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The family effect on performance in an institution-based context and the internationalization process of family firms

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Chapter III

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Family firms have received growing attention in last years as scholars and researchers have acknowledged their pivotal role in today's economic, social and political context. As a matter of fact, family businesses have underpinned the wave of entrepreneurship in both developed and developing countries. In addition, they make a notable contribution to wealth creation, job generation and competitiveness. One of the main findings which have emerged from the growing body of studies concerning family firms is that they are a unique group of organization but they differ within this group especially in terms of degree of family involvement in the firm; the heterogeneity of family businesses made it difficult to find a universal definition which clearly identifies them. As a consequence, the great number of definitions stems from the different degrees of family involvement in ownership, management and board of the firm which have been taken into account by authors that conducted studies concerning family businesses. Further, the institutional complexities of different tax, legal, political and social imperatives have given rise to numerous adaptations in the formal ownership structures of family firms; this has been another reason for which the search for a universal definition of family firms is an hazardous task. The type of definition taken into consideration is not irrelevant at all as, for example, family firms in USA generate between 12 and 59 per cent of gross national product depending on the definition chosen.). However, beyond the specific definition chosen, the most important indicators of a family firm is the active involvement of family members in the ownership, management and board of the firm; what's more, the preference for within firm inter-generational transfers, which is the family willingness to retain ownership and control rights within the family firm across generation, has to be consider another basic trait which distinguishes the typical family firm.

In the first chapter, I will analyze the main peculiarities of family firms both in terms of corporate governance structure and in terms of family-firm specific resources. Moreover, I will discuss the implications of such peculiarities, which may lead to positive or negative consequences. Concerning the corporate governance structure, family firms have a concentrated and closed ownership, where the capital of the organization is in the family' s hands. On one hand, in fact, in many family firms the majority of shares is owned by members of the same family (and that leads to an ownership concentration) while on the other hand some family owners are reluctant to sell equity to outsiders and are averse to debt in order to ensure the independence of their firm (which leads to a closed ownership structure). The family's direct control over the firm may even become an aim in itself for the family business. Therefore, family firms give up some profitability to ensure that the organization remains under family control. As a consequence, this will probably mean less inclination to risk, which in turn leads to less willingness to take chances in markets with which the firm is not acquainted. One of the main characteristics of the typical family firm is the non-separation of ownership and management as owners and managers' interests are aligned because they may be the same person or because they may be tied by families bonds. In sum, the type I (principal-agent) agency problem is found to be lower in family firms than in non-family firms. In contrast, an agency conflict may also exist between a dominant shareholder and a minority shareholder. In this case, information asymmetries and a conflict of interests may exist between the dominant shareholder and the minority shareholder; in particular, in family business groups where a family controls a large number of firms, minority shareholders can be disadvantaged. The family at the top of the pyramid can misappropriate minority shareholders' wealth by self-dealing or tunneling. In others words, type II agency problem (principal-principal) is likely to be present in family firms. In many family firms the locus of decision making is centralized and the management team is usually small in size. In family firms, as in non-family firms, CEO is the focal point setting the agenda for the business. I have analyzed a family company's advantages and disadvantages in employing an "insider/outsider" CEO. Insider CEO often enters the firm at an early age thus achieving deep levels of firm-specific tacit knowledge, which may improve decision qualities regarding innovations or other strategic decisions. On the downside, insider CEO may not possess the skills and capabilities required to manage a firm. As a consequence, the performance and growth of a family firm can be retarded by promoting an incompetent family member to the CEO position. In order to avoid this problem, some family firms train their family members in a variety of businesses before they are allowed to join the family firm. On the other hand, outsider CEO may be prepared to work more closely with suppliers, customers, financiers, professional advisers and competitors. In addition, their wider resource network may enable family firm to adapt to changing market conditions; further, by responding to new technological advances and changes in marketplace they can identify new market opportunities and enhance a family firm performance. In sum, their greater experience and capabilities may benefit the firm. Nevertheless, managerial control of a firm can be used by an outside CEO against the best interest of family owners. An outside CEO may pursue activities which do not reflect the interests and aspirations of the firm' s owner. For instance, family firms are more likely to seek to maximize firm value enabling them to personally realize any gains. In marked contrast, an outside CEO may not pursue profit maximization and growth oriented strategies because he/she prefers to maximize his/her own utility function by pursuing activities which maximize sales revenues. Concerning the families-specific resources, one of the main distinctive features of family firms, which has been claimed to be one of its main strength, is long-term vision, which, as I will explain in the third chapter, is also one of the facilitating factors of the internationalization process. However, long-term vision implies that family firms are concerned on the long-term sustainability of the business. Coupled with the fact that many family businesses provide full subsistence of the family, such a long-term orientation have a strong impact on the risk behavior of family firms, which result, as a consequence, risk averse because a business failure may dramatically reduce the family budget and restrain the possibilities of future generations. Risk aversion, in turn is one of explanations for which family firms are often strongly anchored in the local community, thus holding a local business focus (i.e., co-operation rather with local suppliers, limited levels of foreign trade, employment of local inhabitants). As a consequence, family businesses tend to behave socially responsible. As a matter of fact, in Europe, family businesses are found to make higher social investment (e.g. further education activities for their employees or offering flexible working arrangements) than non-family firms. Another important family firm-specific resource is social capital, defined as the relationships between individuals within the firm and between the firm and its stakeholders. Intuitively, some intangible resources such as loyalty and trust from family members strong kinship ties. Moreover, thanks to the above mentioned local community commitment and to family business longevity, family firms can exploit their stable relationship with business partners and clients which provide them helpful condition in economically difficult times. Further, many clients have claimed that they are more willing to work with an organization that has been existing for a long time. On the downside, family firms may engage in what is called “amoral familism” which is the tendency to see those who are outside the firm as competitors or even enemies. This may harm family firm performance as well as its growth perspectives. Two of Sirmon and Hitt (2003) theorized family firm-specific resources are part of the family firm financial structure. Namely, they are survivability capital and patient financial capital. Patient financial capital differs from typical financial capital, because it is linked to a longer time of investments and not a threat of liquidation in the short-terms. Survivability capital refers to the personal assets that family members provide to the firm. Intuitively, they may be the source of a competitive advantage. However, on the other hand, family firms are often associated with the so called pecking order theory. The pecking order theory claims that when family firms has to deal with the choice of the financing source, self-financing is often the first option considered; the use of external fund, provided by financial institutions such as banks , is alleged to be the second option: the latter includes funds provided by the government and other institution as subsidies to the firms .The third option involves using external capital sources thereby allowing investors to enter the firm. At the basis of this theory there is the above mentioned reluctance of FBs to sell equity to outsiders. Such a structure may be detrimental for family firms as they may miss good growth opportunities (such as internationalization). Overall, family firms present peculiar governance structure and family-specific resources and features. Some of them (long-term vision, survivability capital, patient financial capital, trust, loyalty, owner-managers interests alignment) benefit the firm while others (reluctance to sell equity to outsiders, amoral familism, principal-principal problem) harm them.

In the second chapter, I analyzed the relationship between family firm and performance. While some authors have found a positive relationship, others have found family involvement to have a negative impact on firm performance. In other words, the empirical evidence is mixed. Anyway, there seems to be specific reasons which explains these contrasting findings. Among the others, the above mentioned issue concerning the lack of family firm's universal definition seems to be one of the most relevant. In fact, scholars and authors dealing with family firms studies have used different criteria to include FBs in their sample.: as a consequence, some firms that are regarded as such in an author's article may not have been included in the sample of another research. This may partially explain contrasting results. Size, geographical focus and legal form may be other reasons for such discordance. In the remainder of the chapter I have analyzed the family effect on firm performance in a given level (low or high) of the institutional development in which they play. On one hand, to truly understand the relationship before family firm and performance I have followed Dyer's (2006) vision: definitions of family firms based on mere percentages of family involvement in ownership and management will not lead to identify clear differences in performance. Rather, family dynamics are what give rise to a successful or unsuccessful performance. As a consequence, the point of view that ought to be adopted change; the real question is what family firm-specific characteristics lead to a successful performance. Thus, Dyer has proposed a "behavioral" typology based on two dimension namely the degree of agency cost that of family assets. He concluded that family firms with low agency cost and high family assets are likely to achieve a great performance. On the other hand I have gathered some empirical evidence on the importance of the institutional development level on family firm performance and I have found that family firms are likely to significantly outperform their non-family counterparts in an underdeveloped institutional environment while they are not expected to significantly outperform them in a developed institutional environment because the latter can easily access the external governance mechanisms. Thus, I have explored the family effect on firm performance inb both low and high institutional development level. What I have concluded is that that a firm which is "empirically" favored by the institutional environment (i.e. an underdeveloped one) may not actually outperform their competitors or achieve a sound performance if it does not possess critical resources (patient financial capital, human capital, sound governance structure and practices). At the same time, in a context (i.e. developed institutional environment) where they have to struggle with more powerful non-family firms, as the latter have access to the needed resources and to external governance mechanisms (financial resources, human supply, market for corporate control, labor market), they may indeed outperform non-family firms if they can internally access to critical resources (skilled and expert family members) and assume a proper behavior (reluctance of "amoral familism", alignment of owner-manger's interests, use of universal criteria in choice of employees, reluctance of nepotism) that leads to bear low agency costs. In other words, I have observed how a firm's behavior and its underlying dynamics (i.e. the family effect) can negatively (positively) affect firm performance even if the company plays in a context which is "empirically" favorable (less favorable) for it. To some extent, my classification may help to answer the question: “How important is the family effect on firm performance in a given level (high or low)of the institutional development ? “

In the third chapter, I have analyzed the internationalization process of family firms. Thus I have attempted to find empirical evidence on what factors spur of hinder their propensity to go international, what are the entry market strategies that they adopt, what is their pace of internationalization and what is (assuming that it exists) the relationship between their internationalization and performance. Concerning the first question I would claim that what I have alleged in the first chapter can be easily adapted here: family firm-specific resources and features may both hinder and obstacle their propensity to go international. For example, the reluctance to sell equity to outsiders may hinder growth prospects as they require additional capital to be implemented. In contrast, as it is impossible to separate the vision from the strategy, the fact one of the main family firms’ feature is the long-term orientation mean that they pursue long-term growth strategy and this may increase their willingness to internationalize. Regarding the market entry strategies, among the common factors that affect such decision in any type of firm (be they family or non-family) there are specific determinant for family firms namely the (high) need of control, the(low) risk propensity, resource availability, successive generation and long-term vision. While firms usually present high need of control, low risk propensity and a long-term orientation, what is the level of resource availability depends on the level of internal skills, capabilities and experience and on firm’s behavior and dynamics. The role of successive generations appears to be important as they are usually willing to demonstrate their skills and the want to prove them through implementing and managing such a complex process. Further, many family firms seem to expand into markets which are geographically and culturally close to them. Thus, they follow a stepwise process tracking the Uppsala model. They are the so called “gradual global” firms. However, some family firms expand rapidly into new markets. They are called “born global” firms as their internationalization peace is fast. Basically, gradual global firms differ from born global firms in the approach that they assume when they internationalize; born global firms are more aggressive, they think to acquire knowledge and experience during the internationalization process and they see the world as a single market to which they can sell the same, standardized product. In contrast, gradual global firms follow a stepwise process, they are more local responsive (thus opting for a localization strategy) and gain knowledge about a specific market with time and experience in different stages of the process. As the firms gain knowledge, their level of commitment to invest in more resources increases. Last but not least, no works have been conducted on family firm internationalization and performance. Anyway, Tsao & Lien have provided an agency-theory perspective, claiming that in family firms type I agency problem are less severe than in non-family firms while type II agency problem are more severe than in non-family firms. My observation here is that when the benefits associated with a reduced type I agency problem outweigh the drawbacks arising from type II agency problem, family firms may outperform non family firms in an internationalization context. *Mutatis mutandis,* the opposite condition leads non-family firms to out-perform family firms. In any case, I urge scholars and researchers to create a body of literature concerning this topic, considering that the globalization of markets is leading to homogenous consumer preferences thus spurring family firms to undertake the internationalization process.

Thus, the effect of this strategy on firm performance has to be studied and researched in depth.

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