

TIDYING UP INHERITED ASSETS: SOME LESSONS FOR NEXTGEN

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Succession is the **Achilles' Heel** of
Family Firms

Different ways of dealing with this.

One unique practice is that of adult
adoptions in Japan.



Dec-1 2012

Adult adoption in Japan: Keeping it in the family

Family firms adopt an unusual approach to remain competitive



Last three generations of Suzuki CEOs were adopted as adults.

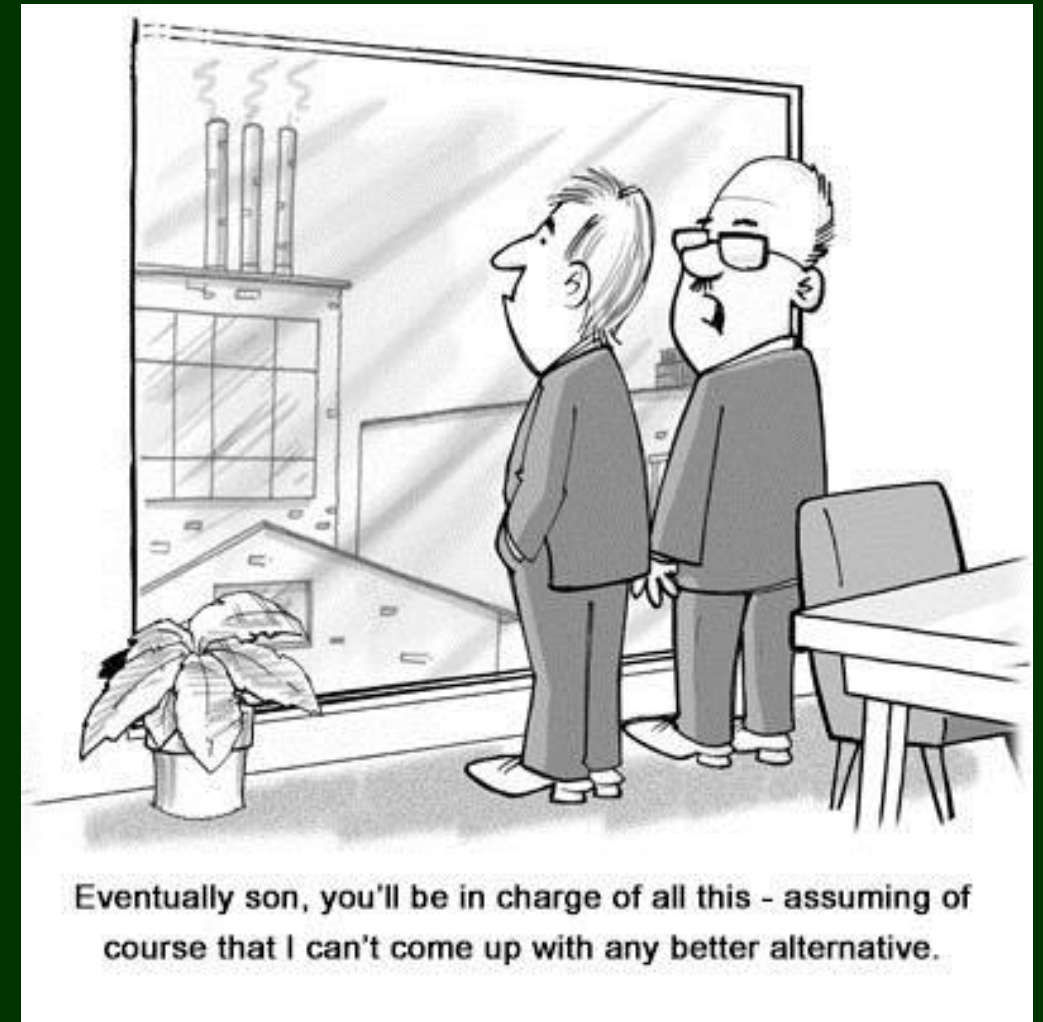
Adoptive Expectations: Rising Sons in Japanese Family Firms

Vikas Mehrotra, Randall Morck, Jungwook Shim, and Yupana Wiwattanakantang

Journal of Financial Economics, 2013.

What about post-Succession?

A Key Challenge for NextGen: Rebalancing Inherited Assets



Rebalancing Inherited Assets



- What to keep and what to shed
- The new generation heirs have their own ideas, talents and passions, and sometimes keeping legacy assets that are past their best by dates can derail the most meticulously made plans by NextGen.

THE BUSINESS MODEL OF MARIE KONDO



Marie Kondo is world-famous for her best-selling book on de-cluttering homes.

At any point, your home is full of stuff you had acquired over several years. It is hard to throw them away, partly because of what you paid for them, and partly due to some other emotional attachment.

The **KonMari** Method is simple: start on a journey with only the items that give you joy.

The end result is a tidy home.



Tidying up the balance sheet:

Hold or Fold?

- Pros and cons of a diversified strategy

THE KONMARI METHOD APPLIED TO A MODERN BUSINESS

Modern balance sheets are also sometimes a mix of assets that were acquired at various points in the past. Perhaps it made sense to invest in Bakelite Transistor Radios at that point in time. Perhaps the **Walkman** was a great product.

It doesn't matter according to the KonMari philosophy. What matters is where you are going, not the past.





WHAT ARE THE CONSTRAINTS FIRMS FACE IN DECLUTTERING?

Assets acquired in the past get embedded with careers. It becomes difficult to dispassionately evaluate each item.

When you are rationalizing assets, you are dealing with employees you have known for years, their families, their careers, etc.

We would expect family firms to be more reluctant to divest assets. When they do, the decision to let go of specific assets must weigh against the higher cost of letting go vs. keeping control for family firms vis-à-vis professionally-managed firms.

Can NextGen create value by culling assets?

Can Family Firms in Emerging Markets Create Value through Divestitures? An Analysis of Indian Family Firms

Mehrotra, Seth, Singhal and Vishwanath (2021)



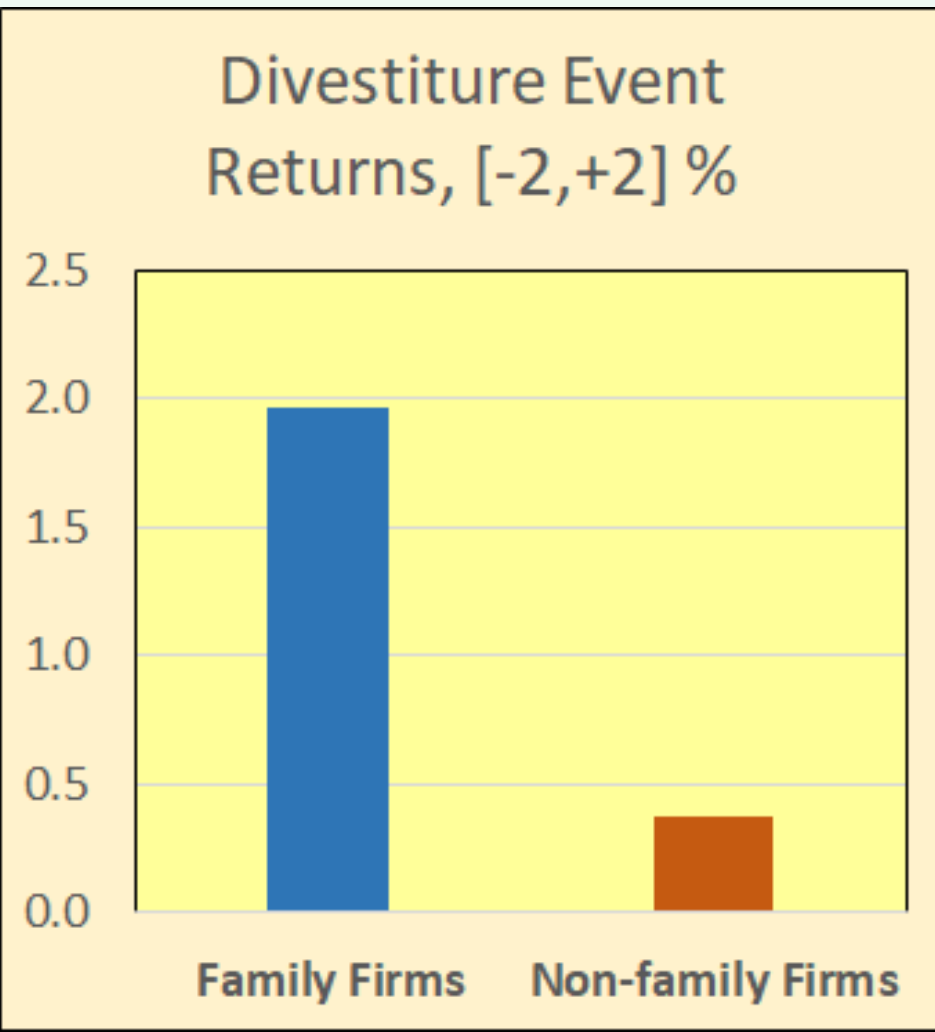
Bombay Stock Exchange

Study examines 714 firms (549 family firms and 165 non-family firms) listed on the **Bombay Stock Exchange** with annual data over 18 years from 2001-2018. Main findings:

- The more diversified the business, the higher the likelihood of divestiture.
- Within family firms, higher levels of ownership is associated with a higher likely of divestiture → cost of managing the divested assets is borne by the owners

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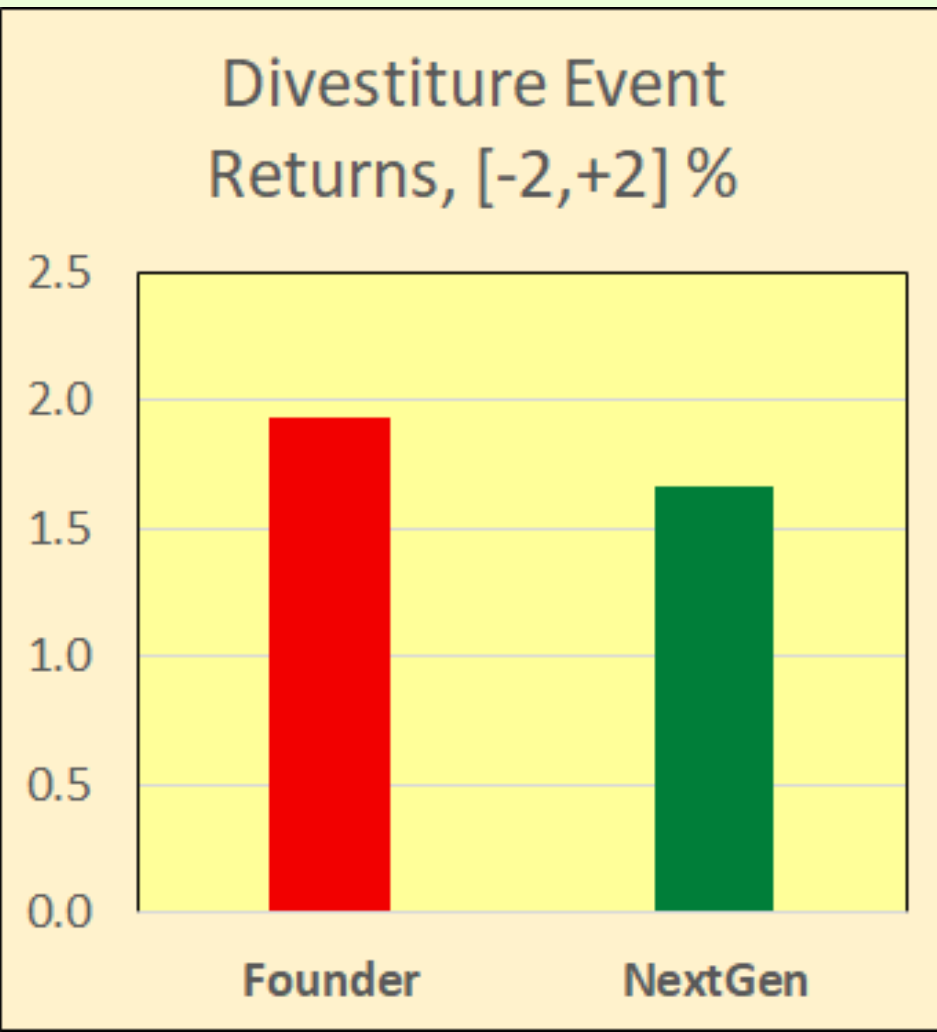
Mehrotra, Seth, Singhal and Vishwanath (2021)



- Markets reward family firms more than non-family firms upon divestiture announcement
 - This could mean discount in valuation when divested asset was held by family
 - Or, family firms are more reluctant to divest assets – they only do so when the gains are larger

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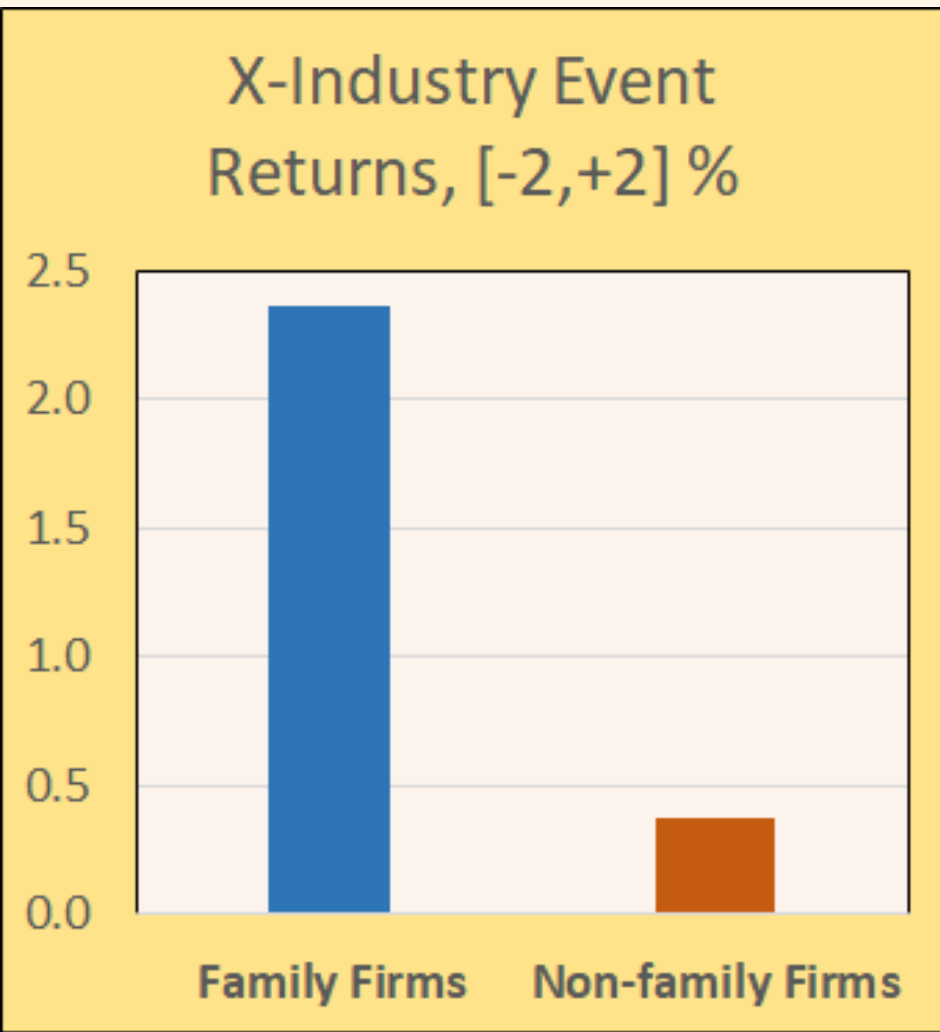
Mehrotra, Seth, Singhal and Vishwanath (2021)



- Similarly, divestitures by founders elicit higher market reaction upon announcement vs. those made by NextGen.
 - This could mean discount in valuation when divested asset was held by founder
 - Or, founders are more reluctant to divest assets – they only do so when the gains are larger

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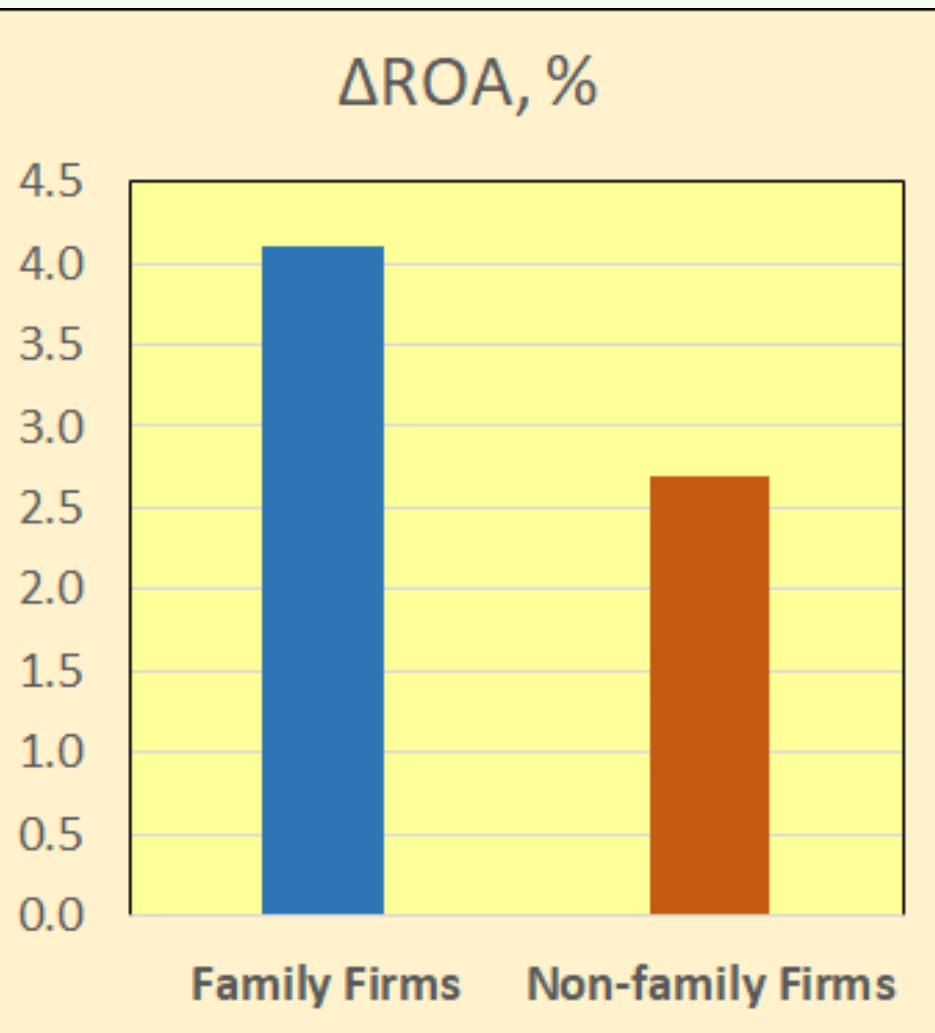
Mehrotra, Seth, Singhal and Vishwanath (2021)



- Why do divestitures create value?
 - *Managing a portfolio of unrelated assets is hard*
➔ *cross-industry divestitures should create more value*
- Returns are even stronger for cross-industry divestitures for family firms vs. non-family firms
- For NextGen, having independent directors on board elicited more positive event returns.

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- **Does it matter?**

- ROA for Family Firms improves, especially relative to non-Family Firms.
- NextGen also show an improvement in ROA, but less than that experienced by Founders.
- Better managed NextGen firms show larger improvement in ROA

Pros and Cons of a Diversified Strategy

*Survey by Maksimovic and Phillips (2013)**

- **Strengths**
 - Cash flow stability
 - Internal capital markets
 - Market completeness

- **Weaknesses**
 - Inefficiencies in resource allocation
 - Managerial self-interest pursuits

**Conglomerate Firms, Internal Capital Markets, and the Theory of the Firm, Annual Review of Financial Economics, 2013. 5:225–44*

Merci beaucoup!