

SOME LESSONS
HISTORY TEACHES US
ABOUT OUR BUSINESSES,
OUR FAMILIES,
AND OUR BEST-LAID PLANS.

Succession & Failure

BY DANIEL GROSS

“Beginnings,” wrote historian and theologian Chaim Potok, “are always hard.” He neglected to add that the second and third acts, so to speak, are even harder. At the start of our careers, we define ourselves, our missions, our beliefs—hard work to be sure, but the blankness of life pushes us on, or pulls us forward, and gradually we fill these voids. However difficult as these small acts of creation may be, our most exhausting struggles are often against the unseen intrusions of entropy, which labors by degrees to undo all that we have done. Whereas, in youth, we see clearly the work before us, time and new generations sometimes obscure our vision: The distinctions between the interests of our families and

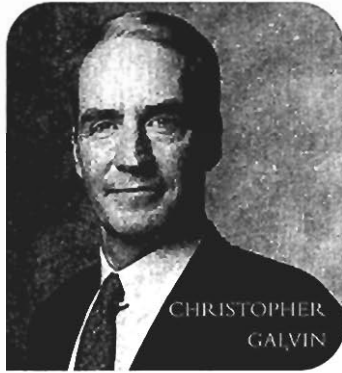
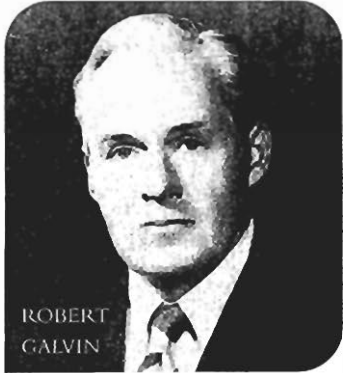
those of our businesses become muddled, and we forget that the same hard work and energy that established these entities must be applied to their preservation and growth.

Leadership succession, continuous growth and innovation do not happen as a matter of course: The very nature of a family business often undercuts these goals, serving as it must all of its stakeholders—customers, employees and current and future owners. A family’s 100-year plan attempts—through its family mission statement, the family’s financial institutions, and a well-considered succession strategy—to manage these tensions to ensure that both family and business prosper. But, to paraphrase the well-worn aphorism, even the best-laid plans are prone to fail.

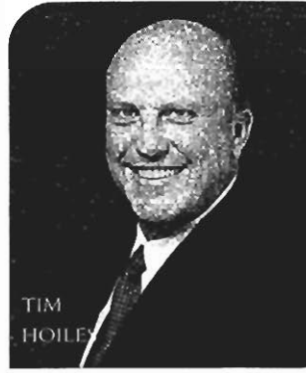
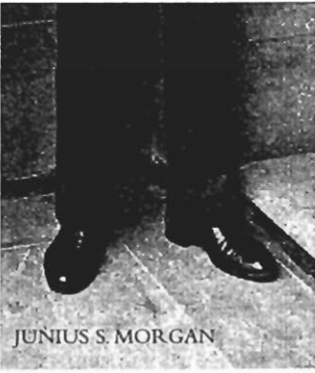
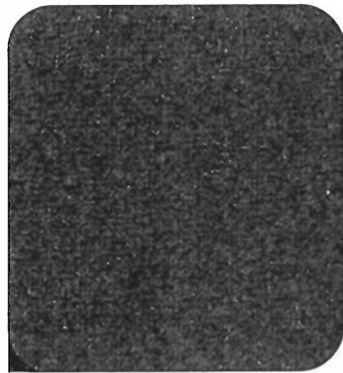
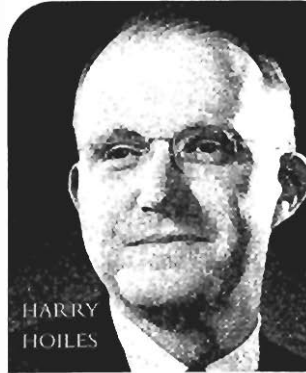
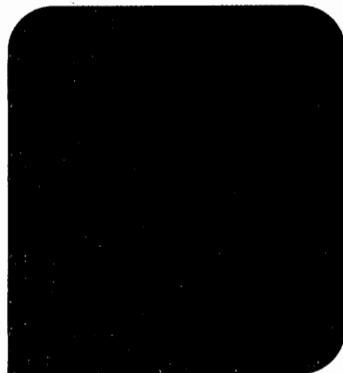
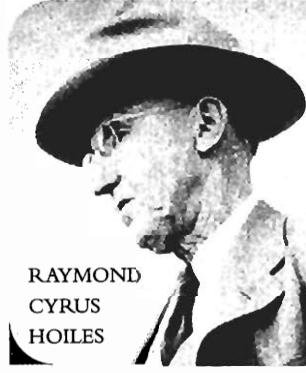
In last month’s issue, we explored the underpinnings of flourishing 100-year family plans. But historians—and present-day readers—can learn as much from studying failure as from studying success. Businesses fail all the time, and the companies that go out

Top view

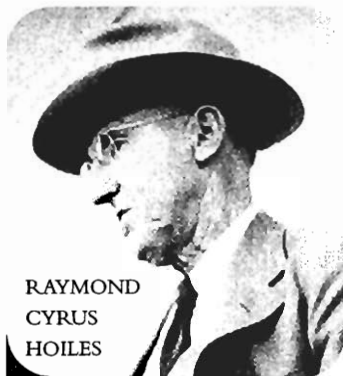
This portion of *Worth’s* continuing series on establishing a 100-year plan meditates on the fates of several family-owned businesses whose multigenerational strategies failed to see them through. The Hoiles family, owners of Freedom Communications, which publishes the *Orange County Register*, has recently undergone a financial restructuring that has affected the company’s prestige and balance sheet in order to give family members exit options. The Galvin family’s influence over Motorola has steadily declined as younger generations, who lacked the instincts and vision of their forebears, led the organization into ill-timed investments and unproductive markets. And the indifference to the legendary bank on the part of the descendants of finance legend J.P. Morgan resulted in the family’s separation from the firm, which would continue to prosper as one of Wall Street’s giants, while the family members gradually vanished from public life.



In youth, we see clearly what time and new generations will obscure: The same hard work and energy that established our families and businesses must be applied to their preservation and growth.



of business after a generation or two seldom leave us scratching our heads. Rather, we find ourselves perplexed by those that plainly thrive with solid franchises and sound business models, yet do not survive as family businesses. Governance and family ties fracture in some cases, as age and new generations dilute ownership, compromising the firm's overall valuation. At others times, a failure of execution and vision within the management of a company that requires constant reinvention can lead to the abrupt end of a family's longtime association. In still other instances, the proprietors of remarkably valuable franchises neglect to furnish the succeeding generation with the necessary mindset and training to contribute meaningfully to the business. Here, we undertake to examine each of these flawed succession scenarios, considering, for the benefit of our own futures, the families and businesses they have shaken.



RAYMOND
CYRUS
HOILES

**The experience of
Freedom Communications
highlights how failing to provide
clear lines of succession and options
for liquidity can undermine the
fortunes of a family business.**

FREEDOM FROM THE FAMILY

**“I believe we are one of the
most dysfunctional families that own
a business in America.”**

—Tim Hoiles

IN MID-OCTOBER 2003, Freedom Communications, the media company that owns the *Orange County Register*, entered into an unusual transaction with Blackstone Communications Partners and Providence Equity Partners. A process that lasted for several years culminated with the private-equity firm agreeing to buy out shareholders of the privately held, family-controlled company who wanted to sell. Those who wished to stay in would still maintain control of the company. The arrangement was an inelegant short-term solution to provide liquidity to those who no longer wished their fortunes to be lashed together with those of their cousins.

The deal marked a potential resolution of a long-running feud within the nation's 12th largest newspaper company. The experience of Freedom Communications highlights what may be an inherent conflict in infusing a diffusely-owned media conglomerate with a libertarian ethos. But it also shows how failing to provide clear lines of succession and options for liquidity can undermine the fortunes of a family business.

Family conflicts lay at the very origins of Freedom Communications. In 1905, 28-year-old Raymond Cyrus (R.C.) Hoiles went into business with his brother Frank, who owned the *Alliance (Ohio) Review*. The brothers' partnership fractured in the

1920s after Frank refused to print R.C.'s criticisms of labor unions. “When I was working on a newspaper that I did not control, I used to wish that I was in another line of business,” R.C. later said.

In 1935, R.C., entranced with the libertarian teachings of philosopher Ayn Rand, moved his family to Santa Ana, Calif., and bought the *Santa Ana Register*. The paper morphed into the *Orange County Register*, a highly profitable beacon of libertarian thought.

R.C.'s two sons, Clarence and Harry, joined the growing business, as did Robert Hardie, who had married R.C.'s daughter, Mary Jane. Upon R.C.'s death in 1970, the three children divided ownership of Freedom Newspapers—composed of 16 publications in seven states—roughly equally among themselves. The eldest son, Clarence, took charge.

At the time Clarence died in 1981, however, no formal succession plan had been established, and the relative stability that characterized sibling relations began to waver. Mary Jane did not want Harry Hoiles to become chief executive and blocked his ascension to the top post. Angered, he filed a lawsuit to break up the company—an action that was dismissed in court, though Harry remained embittered until his death in 1998. This rift extended into the next generation, as Harry's son, Tim, a director, found himself stymied by his relatives within the company.

The theme of fragmentation continued to weave its leitmotif among the numerous third- and fourth-generation owners. Between them, the three second-generation siblings produced 11 children and 18 grandchildren, and the number of family shareholders rose to more than 80 in the 1990s. This meant that the company's annual dividends—although above \$10 million—were apportioned among cousins who were increasingly strangers to one another. Freedom Communications continued to expand in the 1990s, buying newspapers and television stations and launching a magazine division. But with no single person holding more than a 10 percent stake—and all of the shares remaining within the family—the company drifted because its executives were beholden to the family, which itself lacked leadership. The Hoiles, in practice, more closely resembled the Hatfields and McCoy's than the Sulzbergers of the *New York Times*. As Alan Bell, the CEO of Freedom Communications, put it, “You've got people who have disagreed with each other, almost from birth.”

In August 2002, family shareholders assembled at a liquidity forum to explore their options. Some members wanted out; some third-generation members, led by board chairman R. David Threshie, who was married to one of R.C.'s granddaughters, adamantly opposed any sale. And some members of the fourth generation, led by Thomas W. Bassett, one of R.C.'s great-grandsons, favored buying out the dissidents. But the company was reluctant to assume the debt necessary to do so.

In March 2003, Freedom formally placed itself on the block. Last August, the family met to hear bids. The board, in its review process, requested detailed information not only on how strategic buyers such as Gannett would value the company, but also on how the prospective new owners would preserve the company's values—in other words, its family-influenced libertarian editorial policies. These types of questions led some bidders to conclude that, rather than seeking a buyer, the company simply sought to leverage the sale process to establish a value for shares.

Almost to the end, the process remained contentious. In mid-October, just days before a deal was announced, Tim Hoiles complained that it was taking too long. "It's been 20 years of them saying we're going to have liquidity," Hoiles said. "I'm still waiting."

He does not have to wait much longer. Under the agreement, which for the first time brings outside institutions into the circle of ownership and creates a liquidity option for shareholders, dissident family members can sell their shares at a set price, one that reportedly values the company at \$1.8 billion, a price lower than the one it could have commanded in an open market. Tim

Hoiles' inherited 8.6 percent stake is likely to be worth about \$100 million. "I would liken this, in a sense, to Armistice Day," Bell said. "This is the end of the war."

Or it may be the beginning of another conflict—and one that could have been avoided had the Hoiles family delineated clear lines of succession and paths to liquidity early on. Unlike families, private equity firms like Blackstone do not have multigenerational time horizons. And in a few years, R.C. Hoiles' descendants may find themselves again confronting restive minority shareholders who want to cash out of an illiquid investment.

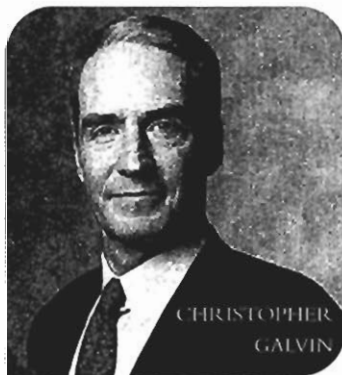
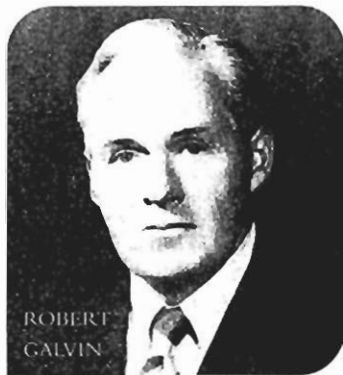
MOTOROLA'S DROPPED CALL

"What is important is the long term," Christopher Galvin, the third-generation CEO of Motorola, told the *Wall Street Journal* in 1998. In 2028, when Motorola would celebrate its 100-year anniversary, he would be "standing on the podium, God willing."

LAST FALL, GALVIN RESIGNED, 25 years short of the century mark. Particularly in the technology field, companies are now often compelled in the name of competition to abandon even profitable businesses to create disruptive next-tier innovations before somebody else beats them to it. The necessary originality of thought and rigor of execution to accomplish this is rare enough to find in one generation, much less two—a reality that explains why so few technology companies remain under family control. IBM survived two generations of family management, while Corning is currently prospering under its founding family's fifth generation. Corning is an unusual exception; Motorola, under its third generation of family direction, as it happens, is not.

Unlike many other family companies that have sold shares to the public, Motorola did not maintain voting stock or special shares for family members. For the past 60 years, the Galvins were always willing to be judged on their performance. In today's climate, however, the window to prove oneself has narrowed considerably—no matter whose DNA one carries.

Founded in 1928 by Paul V. Galvin and his brother, Joseph, Motorola began life as the Galvin Manufacturing Corp., with total capital of \$565. It was truly a family business; Paul's wife, Lillian, was the secretary and treasurer. The Chicago-based brothers produced the first commercially successful car radio in 1930 (dubbed the Motorola), manufactured police radio systems, and made walkie-talkies an Army staple during World War II. The company went public in 1943.



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After an aborted attempt in 1946 to market a gas-powered car heater, Paul Galvin declared the company “will now stick to electronics.” The move proved wise. Motorola built its first television in 1947. Investments in research established the company as an early leader in transistors and semiconductors.

Robert Galvin, Paul’s son, became CEO in 1959 when his father died, and for nearly four decades, Robert *was* Motorola. He guided the company into the jet, space, computer and wireless ages. (Astronaut Neil Armstrong described his first steps via a Motorola transponder.) In 1974, when Motorola produced its first microprocessor, the company sold its declining television business and boldly plowed the proceeds into semiconductor and wireless telephone research. Over the next decade, the company spent \$100 million developing cellular phones, selling its first—a 28-ounce giant—in 1984.

By the time Robert Galvin stepped down as chairman of the board in 1990, Motorola was a highly respected global technology titan. But the transition to the third generation was hardly seamless. The heir-apparent to Robert Galvin was not his son, Chris, who had joined the company full-time in 1973, but George Fisher. Still, the younger Galvin continued to work his way up through the company’s paging division before assuming more senior posts. And in 1993, when Fisher resigned to head up Eastman Kodak, the coast was left clear. In 1997, Chris Galvin was named CEO.

Unfortunately, Chris was a victim of bad timing and poor execution. Motorola’s status as the global leader in both cell phones and pagers made it a huge target for competitors, and hence vulnerable to swift changes in the marketplace. Motorola failed to adequately prepare for the paradigm shift from analog to digital, and its engineering-dominated culture proved ill-equipped to address the evolution of once-clunky cell phones into trendy fashion statements. Meanwhile, the company’s massive investment in Iridium (a satellite-based global phone service) soured; Iridium went bankrupt in 2000. And while the company phased out products, such as car radios and pagers, whose greatest era of growth had passed it stubbornly held onto its semiconductor business, where profits continued to dwindle. Though Galvin essayed to confront these challenges by

restructuring, cutting the 140,000-person workforce sharply, and engineering a 2000 merger with General Instrument, he lacked his father and grandfather’s commanding presence—as well as their credibility. The company continually disappointed Wall Street expectations, and in one interview, Chris uncouthly bristled at the suggestion that he had risen to his position by virtue of genes rather than talent: “Where’s the evidence that the board engaged in nepotism?”

Under Chris’ management, Motorola missed out on opportunities in areas that seemed related to its core competencies: wireless e-mail, wi-fi, flat-panel televisions and satellite radio. Worse still, once Robert Galvin retired from the company’s board in the spring of 2001, Chris remained as the only family member on the inside. His brother and two sisters had elected not to join the company. The Galvins today own about 3 percent of the company’s stock—not nearly enough to exert effective control. In the end, the Galvin family failed because the enterprise—and the market and industries in which it competed—had grown so complicated that it was probably beyond the capabilities of any group of family members—let alone a single one—to master. Steering the corporate ship through these shoals required a captain who was both a gambler and a visionary. These skills cannot, alas, be taught at the Harvard Business School, nor can they always be conveniently passed down from one generation to the next.

DECLINE OF THE HOUSE OF MORGAN

When J.P. Morgan died, the *Wall Street Journal* declared: “There will be no successor to Morgan.” But, of course, there was. In fact, three generations of Morgans have been involved in banking since the death of the man who, a hundred years ago, bestrode the world of finance like a colossus. But while the name lives on, the family’s influence has faded.

WHAT HAPPENED? REGULATION, spurred in part by the firm’s success, changed the bank’s business model. And in later years, even as circumstances required greater preparation, the patriarchs neglected to mentor the succeeding generation by inculcating an ethic of management and hard work. As a result, the bank—in its treatment of the family that created it—ultimately reciprocated the indifference they had shown the institution.

The first great Morgan banker was not the titanic J.P., but his father, Junius Spencer Morgan, who set up shop in London in the 1850s. He assiduously groomed his son, John Pierpont, born in 1837, to join him, just as the Rothschilds prepared their male

progeny. Junius helped establish J.P. in business in New York, and they worked together closely until Junius's death in 1890.

With his own firm, headquartered in Beaux Art splendor at 23 Wall St.—the epicenter of the financial district—J.P. emerged as a force unto himself in the 1880s. Among his many feats were saving the gold standard in 1895; architecting companies like AT&T, U.S. Steel and General Electric; bailing out Wall Street in 1907; and generally acting as a force for stability and industrial agglomeration.

J.P. Morgan sent his son, J.P. (Jack) Morgan Jr., to apprentice in London for several years, and then made him a partner. When J.P. Morgan died in 1913, Jack succeeded him. Perpetually in his father's massive shadow, Jack carried on the family tradition, helping to finance World War I, and, through his leadership, maintaining the firm's status as the preeminent investment bank through the 1920s.

But Jack would not have the same opportunity to initiate his two sons, Junius and Henry (known as Harry), into prominent, lifelong partnerships. The Glass-Steagall Act, passed in 1933, forced firms to cleave their investment banking and commercial banking businesses, and so the House of Morgan split into Morgan Stanley (an investment bank) and JP Morgan & Co. (a commercial bank). Junius went with JP Morgan & Co., and Harry, who had married a descendant of the Adams political dynasty, joined Morgan Stanley as treasurer.

Concerned over liability and the possible loss of capital as partners retired, JP Morgan & Co. incorporated in 1940 and sold shares to the public in 1942. Morgan Stanley remained a partnership.

It was perhaps fitting that Jack died in 1943, for his world was passing. As the postwar-era dawned, massive new institutions arose to fulfill functions previously performed by the House of Morgan. The World Bank and International Monetary Fund stepped in to provide the sort of sovereign financing in which Morgan had specialized. As

author Ron Chernow described the situation after World War II in the House of Morgan: "Morgan Stanley was the leader in investment banking, while JP Morgan was a shabby genteel aristocrat in commercial banking, backed by a great deal of tradition, but without comparable contemporary power."

The same might have been said about Jack's sons, who were nowhere nearly as devoted to banking as their forefathers. Bred to be gentlemen bankers, they were too much the gentlemen and too little the bankers. Harry commuted by seaplane to Wall Street, and as Chernow wrote, "actually spent more time yachting than issuing

securities." So in 1956, when he wanted to bring his son Charles as a partner into Morgan Stanley, his colleagues rebelled. Harry had to trade his rights to the Morgan name—which he still retained—for his son's partnership. Charlie Morgan was obviously unqualified to work at Morgan Stanley and essentially served as an office manager. Several years later, when Harry's younger son, John Adams Morgan, came up for partnership, he was blackballed.

Harry's brother, Junius, was as miscast as a banker as Arnold Schwarzenegger would be in a Woody Allen film. "He didn't know anything about banking, and it was pitiful to watch him," one colleague said. When he died in 1960, the Morgan presence at JP Morgan & Co. ended. Harry died in 1982. And so as the bank grew in stature, and again became a major power on Wall Street, the Morgan family did not particularly benefit.

Ironically, the one Morgan who was expressly prohibited from working in the bank showed some aptitude for the profession. John A. Morgan, excluded from the firm that bore his name in the 1950s, went on to pursue a distinguished career at Smith Barney. For the last 21 years, he has run his own small investment bank, now called Morgan Joseph—a sort of House of Morgan in miniature that serves middle-market clients. Because the fourth-generation did not properly prepare the ground, and because the third generation failed to properly train its successors and inculcate a sense of the family business as a calling rather than as a place to show up and collect paychecks, this fifth-generation Morgan never had the opportunity to prove himself in the family business. ■

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