GOALS

Our Corporate Mission
Fel-Pro is a world leader in the design, manufacture, and marketing of gaskets and related products for the internal combustion engine, as well as industrial chemicals and other sealing products. We meet or exceed the diverse and changing requirements of all the markets we serve. In each of our markets, we will be our customers’ model supplier. At the same time, we will be a model employer of our employees, a model customer to our suppliers, and a model corporate citizen. Fel-Pro is a unique company, truly a corporate family. We will preserve our valued traditions, while ensuring that we continue serving our customers through innovation and responsiveness.

Our Corporate Goals
We are determined to:

Offer the greatest degree of total value to our customers by offering superior service and by providing products that are cost effective, technically proficient, reliable, and durable.

Be a financially strong company for our customers and employees and provide the resources necessary for continuous improvement.

Offer employees challenging and rewarding jobs, growth opportunities, competitive compensation, and excellent benefits to enable them to reach their fullest potential, both on and off the job.

Uphold the values that form the foundation of our company. These include strong commitment to our customers, to supporting our employees’ growth to the fullest extent of their abilities, and to promoting equal opportunity in the workplace.

Contribute positively to the industries we serve and the communities in which we live and work.

Accomplish these goals ethically and responsibly.
EXHIBIT 3: HERZ GENOGRAM

NOTES:

1 Bold border indicates family member was employed by Fel-Pro.

2 Dennis Kessler is the only in-law shown and Keith Kessler is the only fifth-generation family member shown, as they work in the company.
Fel-Pro Case B:
After the Sale
The Lehman Family Transition

In May 1997, Ken Lehman and David Weinberg, co-chairmen of Fel-Pro Inc., met with the Lehman, Weinberg, and Morris families to discuss whether to sell the company after 80 years under family management. Facing major consolidation in its customer base and among its competitors, as well as unprecedented pressure to set up overseas operations and reduce product selling prices, Fel-Pro had to confront major long-term strategic issues. Ken and David shared the results of a difficult meeting they had had with the Fel-Pro advisory committee and COO Paul Lederer.
The family and company management had been collectively engaged in strategic planning for almost two years. Difficult and conflicting questions were raised. Could Fel-Pro match its competitors’ low overseas cost structures and still maintain its award-winning employee benefits and human resources programs for its Skokie, Illinois, workers? Were the owning families ready to take on the hefty debt required to build overseas production facilities? Was Fel-Pro’s value at its peak, given the serious future strategic threats to its business? What was best in the long term for the 3,000 Fel-Pro employees? What was best for the families that owned the company? Might meeting the goals of both constituents be in conflict?

After much painful deliberation, the family agreed that future employee and family interests were best met through a sale of the company. The owners felt that Fel-Pro employees would be better served in the long run by an alliance or union with a multinational engine parts company with the commitment and resources to successfully compete in a global market. For the family, this was the moment that the economic value of Fel-Pro was probably at its peak. As Elliot Lehman explained, “It became a battle between intellect and emotion. The timing seemed perfect, but we had so much emotionally invested in the company, including a huge sense of pride in and responsibility to our employees.” In fact, giving up Fel-Pro was particularly hard for Elliot. As Ken explained, “Elliot said all along that he supported his children’s decisions, and he stuck by that even through the sale. But if he had made the decision himself, I think he would have made a different decision.”

Once the family decided to sell, the sales process moved quickly. Fel-Pro was approached by as many as twelve suitors that were attracted to Fel-Pro’s profitability, strong brand, dominant market share, and reputation as a high-quality parts supplier and outstanding employer. The family itself was seeking a buyer that would have three characteristics: the experience and resources to meet Fel-Pro’s long-term needs for globalization and a more competitive cost structure; clear synergies from a product, sales, and operations point of view; and the desire to maintain Fel-Pro’s people-friendly employment practices.

One such suitor was Federal-Mogul. As a global supplier of engine parts and systems to both the original equipment manufacturers (OEMs) and the automotive aftermarket, Federal-Mogul’s acquisition of Fel-Pro seemed very appropriate and promising. It was unclear whether Federal-Mogul would appreciate and continue to provide the employment practices for which Fel-Pro had become known.

Preserving Fel-Pro’s Employment Practices
Judging from Federal-Mogul’s history of employment practices, it was not immediately evident that it would embrace the Fel-Pro practices. However, the company had recently appointed a new CEO, Richard Snell, who was making major changes in every aspect of Federal-Mogul’s business. Snell publicly told Fel-Pro managers he intended to work diligently to learn Fel-Pro’s human resources practices and its corporate culture. He said that he intended to roll them out as “best practices” to other Federal-Mogul business units.

Fel-Pro owners decided to include guarantees in their negotiations that certain benefits would be provided to their employees after the sale. Family members—including those working in the business and Frances Lehman and Sylvia Weinberg Radov—set priorities on the programs that they wanted to see continued, among them the scholarship program for employees’ dependents, the all-company annual Volunteer Day, the Better Neighborhood Fund (an employee-run contribution program), the day camp at Triple R, the daycare center, and the health and wellness center.

The benefits were protected through a combination of arrangements. First, the sales agreement stipulated that all benefits would be kept intact for a minimum of two years, with the exception of the day camp and the daycare center, for which Federal-Mogul made a one-year guarantee. Family owners were hopeful that once Federal-Mogul saw first hand the positive impact of these progressive practices on employee morale and performance, it would continue these benefits. The family also put aside a sufficient amount of the sales proceeds to fund the scholarship program, Volunteer Day, and the Better Neighborhood Fund for five years. Finally, the company’s charitable foundation, the Fel-Pro Mecklenburger Foundation, was excluded from the sale so that the Fel-Pro and Mecklenburger names would continue to have a presence in the nonprofit community through its ten-year grant-making program, particularly in the Jewish community.

Sharing The News Of The Sale With Fel-Pro Employees
Once the management team had determined to proceed with the sale, a broad internal and external communications strategy was devised. In the past, employees had been told that the sale of Fel-Pro was not a strategic option considered by the owners. Based on the belief that frequent and full communication was far better than relying on the rumor mill, family owners began to implement a multifaceted communications plan. Throughout the sale process, regular employee meetings were held, a presale hotline was

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FEL-PRO CASE B: AFTER THE SALE—THE LEHMAN FAMILY TRANSITION

Sharing The News Of The Sale With Fel-Pro Employees
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established inviting employees to ask questions and voice concerns, and question-and-answer sheets were regularly posted on bulletin boards providing as much information as possible without jeopardizing the confidential negotiations that were taking place. Also, a series of all-employee meetings, including the Employee Forum, were called by top management. The goal was to answer as many employee questions face-to-face as possible. Often the answer would be “we just don’t know,” but employees were glad they had the direct attention of Fel-Pro owners during this unsettling period.

In early January 1998, a letter of intent was signed with Federal-Mogul and a dinner was held for Fel-Pro supervisors to meet many of their counterparts from Federal-Mogul. At the dinner it became apparent that Federal-Mogul management did not fully appreciate the Fel-Pro culture and working conditions. The family members realized that the transition might be more difficult than they had expected. Nonetheless, they felt they were taking positive steps to ensure that the Fel-Pro corporate culture would survive the transition intact. Most important, they continued to feel that the sale to Federal-Mogul was the best way to protect employee jobs over the long term. Federal-Mogul understood and was committed to the growth and product development required by the quickly changing global marketplace.

In February 1998, less than a year after initial discussions of a possible sale of the company, Fel-Pro was acquired by Federal-Mogul for $720 million, $495 million of which was paid in cash, the remainder in stock. Ken Lehman was the only member of the family management retained. He stayed on at Federal-Mogul for about ten of the planned twelve months to help with the transition.

KKP: The Lehman Family After Fel-Pro

As the closing dates of the sale approached, the Lehman family contemplated the significance of its principal holding—Fel-Pro stock—becoming a liquid asset. The family included Elliot and Frances Lehman, son Ken and his wife Lucy, and their three children; daughter Kay and her husband Stanley Schlozman, and their two children; and son Paul and his wife Ronna Stamm, and their three children (see Exhibit 1 for the Lehman genogram). The family members quickly realized that custodianship, asset management, and allocation strategy would be new challenges. They also recognized that by pooling their assets, they would benefit from access to the best managers and fee structures. The Lehman family decided that there were benefits to working together in a family financial enterprise.

In the spring of 1998, the first- and second-generation family members began investigating the feasibility of establishing a family office. They met with various outsiders and concluded that it would be desirable to commission a study, the output of which would be a “family office blueprint.” The study was concluded in early 1999, and in the spring of that year the KKP Group LLC (named after Elliot and Frances’s three children, Ken, Kay, and Paul) was launched and its mission established (see Exhibit 2 and Exhibit 3):

To preserve and enhance our families’ wealth so that both current and future generations of the Lehman family descendents can be comfortable and secure while leading productive, socially useful, and satisfying lives. We agree that the families’ wealth constitutes an enormous privilege that confers concomitant responsibilities to one another and society.

The family office had several goals:

To invest the liquid proceeds of the sale wisely in a diversified portfolio including several asset classes in order to protect present and future generations.

To manage tax compliance and reporting for individual family members and trusts.

To provide an administrative support structure to allow individual family members who wish to pursue other ventures to do so.

To provide other support services, including life insurance management, health and major medical coverage for those who needed it; family foundation administration; and potentially other services desired by the family.

Ken began serving as managing director of the KKP Group. Stan Schlozman, a financial professional, became chairman of the investment policy committee. Two highly trusted and competent former Fel-Pro employees were hired to oversee the day-to-day operations as executive director and office manager. Several other staff members were subsequently hired. All members of the Lehman family who had reached age 18, and their spouses, immediately became members of the KKP Group. As other family members reached the age of 18, they would become members as well.
The members of the KKP Group met annually. Investment performance was reviewed, budgets approved, and the accomplishments and challenges of the past and ensuing year discussed. Information dissemination and family education were the two primary goals of the annual member meeting.

The investment policy committee began meeting regularly as well. Members included chairman Stan, Ken, Paul, and Ken’s son, Peter, who had experience on the private equity side. Nonfamily members were the chief investment officer of the family’s bank and the chairman of their outside investment consulting firm. Initially, investment policy guidelines and allocation strategies were developed and outside financial management candidates were interviewed. This process resulted in different managers being hired in five separate asset classes. The investment policy committee continued to meet regularly. It undertook ongoing manager review, and periodically rebalanced the family holdings, based on past performance and the anticipated future environment for financial markets.

Family members more involved in day-to-day operations received compensation for their relative involvement in the form of annual donations to their personal foundations. The costs of maintaining the family office were billed to the individual family client and to their trusts proportionate to their needs and holdings. Individuals’ companies and the family’s foundations were also billed proportionate to the services required.

New Ventures—Family Members Explore Their Own Interests

Another role of KKP was to assist family members who were starting new ventures and careers. The sale of Fel-Pro opened up new career possibilities to family members. Individuals who were interested in running their own new ventures would need access to capital. Paul sought to combine his love of travel, nature, and physical activity with his experience in business. In June 2000, he joined forces with Dan Austin to start Austin-Lehman Adventures, which organized high-end, multisport, active vacations throughout the Americas.

Peter Lehman, Ken’s son, started his own business based on his passion for car racing. Building upon his experiences working for Fel-Pro during school vacations, specifically with the Performance Parts division, he founded Peter Lehman Racing in 1998. Peter became the youngest championship owner in professional motor sports in 2001 when he guided Lehman Racing to its first International Hot Rod Association (IHRA) championship, and his team retained the title for several years.

Both Peter and Paul funded their companies using a portion of their sale assets as collateral. The KKP office supported them in making the arrangements they needed to establish their businesses. This approach fit well with the family’s philosophy of enabling individual family members to pursue their professional aspirations.

The Family’s Foundations: A Commitment To Service

Since 1969, under the leadership of Frances Lehman, the family had operated the New Prospect Foundation (NPF) to support organizations that worked to alleviate pressing social problems and that emphasized fundamental social change. The foundation held just over $20 million in assets. As with other aspects of post-sale family life, the NPF board of directors decided to take a long-term look at the mission and activities of the family foundation. It engaged an outside philanthropy consultant to help it develop a five-year plan. Among the changes proposed and then adopted, the NPF made funds available to three new foundations formed by each of Frances and Elliot’s children. NPF allocated 30 percent of its funds annually to these new family foundations. Thus, the tradition of philanthropic giving started by the first generation was passed on to the next generation. Concurrently, the foundation’s grant-making guidelines were refined with an emphasis on criminal and economic justice and reproductive rights.

Frances Lehman chaired NPF until late 2002 when her son Paul took over as chairman. Frances continued to serve on the board, along with Elliot, Ken’s children Betsy and Peter, Kay and her son Danny, and Paul and his wife Ronna Stamm. Working with part-time staff assistance, they met twice a year to review and respond to proposals. Board members did not receive compensation for their participation. Forty-five percent of the foundation’s annual funds were granted to projects that were approved by the board, based on the specific goals of the foundation.

The most recent change in the foundation was the creation of a Next Generation Investment Policy Committee. Chaired by third-generation member Peter Lehman and composed primarily of his peers, the committee’s mission was twofold: to invest the assets of the foundation in accordance with its investment guidelines and to educate the third generation on investment strategy and implementation.
Winning Workplaces
The remaining 25 percent of NPF’s annual donations was dedicated to a new initiative. After selling Fel-Pro, the family wanted to continue its work in support of innovative, employee-engaging workplace practices, which they saw as a foundation for a healthy economy and stronger communities. They had been recognized for establishing best practices and wanted to share what they had learned with other companies seeking to develop a satisfied and productive workforce. To understand whether there was a need for services of this kind, they conducted an extensive feasibility study that identified small and midsize organizations as an underserved and underresourced market segment that would benefit from access to information and tools to help develop their workplaces. This led to the development of Winning Workplaces. In 2000 NPF committed $2.5 million allocated over a five-year period to Winning Workplaces—making this new venture the largest single recipient of funds from the foundation.

The nonprofit organization was officially established in February 2001. Ken Lehman served as chairman. The principals also included Paul as vice chairman and Elliot as founding board member. They subsequently hired an executive director and small staff. The board of directors included Ken, Paul, and Elliot, as well as nine outsiders who brought diverse but useful backgrounds and experiences to the table.

Winning Workplaces defined its mission as “helping small to midsize organizations create great workplaces.” Its goal was to provide employers with proven, practical, and affordable tools to support increased productivity and profitability. The services offered to support this mission were extensive and diverse. They covered four key areas: education and training, a clearinghouse for research and information, recognition of innovative, visionary leaders, and employee surveys and advisory services to help organizations improve their workplaces. A set of nearly 50 tool kits offered step-by-step guides to implementing a range of services, from setting up an employee forum to introducing basic benefit packages (www.winningworkplaces.org).

Looking Forward
The family saw room for continuous improvement in the new organizations and systems that it had created since the company’s sale. The new KKP management committee was just beginning to function. There was a need for more structure in KKP Holdings. A new executive director had just been hired to lead KKP. The NPF was experiencing staff turnover.

The Lehman family, however, felt good about its decision to establish a family office. Finding a strong balance between charitable activities, administrative assistance, and sound investment practices, it was committed to carrying on the legacy of Fel-Pro and its family values. At the same time it was pleased to be able to free up time and money for individual family members to pursue their own endeavors while assuring that future generations would have similar advantages.
EXHIBIT 1: ELLIOT LEHMAN FAMILY GENOGRAM

EXHIBIT 2: ORGANIZATIONAL STRUCTURE

**KKP Group**
Managing Director: Ken Lehman  
Executive Director: Phil Fontana (outsider)  
Board of Directors: Ken and daughter Betsy, Kay and son Daniel, Paul and son Jon, and Frances Lehman

**KKP Holdings**
Managers: Ken Lehman, Paul Lehman, Stanley Schlozman  
*Investment Policy Committee:*  
Chairman: Stanley Schlozman  
Members: Ken, Paul, Ken’s son Peter, plus bank CIO and investment advisory consultant

**New Prospect Foundation**
Chairman: Paul Lehman  
Board of Directors: Frances, Elliot, Ken’s children Peter and Betsy, Kay and son Daniel, and Paul and wife Ronna Stamm

**Winning Workplaces**
Chairman: Ken Lehman  
Vice Chairman: Paul Lehman  
Executive Director: Mary Clark (outsider)  
Board of Directors: Elliot, Ken, Paul, and nine independent outside directors
EXHIBIT 3:

KKP GROUP LLC OPERATING PRINCIPLES

The purpose of our family office, the KKP Group LLC, is to preserve and enhance our families’ wealth so that both current and future generations of Lehman family descendants can be comfortable and secure while leading productive, socially useful, and satisfying lives. We agree that the families’ wealth constitutes an enormous privilege that confers concomitant responsibilities to one another and society.

The KKP Group LLC will provide its members with cost-efficient, high-quality, and responsive services. It will help to educate its members regarding the responsibilities and decision-making processes that accompany wealth.

We shall manage the KKP Group according to the highest ethical and legal standards. Services will be provided confidentially and sensitively.

The costs of operating our family office will be allocated in a method agreeable to our members.

Our family office will facilitate joint endeavors while respecting individual needs. The office provides opportunities for family members to work together to achieve common purposes and to optimize long-term outcomes. At the same time, we understand that family branches and their members have individual interests and objectives.
The Center for Family Enterprises grew out of a request by a group of Kellogg M.B.A. students seven years ago to start a club and attend a class focused on the unique aspects of owning, governing and/or managing family businesses. The Center deliberately concentrates on family enterprises, with a focus that includes family businesses, family foundations, family offices, family investment companies and family wealth management.

The Center’s mission is to:

• Provide thought leadership to the field of family enterprise
• Contribute to the body of knowledge through cases, research and publications
• Serve student needs through courses, informal workshops, personal counsel and a resource library
• Build a family business community among Kellogg students, faculty and alumni
• Develop a global network of successful business families who can learn from each other and connect with each other through Kellogg, Kellogg partner executive programs and conferences
• Stimulate awareness and research by other Kellogg faculty on the special issues and opportunities for family firms

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