

# The Role of Intellectual Capital in Mexican Family-Based Businesses: Understanding their Soul, Brain and Heart

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**Abstract.** This paper attempts to highlight a key source of intangible value (i.e., intellectual capital) for family-based businesses. By reviewing the merger and acquisition activity of four Mexican cases, an analysis of the consideration of various intangible assets is conducted. Consequently, we introduce the term *intellectual capital in family businesses* (ICFB) and define it as a sum of a set of quantitative and qualitative intangible assets affecting overall business performance. A metaphor for diagnosing the qualitative intangible assets for family businesses is then suggested encompassing a firm's soul (human capital), brain (structural capital) and heart (relational capital).

*Keywords:* Intellectual capital; family firms; intangible assets; mergers and acquisitions.

## 1. Introduction

Firms typically implement their growth strategies through internal development, joint ventures, alliances or contracting with external partners (Collis and Montgomery, 1997; Durán, 1997; Lorange and Roos, 1992). However, mergers and acquisitions (M&As) have become one of the most significant vehicles for executing corporate growth strategies and relocating resources in the global economy (Bleeke and Ernst, 1993; Gupta and Roos, 2001; Normann, 1997; Sudarsanam, 1996). By applying the resource-based view of the firm (Barney, 1991), M&As can be seen as allowing the firm's portfolio of resources to be strategically transformed for sustainable advantage. According to Duck (2002), fierce competition is stimulating greater industrial

consolidation, promoting M&As around the world. Moreover, several international trends have been driving M&A deals including: low interest rates (Parsley, 1996), available credit, (Stone *et al.* 1996), globalisation (Bleeke and Ernst, 1993; Mallete *et al.* 2003), higher technology, privatisation as well as deregulation, and free trade agreements.

The purpose of this paper is to provide academic researchers, as well as business managers, with as spotlight of some important issues regarding intangible assets—specifically intellectual capital assets—and how they affect the overall value of the firm when attempting M&As. To do so, we analyse four cases of Mexican family-owned businesses that have been merged or acquired by either national or international competitors. We then suggest a framework for analysing key variables within a construct called intellectual capital for family businesses (ICFB).

## 2. Literature Review

M&As are viewed as an external investment alternative to internal growth. Typically, when an M&A opportunity is examined, an appraisal of the desirability of a prospective purchase is conducted (Weston and Brigham, 1978). The process begins with a pre-acquisition phase that involves a careful self-examination of the company and the sectors it participates in. It then continues with a screening

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process during which knock-out criteria are established. Once the criteria are mapped on the candidate company, a business valuation is undertaken. The process ends with a careful negotiation and post-integration plan (Copeland *et al.*, 2000).

### 2.1. *Relationship between mergers and acquisition and family firms*

It is widely recognised that family firms are the most common type of business organisation worldwide (Birley and Godfrey, 1997; Carlock and Ward, 2001; Cromie *et al.*, 2001; Donckels and Frohlich, 1991; Dyer, 1989; Heck and Trent, 1999; Ibrahim and Ellis, 1994; Kotkin, 1992; Reed, 1989; Ward and Sorenson, 1987). In fact, the Spanish Instituto de la Empresa Familiar (IEF) estimates that 60% of current worldwide enterprises are family-owned, generating from 40 to 60% of the world's GNP (see <http://www.iefamiliar.com>).

Since the 1950s there has been a growing research interest in family businesses. Studies regarding founders, members of the Next Generation, non-family managers, conflict and succession—among others—have highlighted the fact that the family is an important, if not critical, variable for the sustainability of family firms. However, even though several advances in the field have been developed, there is no current unified theoretical framework or theory of the family firm that explains why family firms exist and what determines their scale and scope (Christman *et al.*, 2003). Moreover, we have to take into account problems arising about the degree of precision of the term “family firm”, as well as on the definition of what a “family” is. And, although the latter may seem confusing and not helpful when determining the reason family firms exist, a direct contribution clarifying this issue is that of Christman *et al.* (2003), who concluded that “Family firms exist because of the reciprocal economic and non-economic value created through the combination of family and business systems” (p. 7).

Family firms are complex entities in which business and family issues interact in various ways (Cromie *et al.*, 2001). According to Gubitta and Gianecchini (2002) family firms are companies in which two or more key individuals are linked by kinship, close affinity, or solid alliances. These key individuals hold a sufficiently large share of financial capital (full ownership) or board control (controlling ownership/governance) to enable them to make decisions regarding strategic management and overall business goals. In addition, Litz (1995) stated that in classic family businesses, family members aim to perpetuate or increase the degree of family involvement, which refers to the degree a family member incurs

in behaviours/family interactions that produce certain distinctive, synergistic vision and management of the family firm. Unlike non-family companies—those where a family is not involved in the management and/or ownership of the firm, and where trans-generational pursuance is unintended—the success of family firms depends on the ability to manage three networks:

1. The familial network: which encompasses all the family members pertaining to this institution (involved either in the management, equity and/or in the “family interactions”);
2. The organisational network: which includes all the people who take part in the business (at the top, middle and low levels, not including family members); and
3. The environmental network: this involves the external stakeholders, such as customers, suppliers, banks and other institutions.

Studies in family firms at the group level have added to our knowledge one of the most pervasive problems family companies suffer—family conflict. Conflict among family members tends to be directly reflected in the firm, especially if the degree of involvement in the company of the family members is high. That is precisely why, trying to find a balance among these three networks is what Carlock and Ward (2001) called “the family-enterprise dilemma”. At the end, the familial network is so strong that it influences the economic and non-economic development of the firm as well as its sustainability over time. In fact, sustainability over time is pretty difficult when conflict is present. Experience says that when this happens, family firms generally close their doors or sell.

### 2.2. *Family business challenges*

Broadly speaking, there are three challenges that force family business to consider closing or selling options:

1. The average life span of a family business is less than 25 years (Borkowski, 2001) and generally, these companies do not have a generational transition outline (i.e., succession plan) to ensure long-term survival. In Mexico, only 7 out of 60 (11.67%) family businesses consulted in our research had a documented generational transition outline. All seven of them were relatively large companies (i.e., greater than \$1,500,000 dollars a year in income, and over 57 years old); companies which in a way, have passed the threshold of the first and second succession crisis tend to be better suited for future survival.
2. Most family businesses do not have a well-established financial infrastructure—an important amount of

ready-to-use cash or ready-to-cash assets, internal liquidity funds—which enables them to overcome severe unexpected crises (e.g., a major industry downturn, significant drawings by owners, or large divestitures made by family members).

3. Increased conflict and personal disagreements among family members may often drive a family to sell the business in order to maintain family unity (i.e., kinship, affection among members, culture and mutual roots, family bonds/ties, enjoyable time spent together).

In Mexico, during the 1994 economic crisis, many small, medium and large family businesses were closed, merged or acquired. Indeed, even 5 or 6 years later, family businesses were still being sold because they just could not recover from the debt load. In this paper we examine four cases of family businesses that completed a merger, acquisition or both. These cases refer to medium and large family businesses that had difficulty in recovering from the 1994 financial crisis. The main causes of failure were somewhat different in each case, but an external constant remained the same: a weak financial infrastructure in the form of credit constraints and liquidity. The analysis of each case also highlights the elusive consideration of intellectual capital as it relates to the valuation of the business.

### **3. Case 1: Casa Roy—Los Ángeles**

Casa Roy was a medium-sized chain of department stores which became part of Grupo Los Ángeles when it merged with Tienda Los Ángeles during the first quarter of 1994. After a year of working together, Grupo Los Ángeles completed the deal by acquiring the two remaining department stores Casa Roy had, resulting in a 100% acquisition.

Casa Roy was a 100% family-owned business founded in Monterrey, Nuevo León, by Rogelio Guerra more than 40 years before the merger. It was considered one of the top five retailers in the state (Nuevo León) and had an excellent reputation. People often referred to it as “La Boutique Más Grande de Monterrey” (The Biggest Boutique in Monterrey). Even though it was not the same size as Sears, it was considered to be competing at that level i.e., with the biggest global players. As years passed by Don Rogelio never realised that his family was no longer interested in the business. Of his five sons, not even one wanted to take future charge of the family firm. After the sons married, several family conflicts developed since the in-laws argued that financial distribution was, according to them, not “fairly made”. In addition, no management controls were in place. Family members withdrew money as they pleased and merchandise was simply taken from stores using the excuse “this is what others did before”. Eventually, increased family tension and new competitors

in the market place resulted in decreased sales, quality and service.

Grupo Los Ángeles (GLA) was also a young family business, whose main founder was still in charge. Jesús Treviño González was a 40-year-old entrepreneur who wanted to expand his business and increase its value. He was sure that Casa Roy represented a big opportunity for growth since during its best days it had been considered an icon of the fashion industry in Monterrey. GLA kept all Casa Roy employees during the post-acquisition phase. It was important for GLA to continually develop employee potential and even give some of them top management positions. Twelve years after the merger and 11 years after the completed acquisition, most of the employees who stayed in the business were still working there. When asked about her feelings towards the new integrated company, one employee said “there has not been any impact here . . . we are still the company we were, although some procedures are different . . . as I see it, what happened was that our former boss was too old and had to retire, while our new boss is younger, full of energy and with bigger expectations”.

### **4. Case 2: Canadá—Coppel**

Calzado Canadá was a family-owned footwear company founded by Salvador López Chávez in 1940 in Guadalajara, Jalisco. For several decades it expanded throughout Mexico while the domestic economy was protected from external competition. Canadá’s shoes were considered to be symbolic of the “Jalisciense” industry for several decades. When North American Free Trade Agreement (NAFTA) (1992–1993) forced the Mexican government to open its frontiers to new foreign products and suppliers, Calzado Canadá, was pushed to increase its quality, production and service. To do so, the company invested a large amount of money in expanding its capacity, improving its shoe designs and increasing customer service at the shoe stores they owned all over Mexico. All these actions were financed by credit through Mexican banks amounting to more than \$5 million. After the 1994 financial crisis, interest rates sky-rocketed. Calzado Canadá suddenly found itself heavily indebted. The peso devaluation, along with a reduction in sales and accounts receivable made one of the big 500 Mexican companies diminish its market position gradually. A company which in its best years had produced 65,000 pairs of shoes daily, declared itself in debt moratorium (insolvency): it just could not afford its debts. In 1996, revenues fell by two-thirds and by September 1997, banks (creditors) absorbed 80% of the family business. The next generation owners of the company, Sandra López Benavides and Tomás López Rocha lost control of

the company. The liabilities totalled \$45 million and the company, as a result, had to be restructured. The causes of the organisational collapse were both, external (i.e., the economic downturn) and internal (i.e., lack of management and financial infrastructure, cash management, cost of financial instruments, debt).

In March 2002, Calzado Canadá was sold to Grupo Coppel, a family-owned chain of department stores, which had its origins in Sinaloa, México. Industry insiders predicted a resurgence of the old Calzado Canadá. It was thought that Coppel was interested in the famous shoe-business and wanted to get the most out of Canadá's reputable image and relational capital. After all, 64 years in the Mexican shoe market was a good starting point. When Coppel took over control of Calzado Canadá, it decided to discontinue the production of shoes in the plant at Jalisco, and turn the company into a distributor of imported shoes. The last 1000 employees still working at the plant were dismissed. Now, Coppel-Canadá produces only 4000 pairs of shoes per day (compared to the 65,000 pairs it produced before being acquired). The significant drop in production can be attributable to worldwide Brazilian shoe producer Azaléia who was originally involved (in a non-evident way) in Coppel's acquisition of Calzado Canadá. Before the acquisition, Coppel had been a legal agent (sales representative) of Calzado Azaléia in México. Azaléia wanted to penetrate into the Mexican market, but did not want to start such an adventure alone. When Calzado Canadá declared bankruptcy, the Brazilian producer convinced its representative to buy the company and start a joint venture together—Coppel got 49% of the ownership and Azaléia kept 51%.

### 5. Case 3: Salinas Y Rocha—Elektra

Grupo Salinas y Rocha consisted of 86 furniture stores, 10 department stores, 21 warehouses and 3 distribution centres. In the beginning, it was as a small furniture store, founded by Benjamín Salinas Westrup, in 1907, in Monterrey, Mexico. During the first to second generation transfer of family management, some discussions regarding ownership took place. The resulting negotiations caused two family branches to take different courses of action. One of these family branches started Grupo Elektra in 1950. Grupo Elektra did not compete directly with Salinas y Rocha since their focus was on the mass middle-class population. On the other hand, Salinas y Rocha targeted the well-to-do upper class segment. The 1990s were a difficult time for Salinas y Rocha because new competitors such as JC Penney came to the country. Furthermore, bank loans were called since the weak financial structure of the firm could not support the \$100

million operating budget. Ultimately, Salinas y Rocha's poor performance resulted in the banks taking over 94.4% of the company.

Grupo Elektra expanded over the years to become a leading retailer in Mexico with significant operations domestically and in a number of other Latin American markets. On March 10, 1999, a syndicate of banks holding a majority equity interest in Salinas y Rocha declared Grupo Elektra the winner of an auction to acquire the 94.4% outstanding equity interest. Grupo Elektra's leader, Ricardo Salinas Pliego was the great-grandson of Benjamín Salinas Westrup. He was very interested in the acquisition and saw it as a means of bringing back the famed legacy that belonged to his family from previous generations. He won the auction against the richest businessman in Latin America, Carlos Slim, the owner of Grupo Carso Comercial.

After the acquisition, Grupo Elektra initiated a corporate reorganisation to take advantage of certain tax loss carry-forwards reported by Salinas y Rocha. Within a few months, it spun off three operating subsidiaries and within two years sold the acquired department stores to Liverpool (a competitor) for \$58 million.

### 6. Case 4: JC Penney—Carso

On November 30, 2003, Grupo Carso Comercial founded by Carlos Slim, completed its purchase of 100% of the corporate capital of JC Penney Mexico. The purchase consisted of six department stores located in Monterrey, León, Mexico City, Chihuahua, Cancún and Mérida.

JC Penney was one of America's largest department stores, drugstores, catalogue and e-commerce retailers, employing approximately 230,000 associates. It initiated operations in Mexico during 1995 shortly after NAFTA was negotiated among Canada, US. and Mexico. However, the Mexican market was not as profitable as JC Penney expected.

By 2000, JC Penney started implementing a turnaround strategy for its Department Stores and Catalogue business units. The strategy consisted of applying certain steps to continue improving the merchandise offerings, presenting a more integrated and powerful marketing message and lowering expenses. The financial goal was to generate segment operating profit of 6–8% of sales by 2005. Of course, the successful execution of the turnaround strategy would be contingent on the success of the company's new merchandise offerings. Nevertheless, the strategy was not good enough. By 2003, JC Penney closed the sale of its Mexico department store operation as well as 25 US-located stores totalling more than 1.8 million sq. ft. of retail space.

## 7. Valuation in Mergers and Acquisition

One of the most important considerations of an M&A transaction is reaching an agreement on the valuation of each of the companies involved (Weston, 1964). Valuation techniques and methods are fundamentally based on the assumption that maximising shareholder value should be the fundamental goal of all businesses (Copeland *et al.*, 2000; García, 1998; Meigs *et al.*, 1995; Shapiro, 1982; Weston and Brigham, 1978). Measuring and managing the value of companies typically involves a variety of procedures such as: analysing historical performance, forecasting future performance, estimating the cost of capital and calculating and interpreting future results.

### 7.1. Intangible assets in mergers and acquisition valuation

To say that the value of a business equals the present value of its expected future cash flows discounted at an appropriate rate is simplistic. Market valuation should also take into account the synergies and fit that the business may have with potential buyers, along with the intangible assets obtained, transferred or acquired. In fact, the qualitative factors in the M&A process may enable one company to generate synergistic effects obtaining a “two plus two equals five” outcome. And, although there are many sources for synergies to arise, one of them has been suggested to be those intangible assets that make up the intellectual capital (Nahapiet and Ghoshal, 1998): human capital, structural capital and relational capital including family values and ties (Bontis, 1998; 2002). Values and ties are important because they provide a basis for action, they open information channels that reduce the amount of time and investment required for making specific decisions. “Ties provide the channels for information transmission, but the overall configuration of these ties [based on family values] . . . may impact the development of intellectual capital” (Nahapiet and Ghoshal, 1998, p. 252); “and as a result, the firm competitiveness and potential sustainability over time”. In such situations the acquirer may be willing to pay a substantial premium over previous levels of earnings, dividends, market or book values of the acquired firm (Weston and Brigham, 1978; Weston, 1964).

As illustrated in our previous examples, families tend to sell their businesses when there is little or no choice left. Whenever the family sells, the main purpose of this action is to obtain the best financial deal possible, since they are removing the family’s principal source of wealth. The business also typically provides security as well as income and employment for family members. Consequently, including

intangible assets (non-financial measures) in the price is essential.

The research literature investigating the role of non-financial value measures includes several empirical studies which have dealt with establishing the relevance and value of intangible assets (Seethamraju, 2001). Lev and Sougiannis (1996) developed a methodology to value research and development (R&D) capital and amortise it. Amir and Lev (1996) found that investors rely primarily on non-financial information when valuing firms (at least in the wireless communications industry). Lev and Zarowin (1999) made a proposal to comprehensively capitalise intangible investments and to introduce a systematic restatement of financial reports. Moreover, Deng *et al.* (1999) found that patent statistics are associated with the market value of firms owning them. Bontis and Mill (2004) determined that non-financial measures such as web-based metrics were often considered by analysts when valuing dot-com companies. Finally, Ittner and Larcker (1998) proved that customer satisfaction is a leading indicator of financial performance.

Research into intangibles has increased significantly over the last several years (Smith, 1999). Moreover, professional associations such as the Financial Accounting Standards Board (FASB, 2001) and the International Accounting Standards Committee (IASC) are working on intangibles measurement. Under GAAP, most intangible assets are not recognised in the financial statements of a firm, except when they are acquired and identifiable (Seethamraju, 2001; Tuzun, 1992). This fact is in opposition to findings showing that non-financial information about intangible assets plays a significant role in determining firm value. Accountants continue to face the problem of how best to reflect intangible assets on the financial statements and whether or not to disclose them. Generally speaking, intangible assets are included with goodwill and amortised. However, there is considerable discretion in determining the “useful” lives of intangible assets amortised with goodwill (even though some changes have been introduced lately both in North America and in the UK). Consequently, the carrying value of intangibles on the financial statements may not be reflective of their economic usefulness (Seethamraju, 2001).

Goodwill . . . means the present value of future earnings in excess of the normal return on net identifiable assets . . . it is not an identifiable asset. The existence of goodwill is implied by the ability of a business to earn an above average return; however, the cause and precise dollar value of goodwill are largely matters of personal opinion (Meigs *et al.*, 1995, p. 441).

Investor's appraisal of goodwill will vary depending on the estimates of the future earning power of the business. Nonetheless, very few businesses are able to maintain above average earnings for more than a few years. This makes it difficult arriving at a fair value for the goodwill of an ongoing business is a difficult and subjective process (Meigs *et al.*, 1995). Since the market value of a firm is largely determined by the expected returns to the firm's tangible and intangible assets (Shane, 1995) the question of how we determine the expected returns of intangible assets—off-balance sheet items—such as brand name, culture and intellectual capital remains a challenge (Edvinsson and Malone, 1997; Bontis *et al.*, 1999; Choo and Bontis, 2002).

Furthermore, we have to consider that many businesses have never purchased goodwill but have generated it internally by developing good customer relations, superior management, or other factors that result in above-average earnings. Favourable factors such as location, product superiority and quality, service reputation and personnel often generate positive goodwill. Nonetheless, even though these factors may be important assets of a successful business, they are usually not recorded in the accounting records or even voluntarily disclosed (Bontis, 2003).

The central question for family firms considering putting themselves up for sale is: how much is my company worth? For a small- or medium-size of company that is not publicly traded on the stock market, this is a very difficult calculation. There are many emotional factors attached to the book value of the company; moreover, future expectations of the firm, the industry and the market must be considered, too. On the other hand, these firms are rarely aware of the existence of their own intellectual capital.

In the case of Casa Roy, most of the employees who were working before the merger stayed on after it. Moreover, the business continued being a family-owned company. According to the Los Angeles former owner, when he bought the company, it was not in its best moment, even though he paid 1.5 times more than the market value. His stated reason was "...because it had a great geographic location, a long lasting image, loyal customers and really good workers; it was a matter of bringing the best players into my business" (Interview with Jesús Treviño González, owner).

In the case of Calzado Canadá, the selling price was not publicly announced. Coppel dismissed almost all of its workers who had at some point contributed to Calzado Canadá's past success. Of course, one could find strategic reasons for the move (e.g., rationalisation of costs), since the company is not a producer any more, but basically

a shoe reseller. We can infer that they did not consider intangibles like intellectual or human capital when buying the business, since they would have kept at least some of the employees working with them. Dismissing all of them implied that there was no future economic benefit from that particular intellectual capital asset. And, although it is true that intellectual capital has value within a particular context—in this case the family business context—it is also true that the knowledge these employees possessed may have been exploited in a useful way in the new context.

What about the value in a brand? Coppel was not as well known as Canadá in the shoe industry, so to leverage Canadá's customer base and good image it kept Canadá's brand. Was this valued by the owners of Calzado Canadá when they sold the business? Certainly, since the financial statements included a valuation of brands and trademarks Canadá legally owned. However, how well these brands were valued under accounting conventions is not clear.

When Salinas y Rocha was acquired by Elektra, a selling price was chosen through an auction methodology. Only 50% of the employees who worked there continued serving customers in the furniture stores after the acquisition (and before being sold to Liverpool). Although turnover was expected in this industry, there was a concerted effort to maintain some of the human capital of the previous organisation given the former familial ties.

JC Penney México (now called Dorian's) is still employing the same people it had before being acquired, except for the top management team. The final agreement between JC Penney Corporation Inc. and its subsidiary JC Penney México, excludes the commercial name and other related intellectual property (legally registered brand and trademarks) regarding JC Penney. Grupo Sanborns only had the right to use the commercial name and the related intellectual property for a specific transition period. Thus, in this case, there may have been a financial consideration given to the intangibles of this deal.

As reviewed in the cases above, although other intangibles besides brands and trademarks (e.g., human capital) may have been considered during the negotiations, there was no evidence of this within the consolidated financial statements. Moreover, according to IAS 38 (International Accounting Standards) an intangible asset should only be recognised at cost in the financial statements—and therefore valued for selling price purposes—if and only if:

- (a) The asset meets the definition of an intangible asset. Particularly, there should be an identifiable asset that is controlled and clearly distinguishable from an

enterprise's goodwill (such as brands and trademark registrations).

- (b) It is probable that the future economic benefits are attributable to the asset will flow to the enterprise; and
- (c) The cost of the asset can be measured reliably.

Since intellectual capital (particularly human capital) cannot be measured reliably, those intangible assets are not considered as "intangibles" for financial purposes. According to IAS, goodwill is defined as the difference between the cost of the purchase and the fair value of the net assets. Consequently, the surplus price a buyer may pay when acquiring a business (e.g., Grupo Los Ángeles) may not only be related to intangibles such as intellectual capital, but also to a whole series of other non-tangible factors that altogether affect the company's output.

## 8. Role of Intellectual Capital in Family Business

The field of intellectual capital has grown significantly in the last decade (Serenko and Bontis, 2004). Although primarily focused on the firm level of analysis, it has recently been conceptualised for teams (Chauhan and Bontis, 2004) and nations (Bontis, 2004). A firm's intellectual capital consists of the unique collection of intangible resources, and their transformations and interrelationships (Bontis, 1999; 2001). Indeed, synergies involving core intellectual capital (business knowledge and knowing capabilities that foster a sustainable competitive advantage) offer unique opportunities to develop increased performance and sustainable competitive advantage (Bontis *et al.*, 2000; Gupta and Roos, 2001; O'Regan *et al.*, 2001; O'Donnell *et al.*, 2006).

Viewed statically and on their own, intangible resources do not create value. Instead, the value of any resource comes from its interactions with other resources (Seliem *et al.*, 2004). "Following Schumpeter (1934), Moran and Ghoshal (1996) have argued that all new resources, including knowledge [and therefore intellectual capital], are created through two generic processes: namely, combination and exchange" (Nahapiet and Ghoshal, 1998, pp. 247–248). This approach suggests then that intellectual capital is a set of interrelationships intertwined in the organisational system of the enterprise (Bontis and Fitz-enz, 2002). It represents a capability of a social collectivity, and in turn, it is difficult to value and consists of causal ambiguity (Chi, 1994; Gupta and Roos, 2001; Lippman and Rumelt, 1982).

What distinguishes family businesses from publicly traded companies is indeed the "family". Adding

family values, loyalty, pride, know-how, social capital, cohesiveness, reputation, meaning, culture and all the other strengths of family business ownership and management seems to provide sustenance not available to other enterprises (Aronoff, 2001). For instance, a recent study (Anderson and Reeb, 2003) depicts how even among the S&P500, firms that are under the influence of founding families economically outperform those that are not. Some other studies have reached similar conclusions on differences between family and non-family firms in terms of policies and ethics (Adams *et al.*, 1996), succession and post-succession performance (Gómez-Mejía *et al.*, 2001), corporate governance (Randoy and Goel, 2003) and performance characteristics such as size, growth, financial structure, productivity and profitability (Gallo, 1995; McConaughy and Phillips, 1999). In addition, a family business has something most large non-family publicly-traded companies do not have: unity of purpose. Common family bonds and historical legacies—traditions—among family members allow them to do things that stockholders—from different backgrounds—in public companies may not want to do, or may not have the ownership or control to implement at all—power is diluted among many shareholders (Treviño-Rodríguez, 2007).

Indeed, when referring to family firms, values and family ties (unity and trust) act as the backbone of the firm, as intangible resources transmitted and carried traditionally from generation through generation (Treviño-Rodríguez and Tàpies 2006). In fact, a current study (Treviño-Rodríguez, forthcoming) considering how family values and business strategy impacted the M&A post-integration stage in Spanish firms, found out that when referring to M&A deals between family-owned firms, values are a crucial element while addressing integration complexities and performance.

In addition, much of the knowledge in the company is tacitly embedded in cumulative experiences that reside in the memory of workers and/or family members, being not generally codified, but kept in the people's non-formalised but routinised actions and interactions with each other (Treviño-Rodríguez and Tàpies, 2006). The latter means that when dealing with family firms, their capabilities, competencies and innate resources are often comprised of a relevant tacit component rolled in skilled people, organisational culture and traditions, acting as a source of competitive advantage.

All these forms of qualitative intangible assets plus the quantitative intangibles that affect the overall business performance is what we refer to as the intellectual capital of family businesses (ICFB). Thus, based on the cases presented, those qualitative intangibles must include

people, processes, culture, traditions, brands, patents, trademarks, and soon.

Let us assume that the qualitative intangible assets that do not show up on the financial statements of the firm consist of:

1. The soul of the firm—described as the founder and/or family's vision, values, energy, social networks, cohesiveness and commitment transmitted to the employees working there (even after the acquisition). This is often referred to as the human capital (HC) of the firm.
2. The brain of the firm—described as the processes, procedures and policies of the organisation. This is often referred to as the structural capital (SC) of the firm.
3. The heart of the firm—described as the central network of the enterprise through which all relationships among various parts of the firm are preserved (i.e., it pumps blood to the system and preserves life). This is often referred to as the relational capital (RC) of the firm.

From these assumptions, we may say that the set of qualitative intangibles that compose an integral part of the ICFB is based on the interaction of three sets of intangibles: soul (human capital), brain (structural capital) and heart (relational capital). Considering that intellectual capital cannot be changed immediately after the M&A, we may say it resembles the immortality of a "soul". Besides, taking into account that this vital core works together with the "heart" under certain action patterns (brain), we may infer that all of these are going to affect the overall health of the system, which simulates the financial performance of the firm.

### 8.1. *Soul, Brain and Heart*

According to Hughes (2004, p. 17), "the human capital of a family consists of the individuals who make up the family. The intellectual capital of a family is comprised of the knowledge gained through the life experiences of each family member, or what the family member knows regarding the business and relationships achieved". We must add to this definition the fact that family intellectual capital is not only the family members' knowledge gained through life experiences, but also their shared values expressed as traditions (family culture) and business acumen transmitted to the employees while working there (and staying after the acquisition). All these items together form a unique entity. This is what the family tries to pass on from generation to generation in an effort to create new organisational learning processes (Bontis *et al.*, 2002).

The failure to acknowledge and measure the intellectual capital of a family is the principal cause for the failure

of a family to preserve its wealth (Hughes, 2004). If families do not value what they have and what they know about the business, they are not appreciating what keeps their family business alive. Measuring a family's intellectual capital is complex and difficult, since no objective test can exactly calculate what every individual knows or can learn. Moreover, there is no way of measuring the strength of the family ties (bond) and how it fosters certain synergies among family members while in the family firm. The analogy presented above is a framework that we recommend families use in order to articulate the constructs embedded within the intellectual capital.

In the Casa Roy—Los Ángeles case, the soul (HC) of the Guerra family was highly considered in its valuation. One explanation may be that the Los Ángeles owner knew the Guerra family had extensive experience in the fashion industry for almost 50 years. Also, the values and principles of the Guerra family resembled the Los Ángeles family. This particular M&A was an opportunity to harvest the best of each family's soul (HC), brain (SC) and heart (RC).

In the Calzado Canadá—Coppel case, the soul (HC) of the enterprise was not considered when selling the business. Not even the family culture and its special know-how transmitted to the employees was taken into account, since all of them were dismissed. Here is a typical example of how one family exterminated another's family intellectual capital and imposed its own. There was no effort to harvest the brain (SC) or heart (RC) of the firm. Instead there was just complete annihilation of the qualitative intangible value of the organisation.

In the Salinas y Rocha—Elektra case, neither organisation considered the synergistic opportunity in each other's soul (HC) since they just imposed their own. Usually, this happens when large firms acquire other large firms due to the enormous difficulties of integration. The challenge of coordinating two disparate familial cultures is often extremely difficult. Organisational culture is a pattern of basic assumptions that a given group has invented, discovered or developed in learning to cope with its problems of external adaptation and internal integration (Schein, 1983). The business itself creates a series of relationships and assumptions among its members which are a basis for behaviour patterns. In this case, beyond wanting to bring the original family unit back home, the acquiring organisation discounted the value of the firm's brain (SC) and heart (RC).

Finally, in the JC Penney—Carso case, the soul (HC) of the organisation remained after the acquisition. In addition, the value of the brand was justifiably recognised because there was a limitation stipulated in the deal in terms of how long and under what circumstances the

Table 1. Case review.

	Qualitative intangible assets			Quantitative intangible assets	Combined market cap
	Soul Human capital	Brain Structural capital	Heart Relational capital	Brand, trademarks, patents	Growth 1994–2003
Case 1: Casa Roy—Los Angeles	✓✓	✓	✓	✓	+47%
Case 2: Canadá—Coppel	×	×	×	✓✓	+27%
Case 3: Salinas y Rocha—Elektra	✓	×	×	✓	+31%
Case 4: JCPenney—Carso	✓	×	×	✓✓	+12%

× not considered; ✓ implicitly considered; ✓✓ directly considered.

trademarks could be used. Table 1 summarises the four case studies and highlights whether or not the intangible assets were considered in the negotiations.

Results from Table 1 have been derived based on archival data, on interviews with people pertaining to the selected firms regarding the use of qualitative and quantitative intangible assets during the M&A processes experienced, and on financial statements we obtained from these firms (after the M&A deals). In order to estimate the market value or market capitalisation of the enterprises, we used multiple based valuations, since at this time most of the analysed companies were not traded in at the market. The multiple of discretionary earnings method was used in order to assess the total value of the companies along the studied period of time (1994–2003), being that value averaged and compared to the initial estimate of the market value (1994). The percentage shown below in the combined market cap (growth) column shows the estimated value increase the companies experienced after the M&A deal (1993–2003). Clearly, there is a distinction among the cases as to whether qualitative or quantitative constructs were included in the overall M&A analysis.

Although we cannot determine an empirical relationship based on the four cases, we propose that M&A deals in which both qualitative and quantitative constructs are considered, there is a positive impact associated with long-term return on investment, which in turn, is positively associated with market capitalisation growth (dependent on the sector and industry the firm is in).

## 9. Conclusion

After a review of four family business cases of M&As in Mexico, we introduced a new term called intellectual capital in family businesses (ICFB) which recognises both quantitative and qualitative intangible assets. Although quantitative intangible assets (e.g., brands) can be readily found and valued in financial statements, qualitative intangible assets (e.g., expertise) are more ephemeral. In

order to help practitioners, we introduce an analogy that extends the traditional labels of intellectual capital to make more sense in the family business context.

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