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THE NATURE, UNIQUENESS OF FAMILY BUSINESS

CHAPTER 1

Entrepreneurial companies often become family-owned businesses. While the spouse of the founder may have done work on behalf of the new venture in the early stages, the real transition from an entrepreneurial to a family business typically happens when the children of the company founder join the business as employees. The business may very well continue to be an entrepreneurial company and may prefer to be known that way because the owners are concerned with the perception of nepotism and lack of professionalism often ascribed to family businesses. But once next-generation members join the ranks of employees and/or shareholders, the nature of the firm changes, as do its challenges and its unique competitive profile.

Family businesses are ubiquitous. Family-owned and family-controlled firms account for approximately 90 percent of all incorporated businesses in the United States, where approximately 17 million family firms (including sole proprietorships) operate.[1] A full one-third of all Fortune 500 companies are family-controlled, and about 60 percent of publicly traded firms remain under family influence.[2] Many family businesses are small, but there are approximately 138 billion-dollar family firms in the United States alone, with 19 such firms operating in France, 15 in Germany, 9 each in Italy and Spain, and 5 each in Canada and Japan.[3] In the United States, family firms account for 64 percent of the gross

domestic product, or approximately $6 trillion, 85 percent of private-sector employment, and about 86 percent of all jobs created in the past decade. In Germany they represent approximately 80 percent of all businesses and employ 80 percent of the working population. Family businesses are also ubiq-uitous in the economies of Spain and France, where they are estimated to represent approximately 80 percent of all companies and account for about 75 percent of the

[1] Astrachan, J., & Carey, M., Family Businesses in the United States Economy. Paper presented to the Center for the Study of Taxation, Washington, D.C., 1994. Also see Colli, A., The History of Family Business: 1850 to 2000. Cambridge: Cambridge University Press.

[2] Bristow, D. K., Composition of US Stock Exchanges Firms. Los Angeles: UCLA Directors Institute: Unpublished study, 2000.

[3] Rottenberg, D., ed., "The Oldest Family Businesses." Family Business Magazine, Winter 2002, p. 44.

employment. And in Italy, India, and Latin American countries the estimates sky-rocket, with 90 percent to 98 percent of all companies being family firms.

One study also found that contrary to the prevalent stereotype of family businesses as nepotistic and conflict-ridden underperformers, family firms perform better than nonfamily firms.[4] In fact, the study notes, 35 percent of the S&P 500 firms are family-controlled (with the families owning nearly 18 percent of their firms' outstanding equity), and these family-controlled firms outperformed management-controlled firms by 6.65 percent in return on assets (using either earnings before interest, tax, depre-ciation, and amortization [EBITDA] or net income) during the past decade. Similar results were found in terms of return on equity. Family firms were also responsible for creating an additional 10 percent in market value between 1992 and 1999, as com-pared with the 65 percent of the S&P firms that are management-controlled.

The evidence therefore says that U.S. firms with founding-family ownership per-form better, on average, than nonfamily-owned firms. This strongly suggests that the benefits of family influence often outweigh its costs. Arguably, family businesses are the primary engine of economic growth and vitality not only in the United States but in free economies all over the world.

In Europe as a whole, family-controlled firms (with a minimum family stake of 50 percent) outperformed the Morgan Stanley Capital International Europe index by 16 percent annually from 2001 to 2006. (The study controlled for size and sector effects, and neither of these was an important driver underlying the solid out-performance of family-controlled businesses.) Another study of European family-controlled firms (this one with a minimum family stake of 10 percent and $1 billion in market capitalization) found that family companies outperformed the pan-European Dow Jones Stoxx 600 Index by 8 percent annually from the end of 1996 to the end of 2006.[5] Notice that the data all come from family-controlled but publicly traded firms. Unfortunately, no research currently compares the performance of the privately held universe because the data are unavailable to scholars.

Data from research conducted in several other countries are discussed in this chapter's section on Competitive Advantage: The Resource-Based View and sum-marized in Table 1.1. These give us many glimpses of the contributions of family businesses to the global economy.

Besides financial outperformance, families and families in business seem also to be a significant factor in the creation of new ventures. While the venture capital industry seems to be credited for its role, it is wealthy individuals and families in business that provide the bulk of the seed capital and early-stage funding for a large segment of the entrepreneurial population. Of the 286 million entrepreneurs worldwide who launched new ventures since the mid-1990s, only 19,000 were financed by venture capital firms, which raised only $59 billion, versus the $271 billion provided by family and friends operating as angel investors.[6]

On the down side, approximately 85 percent of all new businesses fail within their first five years of operation. Among those that survive, only 30 percent are successfully

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[4] Anderson, R., & Reeb, D., Founding Family Ownership and Firm Performance: Evidence from the S&P 500. The Journal of Finance, 58(3), 2003, pp. 1301–1328.

[5] Credit Suisse, “Family Holdings Outperform Competitors: Credit Suisse Launches Family Index,” press release, Zurich, January 30, 2007.

[6] Kauffman Center for Entrepreneurial Leadership & Babson College, 2002 Global Entrerpreneurship Monitor. Presented to the United Nations, April 2003.

table 1.1 Family Business: The Statistical Story

Family businesses constitute	80%–98%	of all businesses in the world's free economies.
Family businesses generate	49%	of the gross domestic product (GDP) in the United States.
Family businesses generate more than	75%	of the GDP in most other countries.
Family businesses employ	80%	of the U.S. workforce.
Family businesses employ more than	75%	of the working population around the world.
Family businesses create	86%	of all new jobs in the United States.
A total of	37%	of Fortune 500 companies are family-controlled.
A total of	60%	of all publicly held U.S. companies are family-
Number of family-owned businesses in the United States:	17 million	
Number of U.S. family-owned businesses with annual revenues greater than $25 million:	35,000	
Family business outperformance of nonfamily businesses in the United States:	6.65% annually in return on assets (ROA)	10% in market value
Family business outperformance of nonfamily business in Europe:	8%–16% annually in return on equity (ROE), depending on the study.	
Family business outperformance of nonfamily business in Latin	8% annually in return on assets and return	

SOURCE: Dreux, D., Financing Family Business: Alternatives to Selling Out or Going Public. Family Business Review, 3(3), 1990; Gomez-Mejía, L., Larraza-Kintana, M., & Makri, M., The Determinants of Executive Compensation in Family-Controlled Public Corporations. Academy of Management Journal, 46, 2003; Daily, C., & Dollinger, M., An Empirical Examination of Ownership Structure in Family and Professionally Managed Firms. Family Business Review, 5(2), 1992; Beehr, T., Drexler, J., & Faulkner, S., Working in Small Family Businesses: Empirical Comparisons to Nonfamily Businesses. Journal of Organizational Behavior, 18, 1997; Astrachan, J., & Carey, M., Family Businesses in the U.S. Economy. Paper presented to the Center for the Study of Taxation, Washington, D.C., 1994; Oster, S., Modern Competitive Analysis, New York: Oxford University Press, 1999; Bristow, D. K., Composition of US Stock Exchanges Firms. Los Angeles: UCLA Directors Institute: Unpublished study, 2000; Anderson, R.C., & Reeb, D.M., Founding Family Ownership and Firm Performance: Evidence from the S&P 500. The Journal of Finance, 58(3), 2003, pp. 1301–1328. Credit Suisse, “Family Holdings Outperform Competitors” and “Credit Suisse Launches Family Index,” Zurich, January 30, 2007; and Martínez, J., & Stohr, B., Family Ownership and Firm Performance: Evidence from Public Companies in Chile. Unpublished paper presented at the International Family Research Association, 2005.

transferred to the second generation of the founding-family owners. This high failure rate amounts to the squandering of a significant opportunity for job and wealth cre-ation in many communities. Not all family businesses that are not passed down to the next generation go on to close their doors, but many do.

And the odds get worse in the transitions between the second and third generations and the third and fourth generations, when only 12 percent and 4 percent of such businesses, respectively, remain in the family. This seems to prove true the old adage "from shirtsleeves to shirtsleeves in three generations."[7]

Today, there is a widespread myth that a company is prehistoric and on the road to extinction unless it is "high tech" or has grown to be a very large, diversified multi-national corporation. Ironically, this myth is often promoted by news media that are largely family-controlled; leading newspapers such as the New York Times (owned by the Sulzberger family), the Washington Post (the Graham family), and the Wall Street Journal (the Murdoch family) come to mind. Yet, in the presence of widespread global hypercompetition, family businesses that are niche-focused and high quality and have great customer service are thriving. You might be surprised to learn that Smucker's, Perdue Farms, Gap, Levi Strauss, L.L. Bean, Hermés (France), Zara/Inditex (Spain) Mars, Femsa/Tecate (Mexico), Bacardí, William Grant & Sons (Scotland), Osborne Wines (Spain), Fidelity Investments, Banco Popular (Puerto Rico), Timken, Reliance Industries and Modi Group (India), LG Electronics (Korea), Casio (Japan), Marriott/ Ritz-Carlton, American Greetings, Hallmark, Ford Motor, Fiat (Italy), BMW (Ger-many), Kohler, Roca (Spain), Nordstrom, Ikea (Sweden), Metro A.G. (Germany), SC Johnson, Bigelow Tea, and Wal-Mart are all family-owned or family-controlled. And then there are thousands of smaller and less well known, but just as successful, family-owned businesses—companies that build homes and office buildings, manufacture unique products, and provide custom services; that are the backbone of most supply chains and distribution channels; and that are the retailers for much of what consumers buy.

WHAT CONSTITUTES A FAMILY BUSINESS?

What do we mean by the term family business? Because of the variety of firm profiles, the definition has proven more elusive than you might think.

- In a comprehensive study of family businesses, Chrisman, Chua, and Sharma found 21 different definitions of family business in their review of 250 research articles.[8]
- Family businesses come in many forms: sole proprietorships, partnerships, lim-ited liability companies, S corporations, C corporations, holding companies, and even publicly traded, albeit family-controlled, companies. That is why estimates of the number of family businesses operating in the U.S. economy range between 17 million and 22 million. Worldwide, estimates of all enterprises considered to be family businesses range between 80 percent and 98 percent.

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Ward, J., Keeping the Family Business Healthy: How to Plan for Continued Growth, Profitability and Family Leadership, San Francisco: Jossey-Bass, 1987.

8

Chrisman, J., Chua, J., & Sharma, P., A Review and Annotated Bibliography of Family Business Studies, Boston: Kluwer, 1996.

- In a large-scale study of the role of family contractual relationships within the Spanish newspaper industry, a business was considered to be a family business if the last name of the CEO and/or the editor was the same as that of the owners.[9]
- Another empirical study took the position that family firms are theoretically distinct from other closely held firms because of the influence of altruism on agency relationships (relationships between shareholders and management). The authors of this study went on to say that family firms are differentiated by both the active involvement of family in firm management and the intent of family members to retain ownership of the firm. They ultimately defined a family business as an enterprise in which two or more family members own 15 percent or more of the shares, family members are employed in the business, and the family intends to retain control of the firm in the future.[10]
- Another article ascribed the uniqueness of a family business to the very different influence that family has on ownership, governance, and management partici-pation through strategic direction, direct family involvement in day-to-day operations, and/or retention of voting control.[11]

Taking into account this full range of research and analyses, this third edition of Family Business considers family businesses to constitute the whole gamut of enterprises in which an entrepreneur or next-generation CEO and one or more family members significantly influence the firm. They influence it via their managerial or board participation, their ownership control, the strategic preferences of shareholders, and the culture and values family shareholders impart to the enterprise.

Participation refers to the nature of the involvement of family members in the enterprise—as part of the management team, as board members, as shareholders, or as supportive members of the family foundation. Ownership control refers to the rights and responsibilities family members derive from significant ownership of voting shares and the governance of the agency relationship. Strategic preferences refers to the risk preferences and strategic direction family members set for the enterprise through their participation in top management, consulting, the board of directors, shareholder meetings, or even family councils. Culture is the collection of values, defined by behaviors, that become embedded in an enterprise as a result of the leadership pro-vided by family members, past and present. Family unity and the nature of the rela-tionship between the family and the business also define this culture.

This book, therefore, adopts an inclusive theoretical definition of a family business that focuses on the vision, intentions, and behaviors, vis-à-vis strategy, succession, and continuity of the owners. Ownership structure aside, what differ-entiates family businesses from management-controlled businesses are often the intentions, values, and strategy-influencing interactions of owners who are members of the same family. The result is a unique blending of family, management, and own-ership subsystems to form an idiosyncratic family business system. This family–

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[9] Gomez-Mejía, L., Nuñez-Nickel, M., & Gutierrez, I., The Role of Family Ties in Agency Contracts. Academy of Management Journal, 44, 2001, pp. 81–96.

[10] Schulze, W., Lubatkin, M., Dino, R., & Buchholtz, A., Agency Relationships in Family Firms.

Organi-zation Science, 12(2), 2001, pp. 99–116.

[11] Astrachan, J., Klein, S., & Smyrnios, K., The F-PEC Scale of Family Influence: A Proposal for Solving the Family Definition Problem. Family Business Review, 15(1), 2002, pp. 45–59.

management–ownership interaction can produce significant adaptive capacity and competitive advantage. Or it can be the source of significant vulnerability in the face of generational or competitive change. The dominant decisions in a family business, according to this inclusive theoretical definition, are "controlled by members of the same family or a small number of families in a manner that is potentially sustainable across generations of the family or families."[12]

Thus, we arrive at a working definition of a family business as a unique synthesis of the following:

1. Ownership control (15 percent or higher) by two or more members of a family or a partnership of families
2. Strategic influence by family members on the management of the firm, whether by being active in management, by continuing to shape the culture, by serving as advisors or board members, or by being active shareholders
3. Concern for family relationships
4. The dream (or possibility) of continuity across generations

The following characteristics define the essence of the distinctiveness of family firms:

1. The presence of the family
2. The overlap of family, management, and ownership, with its zero-sum (win– lose) propensities, which in the absence of growth of the firm, render family businesses particularly vulnerable during succession
3. The unique sources of competitive advantage (like a long-term investment horizon) derived from the interaction of family, management, and ownership, especially when family unity is high
4. The owner's dream of keeping the business in the family (the objective being business continuity from generation to generation)

SUCCESSION AND CONTINUITY

Family firms are unique in the extent to which succession planning assumes a key and very strategic role in the firm's life. Because competitive success, family harmony, and ownership returns are all at stake at the same time in the firm, carefully orchestrating the multiyear process represented by succession across generations of owner-managers is a priority. There are hundreds of reasons why organizations fail, but in family-owned and family-controlled companies, the most prevalent reason relates to a failure in succession planning. Whether the causal reason is incompetent or unprepared suc-cessors, unclear succession plans, a tired strategy that is unable to contain competitors, or family rivalries and bids for power, if a family business is going to survive, it has to successfully craft its succession process. Chapters 4 and 5 will treat the subject of succession quite thoroughly, but its considerable role in the uniqueness of family firms deserves early recognition in this book.

[12]Chua, J., Chrisman, J., & Sharma, P., Defining Family Business by Behavior. Entrepreneurship Theory and Practice, 23(4), 1999, pp. 19–37.

Three patterns of ineffective succession were identified in one study:[13]

1. Conservative: Although the parent has exited the business, the parental shadow remains, and the firm and its strategies are locked in the past.
2. Rebellious: In what is often an overreaction to the previous generation's control of the firm, the next generation launches a clean-slate approach to the organi-zation. As a result, traditions, legacies, and even the business model or its "secret to success" are destroyed or discarded.
3. Wavering: The next generation is paralyzed by indecisiveness, unable to adapt the business to current competitive conditions; it also fails to make its mark and assume leadership effectively.

The study concludes with the reflection that the patterns were observed so fre-quently that many family firms will undoubtedly have to battle these syndromes in order to provide for family business continuity across generations of owners.

BUILDING FAMILY BUSINESSES THAT LAST

Without vision and leadership from members of two generations and the use of select family, management, and governance practices, the future is bleak for family-controlled enterprises. The blurring of boundaries among family membership, family manage-ment, and family ownership subjects family businesses to the potential for confusion, slow decision making, or even corporate paralysis. An inability to adapt to changes in the competitive marketplace or powerlessness to govern the relationship between the family and the business will ultimately undermine the enterprise. As a result, a family business that lacks multigenerational leadership and vision can hardly be positioned to retain the competitive advantages that made it successful in a previous, often more entrepreneurial, generation.

It takes ongoing dialogue across generations of owner-managers about their vision for the company to build a family business so that it continues. Family businesses that have been built to last recognize the tension between preserving and protecting the core of what has made the business successful on the one hand and promoting growth and adaptation to changing competitive dynamics on the other.[14] Family businesses that are confident that each generation will responsibly bring a different but comple-mentary vision to the business have a foundation on which to build continuity.

THE SYSTEMS THEORY PERSPECTIVE

Systems theory is the theoretical approach most often used in the scholarly study of family business. It remains pervasive in the literature today. In the systems theory approach, the family firm is modeled as comprising the three overlapping, interacting,

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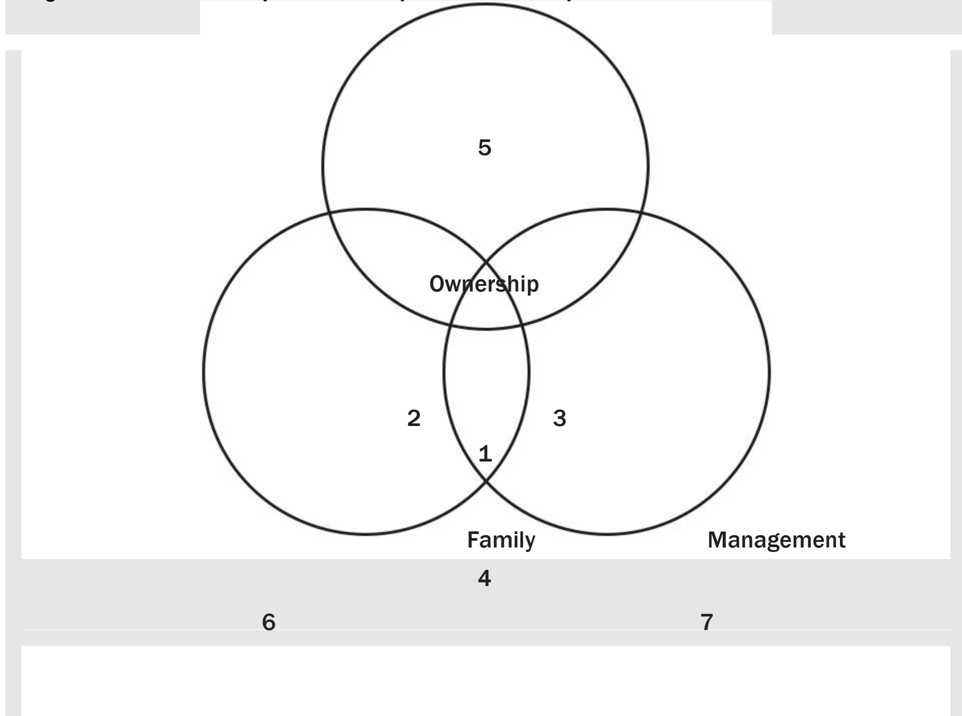
[13]Miller, D., Steiner, L., Le-Breton-Miller, I., Lost in Time: Intergenerational Succession, Change and Failure in Family Business. Journal of Business Venturing, 18, 2003, pp. 513–531.

[14]Porras, J., & Collins, J., Built to Last. New York: HarperCollins, 1997. Note that while the authors do not identify the businesses that are family-owned or family-controlled, many of the enterprises chosen as exemplary are (or until recently were) family businesses.

figure 1.1 The Systems Theory Model of Family Business



SOURCES: Adapted from Gersick, K., Lansberg, I., Davis, J., & McCollum, M., Generation to Generation. Boston: Harvard Business School Press, 1997; and Churchill, N., & Hatten, K., Non-Market-Based Transfers of Wealth and Power. American Journal of Small Business, 11(3), 1987, pp. 51–64.

and interdependent subsystems of family, management, and ownership.[15] According to the systems theory model graphically represented in Figure 1.1, each subsystem maintains boundaries that separate it from the other subsystems and the general external environment within which the family firm operates.[16] In order for the organization to perform optimally, the subsystems must be integrated so that the entire system functions in a unified way.[17] General systems theory also suggests that to reverse the natural progression toward entropy or decline, the three subsystems and the larger family business system all have to increase their requisite variety (internal capabilities) in order to successfully cope with increasing variety in the environment.

This model suggests that a family firm is best understood and studied as a complex and dynamic social system in which integration is achieved through reciprocal adjustments among subsystems. For this reason, the family subsystem is expected to have a strong impact on the ownership and management subsystems, and vice versa. Understanding comes only when all three subsystems, with their interactions and interdependencies, are studied as one system. Emphasis in this research stream is appropriately focused on the interactions of the three subsystems and on the

[15] See Davis, P., Realizing the Potential of the Family Business. Organizational Dynamics, 11, Summer 1983, pp. 47–56; and Lansberg, I., Managing Human Resources in Family Firms. Organizational Dynamics, 11, Summer 1983, pp. 39–46.

[16] Alderfer, C., Change Processes in Organizations. In: M. Dunnette, ed., Handbook of Industrial and Organizational Psychology. New York: Rand, 1976.

[17] McCollum, M., Integration in the Family Firm: When the Family System Replaces Controls and Culture, Family Business Review, 1(4), 1988, pp. 399–417.

integration mechanisms used to determine outcomes of the larger system that provide mutual benefits to all system members.

The developmental processes of the family members and nonfamily managers in the various subsystems, along with the developmental cycle of the enterprise, for example, will also be constantly bringing change to the mix. So, from a system perspective, the family firm will be facing different systemic alignments and misalignments as the next generation joins the firm, the earlier generation ages, and the firm experiences a new period of accelerated growth resulting from product or service innovation, for instance. Interestingly though, some research has found no significant difference in many of the dynamics or practices present in first-, second-, and third-generation family firms, except that a greater number of second- and third-generation firms have engaged in succession planning than did their first-generation counterparts.[18]

Issues, priorities, and problems will be defined differently by different members of the family in business. The individual perspectives of members of the family and the firm will understandably be different because of their positions in the system. For example, a parent who is CEO and 100-percent owner of the firm (represented by position 1 in Figure 1.1) will likely view things very differently than will a family member who is not active in management and does not own any shares in the business (position 6). Similarly, a nonfamily manager (position 7) is likely to have a very dif-ferent perspective as a result of her or his unique placement in the family business system.

In its more extreme forms, this phenomenon leads to categorization of family busi-nesses based on their propensity to have a family-first, ownership-first, or management-first perspective on issues. As a result of this propensity, priority may be given to that particular subsystem over others, and even over the entire system. In other words, in its most extreme forms, this phenomenon can lead to significant suboptimization of the family– ownership– management system commonly known as a family business, which leads, theoretically, to a lower level of performance than the business is capable of achieving.

FAMILY-FIRST BUSINESSES

In family-first family businesses, employment in the business is a birthright. The ste-reotype of nepotism, which still dominates most people's views of family businesses, derives from this not-so-infrequent suboptimization of the family business system. Clearly, if employment is based solely on the applicant's last name, merit and other important criteria in the selection and succession processes are devalued or entirely irrelevant. Understandably, nonfamily managers with high career aspirations are often reluctant to join family businesses out of concern for their future prospects. Unless their exercise of due diligence assures them that their career ambitions will not be thwarted by a lack of family connection, high-potential nonfamily managers may choose never to join family-owned or family-controlled firms.

Because a family-first family business exists primarily for the purposes of the family, perks that transfer from the business to family members are often extensive. Financial systems may be obtuse by design, and secrecy is often paramount. After all, lack of transparency supports the ability of family members to reap rewards beyond what would be deemed reasonable under standard human resource, compensation, and

[18]Sonfield, M., Lussier, R., First-, Second-, and Third-Generation Family Firms: A Comparison. Family Business Review, 17(3), September 2004, pp. 189–201.

benefit policies. Consequently, the business often becomes part of a lifestyle. The Rigas family and Adelphia Communications were ultimately prosecuted by the Securities and Exchange Commission (SEC) and other federal and state authorities as a result of a tangled web of relationships between the business and the family that were deemed to represent extensive self-dealing to the benefit of Rigas family members.

While well-managed and well-governed family businesses may have sound reasons for paying all the members of the next generation in top management equal or nearly equal salaries, family-first businesses tend to equalize compensation regardless of a family member's responsibility, results, and overall merit. Ironically, because their primary concern is family, the level of commitment of family-first businesses to the continuity of the business across generations depends on the agendas of individual family members and the levels of conflict associated with running the business. Family-first businesses are likely to choose continuity only if members of both the incumbent and the succeeding generations aspire to this goal and if the incumbent generation has sufficient resources in retirement to make this possible. In cases in which neither generation dreams of continuity or sees value in having the enterprise be a legacy for the next generation, the business will most likely be sold at the end of a generation. And even if family members aspire to perpetuate the company, family-first businesses have great difficulty in providing for continuity, since successor selection, strategic renewal, and governance of the relationship between family and business all require a strong commitment to sound business-management principles.

The absence of balance and clear boundaries between family, ownership, and management is not always resolved by putting the family first. On the contrary, business management or ownership could just as easily be favored in decision making and action taking, again to the detriment of the whole family business system.

MANAGEMENT-FIRST BUSINESSES

Management-first family businesses are likely to actively discourage family members from working in the business and/or to require work experience outside the business as a prerequisite for employment. The performance of employed family members is reviewed in the same manner as the performance of nonfamily managers, and human resource policies generally apply equally to family and nonfamily employees. Com-pensation is based on responsibility and performance, not on position in the family hierarchy. And the scorecard on business performance is all business; for example, the focus is on profitability, return on assets, market share, revenue growth, and return on equity. Once in the company, next-generation family members are often viewed in terms of how they will be able to manage and grow the firm—in other words, in terms of their utility and potential contribution to the business.

When family members meet socially, the conversation often turns to business subjects. Family events—even weddings and honeymoons—are sometimes arranged (as in the movie Sabrina), canceled, or delayed for business reasons.

There is no automatic commitment to family business continuity among management-first companies because the enterprise is seen as a productive asset. As an asset, it could just as easily be folded into a larger company through

a tax-free exchange of stock with a publicly traded corporation or sold through an employee stock ownership plan.

OWNERSHIP-FIRST BUSINESSES

In ownership-first family businesses, investment time horizons and perceived risk are the most significant issues. When shareholders come first, the priority is risk-adjusted economic returns or owner rents—for instance, shareholder value, EBITDA, earnings growth rates, and debt/equity and debt/asset ratios.

Ownership-first family businesses may have shorter time frames within which financial results are evaluated. Just as impatient and greedy investors on Wall Street, aided by analysts and the media, can pressure well-managed publicly traded companies into short-term thinking, family shareholders who are not active in the business, and who have little understanding of management and the time cycles involved in new strategies or new investments, can get in the way of effective operation of a family-controlled business. These family members can cause the business to lose the founding culture, which valued the role of patient capital, or investing in the family business for the long term.

Patient capital—one of the significant sources of competitive advantage of many family businesses—disappears at the hands of greedy shareholders. Siblings and cousins, caught in the web of high expectations for short-term returns via dividends, distributions, or the creation of shareholder value, are prone to second-guessing family members in manage-ment. Family managers, who better understand the limited capabilities of the business to deliver on the promise of high returns, are most likely managing in the long-term interest of shareholders. If family unity suffers as a result of this pressure by some family members for high returns and short time frames, a loss of will and vision may result. Family business continuity may be abandoned in favor of immediately recapturing, via sale of the company, the value created by previous generations.

BLURRED SYSTEM BOUNDARIES

Because of the complexity implicit in a system that is composed of three subsystems, each potentially with different goals and operating principles, family businesses are vulnerable to the consequences of blurred boundaries among the family, ownership, and management subsystems. Research in the social sciences—both psychology and economics, for example—suggests that emotion can lead to behaviors and actions that rational thought would seldom support. As a result, family patterns or dynamics, replete with emotional content, can easily override the logic of business management or ownership rents.

Lack of awareness on the part of company employees or family members that the particular assumptions that go into decision making are based on whether an issue is considered a family, ownership, or management issue may create incongruent policies and bad decisions. In the most extreme, but still quite common, circum-stances, family rules may overtake the business. For instance, suppose a younger son insists on starting work after 10 A.M. every day, despite the requirement that, as a customer service manager, he report to work by 7 A.M. His father or aunt, to whom he reports, may choose to avoid the conflict and anxiety his tardiness provokes by ignoring it and allowing it to go on. Avoiding resolution of this disagreement out of fear or altruism only diminishes problem-

solving ability; unchecked, problems can grow for years. Succession hurls many of these unsettled issues to the forefront of family business management, often at a very vulnerable time in the life of a family business.

THE ALTERNATIVE TO BLURRED SYSTEM BOUNDARIES: JOINT OPTIMIZATION

Implicit in systems theory is the capacity to jointly optimize interrelated subsystems in such a way that the larger system can be most effective and successful in the pursuit of its goals. Intuitively, reaching this state would seem akin to reaching nirvana, and it is equally as difficult. Yet thousands of family businesses, many of them featured throughout this book, achieve precisely that. They balance the goals and needs of each of the subsystems in what appears to be a masterful walk across a tightrope. Through family forums, governance bodies, strong cultures, family unity, strategic planning, fair policies, and solid managerial practices, they inspire a commitment to something larger than the self—the greater good.

Companies facilitate joint optimization of family, management, and ownership subsystems by writing policies that guide the employment of family members in the business. They further optimize the relationship by developing policies that guide the involvement of family members in nonmanagement roles—for example, board service, philanthropy, and family council leadership. As a result, some family members join the business as employees, while others become responsible shareholders and stewards of the family's resources.

In these companies, the performance of employed family members is reviewed in the same manner as that of nonfamily managers, with compensation decisions based on both level of responsibility and performance. Siblings or cousins in the same generation may, therefore, receive quite different salaries and benefits packages. Other firms engaged in joint optimization may pay a team rate, equalizing com-pensation in the interest of promoting overall corporate—and not just divisional or business unit—responsibility. Family members are encouraged to work outside the business first to get some experience. If they later join the family business, their development for top leadership is often a priority. When family members meet, the pendulum is allowed to swing back and forth between family and business priorities. These families realize that such a flexible and balanced approach allows them to invest in the subsystems in ways that, in the long run, benefit the larger system: the family business.

These families and firms have a commitment to family business continuity. Efforts to jointly optimize ownership, family, and management systems often indicate the family's desire to use the business to transfer important values and a proud history and at the same time to strive for continued improvement and growth. In these companies, ownership and organizational structures accommodate both the family-ownership strategy and the competitive strategy of the business.

A leading family-owned medical device distribution company, for example, devel-oped a statement of company culture and values that displays a deep understanding of the powerful effects of joint optimization. Its culture and values statement says:

We are:

- Family-Owned, Professionally Managed. We are a family acting in the Com-pany's best interest.

We believe in:

- Integrity: We do what we say we will do.
- No Walls: We have no barriers to communication.

- Tenacity: We have an unrelenting determination to reach objectives.
- Profitability: We are committed to performance and results.
- Improvement: We are never satisfied.
- Service: We are loyal to our customers and respect them.

THE AGENCY THEORY PERSPECTIVE

Traditionally, agency theory has argued that the natural alignment of owners and managers (the agents) in a family business decreases the need for formal supervision of agents and for elaborate governance mechanisms, thus reducing agency costs of ownership in family firms. More recently, however, agency theory has been used to support the opposite conclusion. These researchers have hypothesized that family firms have one of the more costly forms of organizational governance. They posit that the altruism of owner-managers leads to increased agency costs emanating from their inability to manage conflict among owners and between owner-managers and nonfamily managers.[19] Other researchers have concluded that when family ties exist between owners and agents, executive entrenchment (the reluctance to transfer power to others) increases and as a result, so do agency costs.[20] Other potential sources of agency costs are attributed by both sides to goal incongruity between the CEO and the rest of the family: (1) the CEO's ability to hold out, based on his or her status within the family, (2) a preference for less business risk, (3) lack of career opportunities for nonfamily agents, (4) lack of monitoring of family members' performance, (5) lack of monitoring of the firm's performance, and (6) avoidance of strategic planning because of its potential for fostering family conflict. Strategic decisions that could highlight potential conflicts of interest between a firm's shareholders and its owner-managers include decisions about diversification, rate of growth, debt intensity, investment, CEO compensation, and CEO tenure or entrenchment.

According to agency theory, a firm's board is an important mechanism for limiting managers' self-serving behavior in situations in which a firm's managers and its owners have conflicting goals. For this reason, experts on corporate governance recommend the inclusion of outsiders as lead or presiding directors on corporate boards to ensure the board's independence from top management. This recommendation is based on the belief that inside directors, by virtue of their employment with the firm, are beholden to a CEO for their careers and are therefore unlikely to monitor the CEO's actions effectively. In contrast, outside directors are expected to provide more vigilant monitoring in order to maintain their reputations and avoid liability lawsuits.

Research suggests that agency costs may be controlled or avoided through the use of certain managerial and governance practices. Some researchers recommend a mechanism that would enable a family business to monitor the performance and decision making of family executives.[21] Others believe that a set of managerial prac-tices, as opposed to any one specific practice, will facilitate control of these unique agency costs.[22]

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[19] Schulze et al., op. cit.

[20]Gomez-Mejía et al., op. cit.

[21]Ibid.

[22]Schulze et al., op. cit.

This third edition of Family Business, on the basis of the latest research, presents this latter perspective. Based on global research on family firms, the book is organized around three leadership imperatives and five best practices to manage the unique risks posed by the overlap of family, ownership, and management of the firm. Chapters 4 through 11 discuss the unique challenges and then, through an action orientation, help the reader arrive at a series of managerial and governance best practices relevant to family firms in general or to an individual family business situation.

THE STRATEGIC PERSPECTIVE: COMPETITIVE CHALLENGES FACED BY FAMILY BUSINESSES

My experience both as a scholar and as an advisor to more than 100 family-owned businesses for the past two and a half decades substantiates what business owners often perceive as posing unique challenges to their businesses. For example, many owners see shrinking product life cycles as requiring their companies to innovate more and to adapt and renew their strategies more frequently. They also perceive intense cost competition and rapid change in distribution and value chains as requiring tremendous agility and, thus, as representing serious challenges to their firms.

Family business owners are also well aware of the increasing individualism in younger generations, whose members often view extended family and legacy as if they were alien constructs. Owners are equally concerned by the media's version of who the winners are in globally competitive markets. According to the media, large multinational, publicly traded companies are the only possible winners in the increasingly competitive landscape. This bias concerns many family business own-ers, who fear that the next generation of owners is growing up thinking that family businesses represent the “lagging edge” and that the exciting career opportunities lie elsewhere.

On the other hand, next-generation members are often concerned about what they perceive as the entrenchment of the current-generation CEO. In an era in which life expectancy has increased significantly, fears about the CEO never relinquishing power may be difficult to dispel. And both generations worry that the growing complexity and severity of corporate, individual, and estate-tax laws may predispose owners to make tax minimization a priority, to the detriment of other important considerations, such as agility and corporate control.

It is important to note that the agency cost studies referred to here did not include a comparative nonfamily business sample. Thus, these studies highlighted possible agency costs of altruism and CEO entrenchment in family firms but failed to address the relative impact of a different set of agency costs on nonfamily firms (e.g., the increased costs of sophisticated financial and auditing systems and staff; in the United States, the costs of compliance with the Sarbanes–Oxley Act alone are estimated at over $800,000 per year for small and midsized firms). Indeed, an equally viable possibility is that the unique differences provided by family ownership and control are a source of competitive advantage and that this advantage outweighs the unique agency costs of family firms. In

other words, the literature on agency costs has not yet helped to resolve the question of whether agency costs hinder family firms or whether the interaction between business and family represents a net positive for the family firm.

COMPETITIVE ADVANTAGE: THE RESOURCE-BASED VIEW

The competitive advantages inherent in family businesses are best explained by the resource-based view of organizations. From this theoretical perspective, a firm is examined for its unique, specific, complex, dynamic, and intangible resources. These resources—often referred to as "organizational competencies"—embedded in internal processes, human resources, or other intangible assets, can provide the firm with competitive advantages in certain circumstances. In a family firm, one of these resources may be overlapping owner and manager responsibilities, which can lead to advantages—such as reduced administrative costs and speedier decision making, the result of streamlined and less-costly monitoring mechanisms that are made possible by the existence of family trust. This owner-manager overlap is also credited with enabling longer time horizons for measuring company performance, which results in share-holders behaving as patient family capitalists.

Other resources unique to family firms may be customer-intense relationships, which are supported by an organizational culture committed to high quality and good customer service, and the transfer of knowledge and skills from one generation to the next, which makes it easier to sustain and even improve firm performance.[23] Owner-ship commitment (willingness to hold on and fight) over the long term, rather than shareholder apathy and capital flight (e.g., readiness to switch from IBM shares to GE shares in the portfolio), is yet another possible source of competitive advantage. The Ford, Hewlett, and Packard families have all exemplified this potentially unique resource in their ownership stance vis-à-vis CEO performance in the past decade.

The unique resources that family businesses can call on to create competitive advantage are:

- Overlapping responsibilities of owners and managers, along with smaller com-pany size, which enable rapid speed to market.
- Concentrated ownership structure, which leads to higher overall corporate productivity and longer-term commitment to investments in people and innovation.
- A focus on customers and market niches, which results in higher returns on investment.
- The desire to protect the family name and reputation, which often translates into high product/service quality and the higher returns on investment that being a high-quality leader produces.
- The nature of the family–ownership–management interaction, family unity, and ownership commitment, which support patient capital, lower administrative costs, skills/knowledge transfer across generations, and agility in rapidly changing markets.

Family firms, for instance, may routinely be able to make decisions more quickly and may therefore take advantage of opportunities that others miss. Quick decision making is critical in business, and tight-knit families in business move fast. Clear Channel Communications grew from 16 radio stations in 1989 to more than 1200 (and

[23] Cabrera-Suarez, K., De Saa-Perez, P., & Garcia-Almeida, D., The Succession Process from a Resource-and-Knowledge–Based View of the Firm. Family Business Review, 14(1), 2001, pp. 37–47.

36 television stations) in 2006. Mark P. Mays, the founder's son, notes that when making acquisitions, they move like lightning.

In 2002, family-controlled enterprises on the S&P 500 reinvested $617.8 million, compared with a meager $79 million for their nonfamily counterparts. (Even though family-controlled enterprises represented only a third of the S&P 500, they reinvested almost 10 times as much during the recessionary year that followed the bursting of the Internet bubble and 9/11.) Family-controlled companies were also less likely to pay out dividends, with 61 percent making these payouts as compared with 77 percent of nonfamily firms.[24] This is compelling evidence of the higher propensity of family-controlled and closely held firms to invest with a long-term horizon. Research has found that the practice by family-controlled and closely held firms to continue to invest in people and technology through the ups and downs of economic cycles leads to higher company productivity. According to another study, three additional competitive advantages that the family firm enjoys are: efficiency, with lower overall administrative costs because of the owner-manager overlap; social capital, with its transfer of knowledge and relationship- and network-building benefits; and opportunistic investment, based on its speed and agility in the face of new opportunities.[25]

In a study conducted in 2003 involving a sample of 700 family businesses in Ger-many and France, the firms in which families had significant influence and there was considerable overlap between ownership and management roles enjoyed appreciably improved financial performance. However, when the family's representation in man-agement far exceeded the cash-flow rights of their ownership stake, the firm's per-formance suffered.[26]

In Spain, the performance of 8000 large- and medium-sized family and nonfamily firms was compared based on 2002 data. Spanish family firms performed better in terms of return on equity than their nonfamily counterparts of the same size and in the same industry. Family involvement in management by itself did not prove to have a positive impact on the firm's performance.[27]

A study of six European stock exchanges, from London's FTSE to Spain's IBEX, done by Thomson Financial and reported in Newsweek consistently found that family firms in Europe outperformed their counterparts.[28]

In Latin America, a study of 175 firms traded in the Bolsa de Comercio de Santiago (Chile's principal stock exchange) compared the performance of 100 family firms with that of 75 nonfamily firms during the 10 years between 1994 and 2003 and found that family firms outperformed their counterparts in return on assets and return on equity (both measures of profitability). They also performed better in Tobin's Q, a proxy

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[24] Weber, J., et al., Family, Inc., BusinessWeek, November 10, 2003, pp. 100–114.

[25] Carney, M., Corporate Governance and Competitive Advantage in Family-Controlled Firms. Entrepre-neurship Theory and Practice, 29, 2005, pp. 249–266.

[26] Jaskiewicz, P., Family Influence and Performance: An Empirical Study for Germany and France,

European Business School, International University Schloß Reichartshausen, Germany. Unpublished paper presented at a meeting of the International Family Enterprise Research Association, 2003.

[27]Menéndez-Requejo, S., Ownership Structure and Firm Performance: Evidence from Spanish Family Firms, University of Oviedo, Spain. Unpublished paper presented at a meeting of the International Family Enter-prise Research Association, 2005.

[28]Best of the Best, Newsweek, April 12, 2005.

figure 1.2 The Relative Performance of Family Firms

Performance of Family Firms and Nonfamily Firms

	Family-Controlled Firms	Management-Controlled Firms
Shareholder Return	15.6%	11.2%
Return on Assets	5.4%	4.1%
Revenue Growth	23.4%	10.8%
Income Growth	21.1%	12.6%
(Between 1992 and 2002, S&P 500 list)		

Performance of Family Firms Compared to Nonfamily Firms

Return on Assets (ROA) + 6.5%* Market value* + 10%†

*In EBITDA terms, between 1992 and 1999, S&P 500 list; similar outperformance in return on equity †Tobin's Q market value to replacement value of assets, between 1992 and 1999, S&P list.

SOURCES: Weber, J., et al., Family, Inc. Business Week, November 10, 2003, pp. 100–114; and Anderson, R., & Reeb, D., Founding Family Ownership and Firm Performance: Evidence from the S&P 500. The Journal of Finance, 58(3), June 2003, pp. 1301–1328.

measure of the creation of market value during that period. In Chile, a majority of the publicly traded firms (57 percent) were family-controlled.[29]

In the United States, it was the pioneering study by Anderson and Reeb[30] that prompted the international research discussed previously. Their study found that family-controlled firms in the S&P 500 outperformed management-controlled firms by 6.65 percent in return on assets and return on equity and created an additional 10 percent in market value between 1992 and 1999. For a comparative view of the data supporting the relative performance and unique competitive advantages of family firms, refer to Figures 1.2 and 1.3.

The ability of a particular family business to capitalize on its unique advantages depends on the quality of the interaction between business and family. It is precisely this interface that agency theorists suggest needs to be addressed with a series of managerial and governance practices that will safeguard the firm from any family-based hazards. Measuring the perceptions of different stakeholders, monitoring executive performance, and implementing a particular set of prescribed managerial and gover-nance practices can all contribute to controlling the hypothesized costs and turning the unique features of family firms into resources that actually produce competitive advantage.

The importance of (1) jointly optimizing the ownership, management, and family subsystems, (2) controlling agency costs, and (3) ultimately exploiting the unique resources available to family businesses in order to achieve competitive advantage provides both the theoretical framework and the practical take aways contained in this book.

[29]Martinez, J. & Stohr, B., Family Ownership and Firm Performance: Evidence from Public Companies in Chile. Unpublished paper presented at a meeting ofthe International Family Enterprise Research Association, 2005.

[30]Anderson, R., & Reeb, D., op. cit.

figure 1.3 Competitive Advantages of Many Family Businesses on Seven Dimensions

I. Speed to Market (Data based on firm size, not form of ownership. Family businesses, on average, are smaller.)

Market	Company Size (in sales)	Time to Bring New Product to Market
United States	>$100 million	22.6 months
	<$100 million	16.0 months
In Japan	>$100 million	19.1 months
	<$100 million	14.0 months
In Europe	>$100 million	23.4 months
	<$100 million	15.9 months

SOURCE: Boston Consulting Group, http://www.bcg.com.

II. Strategic Focus on Niches*

Market Size	Business Performance† (as measured by ROI)
<$50 million	28.1%
$50 to $100 million	26.8%
$100 to $250 million	24.2%
<$1 billion	10.9%

*Based on market size served, not family ownership. Family businesses more often than not compete in the relatively smaller niche markets as opposed to larger market segments)
†4-year average return on investment (ROI).

SOURCE: Clifford, D., & Cavanagh, R., The Winning Performance: How America's High Growth Midsize Companies Succeed. New York: Bantam, 1985.

III. Ownership Concentration and Corporate Productivity*
Stock concentration is positively correlated with

- Related diversification
- R&D expenses/employee
- Training expenses/employee
- Overall corporate productivity

*Sample composed of largely but not exclusively family-controlled companies
SOURCE: Hill, C., & Snell, S., Effects of Ownership Structure and Control on Corporate Productivity. Academy of Management Journal, 32(1), 1989, pp. 25–45.

IV. Relative Quality and Return on Investment*

Relative Product Quality	Return on Investment† (as measured by ROI)
High	27.1%
Medium	19.8%
Low	16.8%

*Based on quality positioning, not on family ownership. Family businesses have a demonstrated capacity to compete on the basis of brand, reputation, and high relative quality, but the sample includes nonfamily firms.
†4-year average ROI.

SOURCE: Clifford, D., & Cavanagh, R., The Winning Performance: How America's High Growth Midsize Companies Succeed. New York: Bantam, 1985.

figure 1.3 (Continued)

V. Patient Capital and Long-Term Perspective

- Average tenure of 18 years for owner-managers versus 8 years for public-company CEOs is correlated with commitment to the long term and making efficient long-term investments in the family business.*

- Company continually optimizes the mix among family, management, employees, customers, and ownership for higher long-term profitability.†

† Adapted from Waterman, Robert H., Jr., What America Does Right. New York: W. W. Norton, 1994.

VI. Total Costs

	Family Businesses	Other Businesses
Lower cost of capital*	When the business owner controls 100% of the stock and the stock is in the hands of family shareholders enjoying family harmony, the effective cost of capital is nearly 0%. While there is an opportunity cost, cash flow from the business can be reinvested for growth without paying out high dividends or taxes or incurring high interest on debt.	Financing costs for other businesses can range from 25%–30% for venture capital to 17%–20% for mezzanine financing to the prime rate for bank financing.
Lower administrative costs†	According to the agency cost literature, the overlap between owner and manager or principal and agent allows family-owned businesses to enjoy lower administrative costs because of lower CEO compensation, reduced levels of supervision, and reduced investment	

*deVisscher, Francois, When Shareholders Lose Their Patience. Family Business Magazine, 11(4), 2000.

†Gomez-Mejía, L., Larraza-Kintana, M., & Makri, M., The Determinants of Executive Compensation in Family-Controlled Public Corporations. Academy of Management Journal, 46(2), 2003, pp. 226–237.

VII. Agility and Customization Capability in Rapidly Changing Markets

- Inventory and quality costs of capital-intensive, long-run manufacturing have increased in the past decade. The greater flexibility of new manufacturing and distribution-retail-service technology (including numerical control equipment in the factory and low-cost PCs in distribution centers and retail points) makes smaller runs economically attractive. Family firms often populate this space.

- Increasing demand for customization, rapid changes in consumer preferences, and shorter product life cycles lead to rewards for opportunity-seeking owner-managers who can make decisions fast. Family firms often compete in this space, a legacy of their entrepreneurial past.

- Internet-based, value-added partnerships in the supply chain make agility possible across the value chain. An early example was the Milliken–Levi

SOURCE: Poza, E., Look Who's Out There on the Cutting Edge. Family Business Magazine, 4(1), 1993.

THE STEWARDSHIP PERSPECTIVE

This perspective claims that founding-family members view the firm as an extension of themselves and therefore view the continuing health of the enterprise as connected with their own personal well-being.

In a meeting of the fifth generation of the Blethen family, owners of The Seattle Times Company, chairman and publisher Frank Blethen spoke of the commitment from every Blethen generation that resulted in 100 years of caring leadership and stewardship of The Seattle Times and other newspapers in the corporate group. He emphasized the need to value the extended family over individual or branch needs and challenged individuals who accepted participation in the family clan to assume the stewardship responsibilities in order for them to be successful as individuals.

He went on to assert that understanding the individual's responsibility toward the group is essential—as is having realistic expectations of what you do and do not get from being a member of the Blethen family and The Seattle Times Company. More than money, family members inherit a responsibility to others, to stewardship, so that the enterprise they received from the earlier generation may successfully pass on to the next.

In 1980, a long strike threatened the viability of this commitment. "Frank Blethen concedes the strike was a tremendous financial hit to The Times, causing him for the first time in his life to consider the possibility of selling. Fortunately those darkest moments ultimately strengthened the family's resolve. The stewardship they feel toward the newspaper and its place in this community is too important."[31]

As stewards of the firm, family owners often place individuals on the board who have industry knowledge and who can provide objective advice and advocate for a going concern. The independence of the board is less an end in itself than a reflection of the family's commitment to avail itself of complementary skills that the family lacks, such as legal, financial, succession-planning, accounting, and international-marketing skills and knowledge. The directors are chosen to promote continued corporate health, based on their ability to provide advice that adds value. As such the board has a positive impact on the financial performance of the firm through its advice more than through its monitoring or supervisory function.

Interestingly, among S&P 500 firms, independent directors hold more than 61.2 percent of the board seats in nonfamily firms but only 43.9 percent in family firms. And the performance advantage, in terms of return on assets/return on equity (ROA/ROE) and market valuation, demonstrated by family firms between 1992 and 1999 relative to management-controlled firms[32] vanishes in the absence of an independent board providing company oversight. Even more strikingly, and consis-tent with agency theory, the most valuable S&P 500 firms are those in which inde-pendent directors balance board representation by family members. Firms with continued founding-family ownership and relatively few independent directors per-form significantly worse than do nonfamily firms.[33]

In family firms then, whether from an agency or a stewardship perspective, inde-pendent and advisory directors remain the primary line of defense against the mana-gerial opportunism, expropriation, and entrenchment that large, controlling

[31]The Seattle Times, Sunday, January 21, 2001.

[32]Anderson, R., & Reeb, D., op. cit.

[33]Anderson, R., & Reeb, D., op. cit.

shareholders can exercise in relation to minority shareholders, employees, and other stakeholders. From the agency perspective, they do so through their monitoring and supervisory role; from the stewardship perspective they do so through their advisory, objective, and committed stance to the ongoing concern. Independent and advisory directors can prevent excessive CEO compensation, flawed decision-making processes, stale strategic planning, and unearned perquisites, while limiting the family's undue influence through enhanced board dynamics and subcommittees of the board. Most importantly these boards can prevent an unqualified or incompetent family member from becoming the next CEO.[34]

ETHICS, SOCIAL RESPONSIBILITY, AND THE FAMILY BUSINESS

Family businesses are generally perceived as being less socially responsible because of their incentive to protect family wealth. They are also often perceived as less ethical because of their incentive to reduce tax liabilities and derive competitive advantage by whatever means possible in the often private, less-transparent world of most family businesses. But there is an opposite and quite compelling argument: that family businesses have a built-in desire to uphold the family company's image and protect the family's name and reputation. In fact, this third edition of Family Business makes the related argument with regard to the quality of the product/service the firm creates (see Figure 1.3, IV) by presenting the higher returns on invested capital possible when the firm is a high-quality provider. S.C. Johnson (maker of Raid, Off, Windex, and Oust) reminds us that they are a family company at the end of every company ad. They do this because of the perception (supported by their own market research) that family businesses care more about quality, care more about the environment, and can be counted on to stand behind their product/service far into the future.

Research using data drawn from BusinessWeek and the social performance rating given by Kinder, Ludenberg, Domini & Co., compared 261 firms—some family-controlled, others management-controlled—from the S&P 500 over a 10-year period. It found that although family businesses are no more likely to engage in positive social initiatives than are nonfamily companies, they are less likely to engage in activities that have negative social consequences. The authors conclude that the results point to the importance that image and reputation have for family businesses.[35]

FAMILY BUSINESS RESEARCH

The field of study of family enterprises goes back only to 1975, when entrepreneur, family business educator, and consultant Dr. Léon Danco published his pioneering work, Beyond Survival: A Guide for the Business Owner and His Family.[36] Two

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34 Shleifer, A., & Vishny, R., A Survey of Corporate Governance. Journal of Finance, 1997, pp. 737–783.

35 Dyer, W.G., & Whetten, D.A., Family Firms and Social Responsibility: Preliminary Evidence from the S&P

500. Entrepreneurship Theory and Practice, 30, 2006, pp. 777–783.

[36]Danco, L., Beyond Survival: A Guide for the Business Owner and His Family. Cleveland: The University Press, 1975.

watershed events played key roles in turning the study of family business into a field:

1 The publication of a special issue of the journal Organizational Dynamics in 1983[37]
2 The launching of a specialized journal, Family Business Review, in 1986[38]

Still, between 1975 and the early 1990s, most of the published work on family busi-nesses was anecdotal, rooted in the stories of consultants and observers of these mostly privately held enterprises. Only in the past decade has research begun to struggle with the definition of family business and to address its unique characteristics.

Notwithstanding the dearth of research on this unique form of organization, family businesses most likely constitute the earliest form of enterprise. Whenever parents— whether engaged in making a craft, cultivating the soil, or even ruling a country— welcomed members of the next generation as helping hands in the pursuit of that enterprise, a family business was born.

Today, family businesses are considered by many scholars to be on the cutting edge of corporate performance, job creation, return on investment, quality of product and service, flexibility, customization capability, and speed to market.[39] They are also well known for their vulnerability to decline after the retirement or demise of the founding entrepreneurial generation.[40] The agency cost literature has traditionally argued that when owners hire managers or agents, additional oversight and control mechanisms are required, resulting in an increase in enterprise-management costs.[41] More recent literature argues that agency costs are significant for family companies as a result of CEO entrenchment, conflict avoidance, and altruism.[42] The most recent research on family-firm performance, discussed earlier in this chapter, puts most of these competing arguments in perspective by clearly demonstrating that the benefits of the family– business interaction outweigh its costs on the basis of overall performance over extended periods.

One of the research studies we will be referring to in this third edition of Family Business is the Discovery Action Research on Family Business. This study was con-ducted in the form of “action research,” with companies participating in the Part-nership with Family Business at the Weatherhead School of Management, Case Western Reserve University, and in family business programs at the University of Pittsburgh and the University of St. Thomas. The action research constituted an iterative process of diagnosis, feedback, and collaboration with members of partic-ipating firms and families. The sample for this study included 868 executives and family members who had been involved over the past 11 years in 90 businesses. Specifically, the sample was made up of 303 family members in the business (68 percent of family members), 145 family members not active in the management of the business

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[37]Burke, W.W., ed., Organizational Dynamics. New York: American Management Association, 1983.

[38]Lansberg, I., ed., Family Business Review, 1(1), 1986.

[39]See Astrachan & Carey, op. cit.; Kleiman, R., Petty, W., & Martin, J., Family Controlled Firms: An Assessment of Performance. Family Business Annual, 1, 1995, pp. 1–13; and Poza, E., A la sombra del roble. Cleveland: Editorial Universitaria, 1995.

See Danco, op. cit.; Poza, E., Smart Growth: Critical Choices for Family Business Continuity and Prosperity. San Francisco: Jossey-Bass, 1989; and Ward, op. cit.

[41]Daily, C., & Dollinger, M., An Empirical Examination of Ownership Structure in Family and Professionally Managed Firms. Family Business Review, 5(2), 1992, pp. 117–136.

[42]See Schulze et al., op. cit.; and Gomez-Mejía et al., op. cit.

(32 percent of family members), and 420 nonfamily managers. Of those family-member respondents who identified their position in the family, 90 were CEOs (22 percent), 48 were spouses of CEOs (12 percent), 111 were sons (27 percent), 73 were daughters (18 percent), and 84 were "other" (21 percent). This "other" category included siblings of the CEO, sons- and daughters-in-law, nephews, and nieces.

This study's findings suggest that a positive family–business interaction is at the heart of creating unique and idiosyncratic competitive advantages in family firms. This research suggests safeguards that can prevent higher agency costs and highlights resources and capabilities borne out of the positive family–business interaction that can provide unique benefits to family firms. Both the safeguards and the sources of com-petitive advantage will be discussed in the chapters that follow.

How a family's influence might affect the strategic and economic decisions of a business and how these might affect the company's performance (and vice versa) is the frontier of much current research. Until recently, most business scholars ignored family businesses. This notwithstanding, most businesses globally are family businesses.

Scholars who did research family firms for the most part concluded that they were anachronisms and that because of nepotism, agency problems, and family conflict they were largely inefficient.[43,44]

Recently, three characteristics of the family form of governance have been identified as distinguishing them from other forms of organization. These were referred to by Carney[45] as parsimony, personalism, and particularism. Parsimony refers to the pro-pensity of family firms to be vigilant about their financial resources, due to the fact that the family owns those resources. Personalism refers to the unique power resulting from the combination of ownership and control held by the same family. This concentration of power frees family firms, relative to nonfamily firms, from the need to account for their actions to other constituencies, giving them the discretion to act as they see fit. Particularism is the product of this concentration of power and its resulting discretion. Family businesses, scholars argue, have the particular ability to use idiosyncratic criteria and set goals that deviate from the typical profit-maximization concerns of nonfamily firms. And these three characteristics provide family firms with advantages in efficiency, social capital, and opportunistic investment.[46]

There has been modest diffusion of family business research and education in the past decade. According to the Family Firm Institute in Boston (see http://www.ffi. org), there are now more than 100 family business programs in the United States alone. And while most of the substantial research with lasting impact has also been produced in the past decade, its influence on the larger fields of management and organization is still minuscule. Great incentives for further research on family firms and for greater impact on managerial science by family firm studies now exist, given the well-documented higher performance of family firms relative to their nonfamily counterparts. Mainstream organizational research has ignored the unique advantages of the family business form, largely as a result of stereotyping family firms as the

[43] Carney, M., Corporate governance and Competitive Advantage in Family Controlled Firms. Entrepre-neurship Theory and Practice, 29, 2005, pp. 249–265.

[44] Chrisman, J.J., Chua, J.H., & Steir, L.P., Sources and Consequences of Distinctive Familiness: An Introduction. Entrepreneurship Theory and Practice, 29, 2005, pp. 237–247.

[45] Carney, op. cit.

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Chrisman, J.J., Steir, L.P., & Chua, J.H., Personalism, Particularism and the Competitive Behaviors and advantages of Family Firms: An Introduction. Entrepreneurship Theory and Practice, 30, 2006, 719–729.

antithesis of professionally managed firms—nepotistic, irrational because of the family influence, secretive, and small and insignificant. Given the recently documented outstanding performance of family firms relative to management-controlled firms these assumptions would appear to be in dire need of a substantial update.[47]

SUMMARY

1 Family businesses are the primary engine of economic growth and vitality in free economies all over the world. Being unique in their attributes, they are also unique in the assets and vulnerabilities that they bring to the marketplace.

2 Family businesses constitute the whole gamut of enterprises in which an entrepreneur or next-generation CEO and one or more family members influence the firm via their par-ticipation, their ownership control, their strategic preferences, and the culture and values they impart to the enterprise.

3 Family businesses that have been built to last recognize the tension between preserving and protecting the core of what has made the business successful and promoting growth and adaptation to changing competitive dynamics.

4 The Discovery Action Research project is a longitudinal study whose findings suggest both safeguards that can prevent higher agency costs and resources and capabilities that can provide unique benefits to family firms.

5 In the systems theory approach, the family firm is modeled as comprising three over-lapping, interacting, and interdependent subsystems of family, management, and own-ership, making possible significant adaptive capacity and competitive advantage through joint optimization.

6 Agency theory has traditionally suggested that the overlap in ownership and manage-ment found in family firms is an asset.

7 More recently, agency theory has been used to argue that family firms have one of the more costly forms of organization. Increased agency costs result from the owner-managers' inability to manage conflict, executive entrenchment, lack of performance monitoring, and a prefer-ence for less business risk, among other things. A firm's board is an important mechanism for limiting managers' self-serving behavior in situations in which a firm's managers and its owners have conflicting goals.

8 The resource-based view of family businesses holds that competitive advantages result from: (1) overlapping responsibilities of owners and managers and small company size, enabling rapid speed to market; (2) focus on customers and market niches, resulting in higher returns on investment; (3) concentrated ownership structure, leading to higher corporate productivity; (4) desire to protect the family name and reputation, translating into high-quality products/services; and (5) family–ownership–management interaction, family unity, and ownership commitment, supporting patient capital, lower administrative costs, skills/knowledge transfer between generations, and agility in rapidly changing markets. A prescribed set of management and governance practices will help the firm capitalize on these resources.

9 The stewardship perspective on family firms argues that responsible ownership by any given generation is characterized by its commitment to something larger than the indi-vidual (e.g., the family clan) and by its dedication to passing a healthy firm on to the next

[47] See Daily & Dollinger, op. cit.; and James, H., Owner as Manager, Extended Horizons and the

Family Firm. International Journal of the Economics of Business, 6(1), 1999.